German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on BCBS Consultation Paper "Revisions to the Standardised Approach for Credit Risk" (BCBS 307)

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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I. General comments

We basically acknowledge the Basel Committee's initiative to revise the standardised approach for credit risk (CRSA) and design it in such a way that, on the one hand, it will become more risk-sensitive than the former CRSA and, on the other, continues to be easy to apply. The simplicity aspect is to be emphasised particularly to ensure that ultimately the standardised approach will continue to be applicable with reasonable expenditure by the large number of smaller banks. A positive fact to be emphasised is the Committee's working premise to adjust the standardised approach for credit risk only in those cases where this is sufficiently justified, i.e. necessary. We also welcome the intention to not increase the capital requirements altogether.

Since the changes are of a fundamental nature, we are, on the one hand, grateful that the proposals are to be evaluated by means of a comprehensive impact study. On the other, we support the constructive process which the Basel Committee intends to apply with respect to the revision of the CRSA. Thus, we believe it is proper and important to carefully examine the comments on the present consultation paper, to again invite comments on the proposals revised on that basis and to subject these proposals to another impact study.

Overall, however, we have objections in principle against some of the assumptions on which the Committee's deliberations are based. Moreover, many of the goals outlined above can, in our opinion, not be achieved by means of the proposals put forward by the Committee.

Removal of external ratings under the CRSA not reasonable

We believe a complete removal of external ratings under the CRSA is going too far. For example, the claim of politics under the impression of the financial and sovereign debt crisis was to reduce the dependency on external ratings in the set of rules. However, a complete ban of external ratings was in our opinion not the subject of negotiation and, apart from that, does not make sense. A rating by a recognised rating agency includes far more information than the parameters suggested in the consultation paper can even begin to provide.

An essential advantage of external ratings is the fact that they consistently take account of certain forward-looking components. Consequently, ratings reflect risks of an exposure much more precisely. That substantial added value is completely lost when indicators determined individually by banks are resorted to. Although external ratings had been criticised in connection with the subprime crisis, the ratings of banks and corporates are fundamentally different kinds of rating methods. Also, the Basel Committee itself, when revising the securitisation framework, did not go so far as to completely do without external ratings.

Moreover, at least in Europe, banks are not allowed to base lending decisions entirely on ratings, but they always have to form their own opinion about the risk entailed by a position. Furthermore, the uniform use of external ratings guarantees comparability of capital requirements. This is not guaranteed for the risk drivers proposed, as will be explained below. In addition, the reasons stated in the consultation paper for the necessity of the revision to the CRSA in many places refer to an insufficient risk sensitivity of the existing regulations. Apart from increasing the risk weights, this is to be counteracted by introducing new risk drivers.

However, with respect to many of the parameters proposed, the Basel Committee is already pointing out that they are either difficult to determine or subject to undesired cyclical fluctuations. Even so, instead of looking for other, more suitable indicators for a risk-sensitive measurement of credit risks, the indicators suggested are each simplified so much that their meaningfulness is drastically reduced. Insofar, we emphatically speak out in favour of continuing to use external ratings at least in the bank and corporate exposure classes. Only where an external rating is not available or a rating agency is not named should determination of the risk weight, for the bank exposure class, be based on the presently used country of incorporation method and, for the corporate exposure class, derived on the basis of the new and easy-to-determine parameters. Alternatives might be permitted for jurisdictions where the use of external ratings is restricted.

Proposals result in an increase of the capital requirements

We have the impression that the goal originally set by the Committee to keep the capital requirements stable compared to the current CRSA is not achieved to a large extent. For example, the capital requirements seem to clearly increase altogether, in particular in the bank and corporate exposure classes, for exposures secured by real estate and for off-balance sheet exposures. Hence, this is no longer just a shift of the capital requirements within the individual exposure classes. According to the systematics, the risk weights should not be used to increase the capital requirements altogether. Other instruments are implemented for this. What is to be taken into account especially in this regard is that the introduction of the capital conservation buffer already causes a de-facto increase of the capital requirements for all banks.

Moreover, it has to be borne in mind that the changes to the CRSA also have effects on other regulation initiatives. For example, the TLAC requirements are calibrated on the basis of the leverage ratio and the RWAs. An increase of the capital requirements under the CRSA might then, if the calibration of TLAC remained unchanged, let the capital requirements all in all increase even further.

With the exception of a very narrow sub-portfolio[1], increases of the risk weights – some of which are considerable – are envisaged in all exposure classes. This is worrying in particular because banks can no longer counteract this tightening of existing regulations by means of allocative adjustments to the credit portfolio, as all exposure classes are affected. The blanket reason for this tightening of regulations given in the consultation paper is insufficient risk sensitivity in the crisis of the past years, or reference to elimination of a better position compared to the regulations of the foundation approach. What is lacking in this context is a critical debate of the question whether, for example, the specifications in the foundation approach, which are sometimes hard to prove empirically, are appropriate. If you look at the parameters which are determined statically and validated on a regular basis under the advanced measurement approach, an overemphasis of the risk due to the foundation approach can be found in a large number of portfolios. Insofar, uncritical adoption of the specifications and results for the CRSA appears to be not very expedient and inappropriate.

The first calibration of the risk weights has possibly been made in a very conservative manner. The quantitative analyses, assumptions and expert-based adjustments for the definition of the risk weights should be disclosed to make it possible to understand the appropriateness of the calibration.

[1] Exposures secured by residential real estate with an LTV < 40%.

A too conservative calibration should be avoided with an eye to the supply of credit to the economy, in particular to SMEs, as they are frequently financed by CRSA banks. Should in the future the CRSA act as a capital floor, the conservative calibration of the CRSA will also have an effect on the IRB banks.

Likewise, we believe the risk weights are too high, for example where information is not available or not provided in time in the bank and corporate exposure classes.

We find that the calibration of the risk weights envisaged for exposures secured by real estate is too conservative altogether.

Weaknesses of the factor models

The defined goal of the new regulations is to preserve the CRSA as a simple credit risk measurement approach reasonable for a large number of banks and business models. For a number of exposure classes, the new regulations would introduce tableaus with two risk drivers the interaction of which yields the respective risk weight of the credit exposure. Such a structure increases the complexity of the CRSA and hence makes derivation of control impulses in the context of the credit decision difficult. Therefore, freely available risk-sensitive information such as external ratings should be used if it is available.

Moreover, the changes proposed increase the procyclicality of the capital requirements, because as the economy weakens, the risk drivers are likewise to be expected to worsen – and to a greater extent than with the external ratings used hitherto. Again, this is true for both CRSA banks and, due to the capital floor, for IRB banks. In this respect, the use of the Common Equity Tier 1 (CET1) ratio might trigger a further "build-up" of the capital requirements due to their relationship with the risk-weighted assets. Derivation of the risk weight on the basis of, usually, two factors means that a clearly higher fluctuation intensity is accepted. This makes the planning at the banks demanded by the supervisory authorities difficult and poses the danger of a permanent destabilisation of the financial system especially in the sensitive and essential area of capital requirements.

It must also be noted that according to the proposals of the Basel Committee the administrative expenditure for the management of the input information at the banks would increase substantially. This also includes the continuous follow-up of the necessary data on banks and corporates. This would cause disproportionately rising costs. Where information is not available, a risk weight of 300% is defined which means at least a triplication of the former capital requirement. We believe this is inappropriate. Moreover, the banks' IT capacities have to be substantially extended, which will likewise cause additional expenses.

Other risk drivers as well exhibit methodological weaknesses. The net non-performing assets (NPA) ratio in the bank exposure class is insufficiently comparable at the international level, because different accounting regulations result in different amounts of the provisions for risks that have a crucial influence on the value of this risk driver. The risk driver "revenue" in the corporate exposure class favours inappropriately high batch sizes. A profitability risk driver seems to be more reasonable.

For the DSC indicator for exposures secured by residential real estate, substantial systematic simplifications are applied already upon determination, which clearly impair the quality of the risk driver already when a loan is granted. The hard test[2] should replace this risk driver.

[2] Cf. footnote 59, bullet 4, of the consultation paper.

Proper delimitation of the exposure classes necessary

We are critical of the implied change of the definition of the bank exposure class. This might result in groups of customers, which hitherto rightly are assigned to that exposure class based on their essential characteristics, will in future have to be assigned to the corporate exposure class. Here, we believe that, on the one hand, these customers would be treated incorrectly and, on the other, the corporate exposure class would be made more heterogeneous. This would have to be regarded as critical also against the background of the risk drivers defined for that exposure class. Therefore, the definition of the bank exposure class should not be changed.

Furthermore, it should be possible to assign medium-sized companies to the retail exposure class, in addition to small ones, where the exposure limit for retail loans is not exceeded.

Definition of the scope of application and implementation period necessary

The paper does not state when the planned changes to the CRSA are to be implemented. In connection with this, we would like to point out at an early stage that not only the banks, but also the IT service providers, are currently working to capacity to implement a large number of regulatory projects. The changes addressed in the paper have an impact on the supervisory foundations of the banks, so that a sufficiently long handling time must be granted for planning and technical implementation. It should also be noted that, in the context of the capital planning of the individual banks, it is becoming ever more difficult to estimate on which bases the capital requirements are to be estimated altogether on the medium-term planning horizon. However, the supervisory authorities are demanding such planning. At present, the banks are facing various regulatory measures the effects of which cannot be estimated at the moment. However, these effects may be so extensive – and may multiply in combination with the already applicable requirements – that a long period is necessary to create appropriate prerequisites (e.g. sufficient capital resources). In this respect, the room for manoeuvre is often limited especially for small and medium-sized banks.

Like all other standards issued by the Basel Committee, the regulatory framework will be immediately applicable to internationally active banks. According to the consultation paper, however, the standardised approach is to be suitable also for a larger number of states and banks, which would also be in line with the existing orientation of the CRSA. However, an express clarification analogous to the "Supervisory framework for measuring and controlling large exposures" (BCBS 283) should be included in the paper stating that the member states are free to take over the regulations or to develop a different approach in sub-areas for banks which are not governed by the Basel framework if they consider this necessary.

The intended application of the CRSA as a capital floor for the IRBA will mean that the changes to the CRSA will entail substantial implementation needs also at IRB banks, so that in particular smaller IRB banks will be burdened disproportionally. In particular, many of the data required for calculating the parameters are not yet available in the banks' IT systems. We, therefore, ask to provide a reasonable implementation period of not less than five years after passage of the final regulatory framework.

What is also necessary is a grandfathering regarding positions acquired prior to the coming into force of the new CRSA. As an alternative, sufficiently long transition periods are to be defined.

II. Specific comments

Bank exposure class

As stated in the general comments, external ratings should as a rule continue to be applied where they are available or approved rating agencies have been named. Only where this is not the case should the present country of incorporation method be applied.

Based on the systematics, it cannot be understood why the country of incorporation method in use hitherto should be dispensed with if the sovereign exposure class is not revised by the current consultation paper. According to the country of incorporation method, the risk weight for banks can be derived from the rating of the country of incorporation. We believe it is in inconsistent to not revise the risk sensitivity of states, on the one hand, but simultaneously eliminate the country of incorporation method, on the other. We, therefore, plead in favour of preserving the existing option to derive the risk weight for banks from the credit rating of the country of incorporation.

With this proviso, we would like to make the following comments on the risk drivers proposed:

We are critical of the intention to assign higher risk weights to interbank exposures without exception. This does not take account of the fact that it has shown during the financial market crisis that in addition to the endangered banks there also are very robust banks with a good credit standing. Insofar, rather a greater spreading of the risk weights with a floor of clearly less than 30% would be appropriate instead of a general tightening. Moreover, the most recent regulatory measures should likewise contribute, or have contributed, to improved stability of the financial sector, so that the question arises in connection with this to what extent statistical observations from the time before these new regulations are still suitable at all for a determination of the risk weights.

In addition to the reduction of the risk weights for banks, the remaining time to maturity should be introduced as another risk driver, because a general assumed average term of 2.5 years in the bank exposure portfolio appears to be clearly too long. The risk weights for short-term exposures likewise seem to be clearly too high. This is true in particular for the floor of 30%. This corresponds to an increase of 50% compared to the status quo.

A fundamental point of criticism which is to be emphasised regarding the calculation of the risk weight as a combination of CET1 ratio and net NPA ratio is the insufficient comparability of these indicators which results from the application of different rules of interpretation in different countries. There will be serious differences in this regard even within the EU, and the effect will be even greater globally. For example, the different accounting standards HGB [German Commercial Code], IFRS, US GAAP and other local GAAP in the individual jurisdictions result in different amounts of provisions for comparable credit risks and hence in different net NPA ratios. Due to this, it will still be long way to a level playing field.

Difficulties may arise with respect to the determination of the risk weights for banks if CET1 ratio and net NPA ratio are not available. At least in such case, the use of external ratings should still be permissible. As an alternative, a flat risk weight of 100% is conceivable, and also a flat risk weight plus a country rating dependent add-on.

Comments on BCBS Consultation Paper "Revisions to the Standardised Approach for Credit Risk" (BCBS 307)

We are extremely critical of the proposal to apply a risk weight of 300% if, among other things, a national minimum prudential standard is not met. This will in the short term result in a worsening of the creditor's position which is not appropriate, because he should not be liable for the failures of third parties. With regard to this, the creditors should be granted a reasonable period of time within which certain positions can be sold.

Moreover, it is not clear how the term "minimum prudential standards" is defined and how, in particular, this information is to be provided to the lending bank. We ask for clarification.

Likewise to be judged as critical is the amount of work created at the investor's for the annual determination and registration of CET1 ratio and net NPA ratio for each borrower. Moreover, due to the varied possibilities of national regulations that may in some cases define bank-specific capital buffers, it is difficult to follow-up all minimum prudential standards, in particular in international business.

For the reasons specified above, substantial effects on the lending business result for business development banks, because they grant loans not in a direct relationship to a customer, but in the context of the house bank principle. Accordingly, considerable increases of the capital requirements would result for these pass-through loans which are classified as bank exposures, based on the risk drivers proposed and the risk weights resulting from these drivers. The financing of economic sectors requiring support (such as start-ups, residential construction, renewable energies) would become substantially more expensive and the fundamental idea of promotion would be reduced to absurdity by the application of the supervisory law.

Delimitation of the exposure class

In accordance with paragraph 19 of the consultation paper, exposures to securities firms and other financial institutions will only be treated as exposures to banks, provided these firms are subject to prudential and supervisory arrangements equivalent to those applied to banks and the risk drivers are publicly disclosed. The condition that the risk drivers must be publicly disclosed would most likely mean that not many securities firms and other financial institutions would be treated as "bank exposures". This specific condition should be dropped and instead, the external rating of the entity should be used (see general comments regarding "Removal of external ratings under the CRSA not reasonable").

With respect to the proposed new definition for banks, we feel the classification of the financial leasing companies is unclear. We ask for clarification that financial leasing companies are likewise to be classified into the banks exposure class, because, in addition to banks, leasing companies provide an important portion of financing, in particular to SME. The treatment of leasing companies as companies would probably make their refinancing noticeably more expensive, which we do not deem reasonable.

Q1. What are respondents' views on the selection of the capital adequacy ratio? In particular, is the CET1 ratio superior to the tier 1 ratio or the leverage ratio? Do respondents agree that it is necessary to require calculations in accordance with Basel III in order to ensure a consistent implementation?

We believe that the table relating to paragraph 13 currently contained in the consultation paper is not correct with respect to the designation CET1 and the percentages given for the CET1 ratio. This is associated with an inconsistency with the risk weights to be derived from it. In our opinion, it is necessary to make adjustments in this respect.

Since only the CET1 ratio and the net NPA ratio are applied to derive the risk weights in the bank exposure class, we ask ourselves the question about the future significance of AT1 capital. AT1 capital is by all means of importance to the assessment of a bank and hence the derivation of the risk weight. We, therefore, speak in favour of a tier 1 ratio instead of a CET1 ratio. To supplement this, compliance with capital specifications in the context of recovery and resolution (MREL/ TLAC) should also go into risk measurement, as a consequence of a possible discontinuation of the country of incorporation principle.

By contrast, we regard the leverage ratio as not suitable due to the lack of risk sensitivity.

Since the specifications defined by the Basel Committee have to be transposed into national law, we assume that it is admissible to take the national implementations or, in Europe, the European requirements of the CRR (cf. Art. 92, Para. 1 Letter a of the CRR), which are equivalent to the Basel requirements, as the basis and that no additional tier 1 ratio has to be calculated or published. We ask to clarify this. Moreover, all transitional regulations regarding the determination of CET1 and AT1, as intended by Basel III and implemented into national regulations or at the European level, should be taken into account accordingly for the determination of the tier 1 ratio.

We share the concerns that banks which due to their situation have to keep higher capital buffers under the supervisory requirements are preferred. Due to the great demand for exposures with a low risk weight, especially these banks might be preferred and obtain clearly more favourable refinancing conditions. In this respect, it has to be noted that compliance with the capital requirements has to be assumed per se, irrespective of their individual levels. There cannot be a reward for fulfilling a statutory duty. Rather, this must be a prerequisite. Therefore, the reasonableness of the capital criterion for the determination of the risk weight has to be questioned.

Q2. Do respondents believe the net NPA ratio is an effective measure for distinguishing a bank exposure's credit risk? What alternative asset quality measure, if any, should be considered by the Committee?

The net NPA ratio is to serve as an indicator of a bank's asset quality. We believe that, in actual fact, this risk driver does not allow of a valid conclusion as to the quality of a bank's assets, because in particular the degree of collateralisation of exposures in default is not taken account of. In our opinion, therefore, the NPA is not suitable to serve as a risk driver, because the economic amount of loss is clearly overemphasised in the context of that risk driver. Moreover, reasonable determination is not possible also due to the lack of an internationally uniform definition of default or non-performing, apart from the reason of the different accounting standards already mentioned.

In addition, the structure of the liabilities side should be taken into account for a meaningful credit assessment of a bank.

Q3. Do respondents have views on the proposed treatment for short-term interbank exposures?

The risk weights for short-term exposures with an initial term of 3 months or less appear to be clearly too high. Moreover, we find that not the original maturity, but the residual maturity, is a suitable risk driver. At the moment, the CRR likewise provides for a preferential treatment on the basis of the residual maturity. The floor risk weight of 30% means a 50% increase of the capital requirement for short-term exposures. This seems to be inappropriate. For the assessment of short-term exposures as well, it should still be possible to use external ratings.

Furthermore, we regard as unreasonable the specification defined in the consultation paper that, in future, short-term interbank claims with terms of three months or less may be taken into account with a reduced risk weight only if they are not prolonged on a regular basis. This is a fundamental change of paradigm, because hitherto – both for interbank loans and, e.g., for loan commitments – a reduced risk weight has been correlated with an option to react to creditworthiness downrating and has also been justified through this. This option to react is contractually established also in the case of roll-over loans, which is why equation to loans contractually tied for a longer period is not comprehensible and must be objected to from a risk point of view.

Q4. Do respondents have suggestions on how to address these concerns on the treatment of exposures to banks? In particular, do respondents have views on how to treat exposures to banks not subject to Basel III in a consistent and risk-sensitive manner?

We agree with these concerns. Difficulties may arise in the case of loans to banks in countries which have not yet implemented Basel III. Due to market discipline and available resources, it certainly is possible and reasonable only for very large banks to determine the necessary ratios. As explained above, we continue to believe that for this area as well the use of external ratings is appropriate and reasonable to determine the capital requirements. Where external ratings are not available, the country of incorporation method should be applied.

A special consideration should be given to low-income countries, which do not apply Basel III and whose banks will hence not publish CET1 ratio or NPA in accordance with Basel III. In addition, these banks can be assumed to be unrated. While risk weights applying to these banks are today as a maximum 150% (point 63 of BCBS 128), it is now suggested to apply them a 300% risk weight which would be detrimental to the financing of International Trade, meaning on short-term trade related transactions which often involve interbank exposures (e.g. confirmation/negotiation of export L/Cs and trade regulated guarantees), and whose importance was recognized by BCBS Working Paper 205 which waived the Sovereign ceiling for these banks. The actual methodology should be maintained for banks established in countries which do not apply Basel III (including low income countries).

Corporate exposure class

Just like for the exposures to banks, external ratings should continue to be used also for the corporate exposure class. As a rule, alternative indicators should be used for companies without rating. However, we raise doubts as to whether the indicators presently proposed actually are very meaningful and well reflect the risk. Therefore, we recommend to check the suitability of other possible indicators in the

context of another QIS conducted on a better data basis (cf. the following remarks on the questions 5 to 7). In principle, however, we believe that relative variables (e.g. return on sales) should rather be used instead of absolute indicators (e.g. revenue).

Alternative proposal by the German Banking Industry Committee

Due to the conceptual weaknesses (cf. questions 5 to 7) of the parameters suggested, we recommend an approach which is initially differentiated by the amount of exposure in the corporate exposure class for non-rated debtors (see Fig. 1). This would avoid the disadvantage of companies with smaller revenues variables (see also the remarks on question 6).

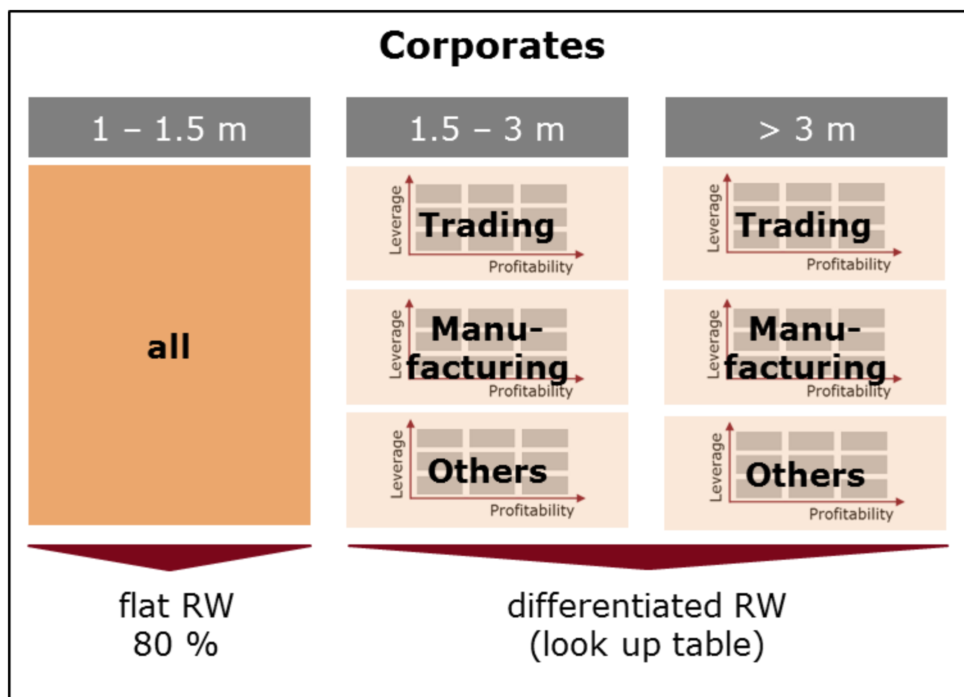

Fig. 1: Alternative proposal for the corporate exposure class

A flat risk weight of 80% is applied to minimal exposures of between EUR1 m and EUR1.5 m. This takes account of the fact that such exposures usually are diversified due to their size. Exposures in excess of EUR1.5 m are looked at based on risk drivers. In addition to the leverage ratio, an indicator based on profitability should be used here instead of revenue. In order to do justice to the different economic sectors, separate scales of risk drivers and risk weights should be provided for trading, manufacturing and other companies that cannot be assigned to any of these categories.

Q5. Do respondents have views on the selection of risk drivers and their definition, in particular as regards leverage and the incorporation of off-balance sheet exposures within the ratio? Would other risk drivers better reflect the credit risk of corporate exposures?

The use of the **leverage ratio** is basically comprehensible. In Germany, the equity ratio, which is identical in content, is usually applied to assess the capital resources. However, it has to be taken into account that different business models require different amounts of economic equity capital to cover the

risks inherent to the respective business model. In this respect, the formation of risk clusters should be examined to increase risk sensitivity, while at the same time pursuing the aim of simplicity. One option is to form a cluster for manufacturing companies, on the one hand, and for trading companies, on the other, and one for other companies which cannot be assigned to either of these categories. All this would, however, still not equalise the existing differences as to the accounting standards to be used by the borrowing companies. The balance sheet equity ratio of, e.g., a corporation that draws up annual financial statements according to the IFRS can for this reason alone hardly be compared to that of a partnership drawing up its annual financial statements according to the national accounting rules. For instance, the differences in the accounting of leasing transactions according to the German Commercial Code (HGB) and according to the IFRS result in substantially different equity ratios to be reported according to the German Commercial Code and the IFRS. As a consequence, the respective leverage ratios based on HGB and IFRS figures are clearly different.

Any attempt to compensate this in the approach applied would at any rate result in a further complication of the CRSA in the relevant segment, which should be avoided by all means (cf. preliminary remarks).

We are very critical of the use of the "**revenue**" indicator, as this substantially disadvantages smaller companies, as described below at question 6. The matrix privileges larger companies, while higher risk weights are assigned across the board to small and medium-sized enterprises (SME) with lower revenues.

Moreover, the factors leverage and revenue are extremely fluctuating and, therefore, not suitable as absolute measurement variables. Any new investment changes the debt ratio, so that risk weight fluctuations would occur frequently. This prevents the long-term capital planning and scheduling desired by the legislator. Furthermore, new investments (with borrowed capital) usually generate future sales. Hence, the two measurement variables frequently occur not simultaneously, but one after the other. This again increases the volatility of the risk weighting. Moreover, there is a danger that small and medium-sized industrial companies which primarily finance themselves through bank loans postpone or do not make necessary investments in order to avoid a leverage ratio that results in a higher risk weight and hence a higher capital requirement. CRSA banks as well will be compelled in future to consider the differences in the capital requirement in their pricing. As a consequence, covenants regarding compliance with a certain leverage ratio will probably become much more frequent in credit agreements.

Although this means a certain vagueness, off-balance-sheet liabilities should not be taken into account so as to keep indicator determination simple. In isolated cases, off-balance-sheet items may have a considerable volume, but these are exceptional cases which do not justify a further increase in the complexity of indicator determination for the purpose of determining capital requirements in a portfolio. Inclusion of off-balance-sheet liabilities would cause substantial additional expenditure at the individual banks. Banks would have to request the submission of additional documents by their corporate customers. So far, however, the necessary information can in many cases not be gathered from the annual financial statements, especially in the case of partnerships.

As hitherto, insurance companies are included in the corporate exposure class. However, insurance company balance sheets cannot be compared to those of conventional industrial companies. As in the case of banks and financial companies, the leverage of insurance companies is clearly higher than that of industrial companies. Accordingly, we believe that derivation of the risk weights for insurance companies based on the risk drivers revenue and leverage is unsuitable. Where external ratings are available, they should still be used to determine risk weights. Non-rated insurance companies should be given a flat risk weight of 100%. Insofar, insurance companies require suitable special treatment.

We believe a risk weight of 300% for exposures where current annual financial statements are not available is clearly too high. For example, in the leasing business with corporates where decisions are taken within the corporate credit process, the annual financial statements are procured and evaluated on a regular basis prior to concluding leasing agreements with the lessees. However, the leasing companies which are included in the determination of the capital requirements on a consolidated basis, have no exposure in the subsequent years to have the annual financial statements submitted to them. In some cases, this can also not be enforced in the competition with the leasing companies on the market which are not subject to supervision. This is a problem in particular where statutory disclosure obligations do not exist for these companies. As a result, a risk weight of 300% would need to be assigned to lessees for which the leasing company does not have current annual financial statements. This is not risk-adequate. We, therefore, suggest that the higher of the 100% risk weight and the risk weight which has been calculated from the indicators of the last available annual financial statements shall be used as the basis where current annual financial statements are not available.

Q6. Do respondents have views on the appropriateness of the proposed treatment, especially with regard to SMEs? And about the more lenient treatment for start-up companies?

At the moment, the rating-independent flat risk weight of 100% is often applied, in particular to the financing of small and medium-sized enterprises. The Basel Committee initially states that the revision of the CRSA is not meant to trigger an increase of the capital requirements. Nevertheless, the factors are extended from 100% to 110% or 130%, as shown in the tables for the example of the small enterprises (< EUR5 m sales), whereas the provision of a lower risk weight below 100% would be logical.

With respect to the calibration of the risk weights it shows that large companies are made better off than smaller ones. Although it is true that on average larger companies default less often than small ones, this is usually due to the fact that large companies on average can rely on a broader refinancing basis than small companies, for example by direct access to the capital market. Against that background, procurement of equity or capital similar to equity (e.g. mezzanine capital) is made considerably easier for large companies. By contrast, small and medium-sized enterprises are depending on own funds of a very limited group of owners which need to be supplied by means of contributions or built up by means of internal financing. Accordingly, the size of an enterprise is a rather weak economic argument to explain the causality between size and default risk, although a statistically significant connection between size and default risk exists. The Basel Committee's analysis should, however, take account also of the individual credit amounts of small and large enterprises within the meaning of diversification – i.e. the possible amount of loss. Accordingly, large credits seem more likely in the context of the financing of large companies, while the amounts lent for the financing of small and medium-sized enterprises are clearly lower. It is thus not comprehensible from an economic point of view that a large company with a just low equity ratio of, say, 0.1% receives a risk weight of 90%, while companies with sales of up to EUR50 m receive, e.g., a risk weight of 120% when their equity ratio is 19%.

We, therefore, believe it is necessary and appropriate to derive the risk weights for large companies and SME separately and to make a separate calibration. Another argument in favour of this is that the ratio of unexpected and expected losses is clearly more favourable for SMEs than for large enterprises. A statistically observable higher default rate of SMEs finds expression in higher expected, but not necessarily in higher unexpected losses. However, the higher expected losses are already taken account of in the pricing. Yet, the purpose of the capital requirements is not securitisation of expected, but of unexpected losses. Therefore, see our alternative proposal on this in "Fig. 1: Alternative proposal for the

corporate exposure class". Moreover, the option to assign SME commitments of up to EUR1 m to the retail portfolio should remain (see remarks on the retail exposure class).

Therefore, for the purpose of a risk-adjusted design of the capital requirements of the CRSA, we demand a clear reduction of the risk weights for receivables from small and medium-sized enterprises. In addition to this, the consultation paper does not state to what extent the Basel Committee will provide a clear definition of smaller (and medium-sized) enterprises. Diversification effects, like those resulting for corporate SMEs for a large number of exposures, appear to have not, or not sufficiently, been considered in the risk weights proposed. Accordingly, we believe the risk weights for corporate SMEs are clearly excessive and we suggest a flat-rate deduction in the calibration of the risk weights for enterprises with sales of up to EUR 50 m to take account of the diversification effects (figure for Europe, possible quantitative operationalization for local markets).

The proposed privileging of start-ups (use of a risk weight of 110% in the year of foundation) should not be usable exclusively on the basis of the availability of balance sheet data. Rather, the privileged risk weight should solely be linked to the fact of a start-up. Due to the high initial investments and losses of such enterprises, the revenue-based risk drivers proposed above do not seem to be reasonable. Rather, the Basel Committee recognises the necessity for support for start-ups within the scope of the issue. Consequently, against the background of the average time until reaching the break-even point, it should be possible to apply the privileged risk weight for up to five years after foundation of the company.

Q7. Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity?

We suggest to continue to allow the external-rating-based approach at any rate for large enterprises and/or enterprises that access the capital market, because for large enterprises this approach is substantially more risk-sensitive than a "two-factor model" and the central criticism, that external ratings are not available for a large share of the portfolio, is not justified here. Almost all large, and in particular the capital-market-oriented enterprises have external ratings.

Specialised lending

Q8. Do respondents agree that introducing the specialised lending category enhances the risk sensitivity of the standardised approach and its alignment with IRB?

Basically yes. However, under the new CRSA the typical IPREs should not have higher risk weights than unsecured senior debt corporate exposures. In well-developed and long-established property markets, this is a biased minus point and gives detrimental control impulses. In principle, it should be possible to exempt a real estate financing from assignment to the specialised lending exposure class, e.g. if it can be proven by means of a hard test[3] that the market is a well-developed and long-established property market.

[3] Cf. footnote 59, bullet 4, of the consultation paper.

Furthermore, the default dependence should be added in paragraph 21 as another characteristic of the specialised lending exposure class, i.e. the value of the assets is materially depending upon the credit quality of the borrower.

We object to the inclusion of, e.g., pure infrastructure financing into the specialised lending category. The necessity defined by government authorities for support for such projects (public private partnerships) should not be counteracted by supervisory law.

We welcome that proof that a lending is not specialised lending can still be furnished by means of cash flow independence, and also in individual cases. In addition, it should be defined that the hard test can be used to prove cash flow independence.

The aim of the revision of the CRSA is to remove the dependency of flat-rate risk weights and ratings. Now, two new flat-rate risk weights are to be introduced in particular for property developer financing. We can understand the Basel Committee's difficulties to arrange within the matrix for corporate exposures. Here, advance financing (increase of leverage) and subsequent turnover play an important part, so that property developer financing would be subject to extreme fluctuation in the matrix. Nevertheless, the flat-rate specification of 120% or 150% does not seem to be quantitatively based and contradicts the experience made by banks. Thus the property developer business is not per se associated with higher risks compared to classical corporate exposures. Quite the contrary is the case: Risks seems to be better covered due to the higher interest margins for these transactions. Furthermore, in booming regions, properties are usually sold immediately by construction stage already prior to the start of construction, so that de facto they are fully collateralised. Finally the effective risk is mainly determined by the creditworthiness and the degree of professionalism of the property developer itself. Therefore it does not seem to be sound to assume overall higher risk weights for property developer financing.

Finally, holding companies or special purpose entities resulting from company split-ups should be excluded. In these cases, the holding company lets the property to the operating company, which is a uniform risk in that payment of the rentals depends on the operating company's credit rating, while in turn the operating company cannot continue its business without the rented property. After the split-up of the company, the holding company's risk is not greater than if the company had not been split up. It should, therefore, be allowed to treat the operating and the holding company as a unit and assign a single risk weight to it.

Subordinated debt and equity

The aim to harmonise the IRB approaches and the new CRSA as regards methodology is not achieved by the two risk weights of 300% and 400% under the new CRSA, because in the simple risk weight approach of the IRBA, the differentiation is by three risk weights including expected losses (EL), namely 200% (190%+10% EL), 300% (290%+10% EL) and 400% (370%+30% EL). Insofar, we suggest to provide an additional risk weight of 200% under the CRSA.

As no consistent argumentation is given, it cannot be understood how the risk weights of 300% and 400% for holdings arise. Risk weights of 400% for holding positions which are not traded on the stock exchange appear to be clearly too high, i.e. the rapid increase from currently 100% to 400% is not appropriate. This also goes for subordinated debt with a risk weight of 250%. A subordination agreement does not by itself increase the contracting party's probability of default.

A loss would only be higher if it occurred. In addition, should subordinated exposures not be recoverable, specific provisions for bad debts would have to be made. Therefore, a risk weight of 250% is an unreasonably high capital requirement, the more so as the capital may already have been reduced by provisions for bad debts. We suggest to preserve the risk weight for subordinated debt in dependence on the respective exposure class analogous to exposures without a subordination agreement. Also conceivable is a lower add-on to the risk weight for subordinated debt. At a LGD rate of 75% for subordinated debt and of 45% for positions which are not subordinated, an add-on of about 70% (75/45 = 1.666) to the corporate risk weight seems to be more appropriate.

The privileging of receivables from start-ups (risk weight of 110%) proposed for the corporate exposure class should be extended to risk positions from subordinated debt and holdings. In the context of granting loans to start-ups, start-up financing is predominantly provided in the form of venture capital (loans with subordination, equity capital loans). Insofar, in addition to the possibility of privileging appropriate risk positions, we ask for an application period of the reduced risk weight of up to five years after foundation of the company due to the time a start-up needs on average to reach the break-even point.

Retail exposure class

In the area of the retail exposures as well, we do not see any fundamental need for changes to the existing regulations. According to sub-section 34, the "orientation criterion" is restricted to small enterprises. We suggest to extend the scope of application to medium-sized enterprises as regards both language and contents. This is actual practice in Europe. According to this, an enterprise with sales of ≤ EUR50 m or a balance sheet total of ≤ EUR43 m is an SME.

Q9. Can respondents suggest, and provide evidence on, how to increase the risk sensitivity of the regulatory retail exposures treatment, either by differentiating certain product subcategories for which a specific risk weight may be appropriate; or by suggesting simple risk drivers that could be used to assess the risk of all retail exposures?

Alternative proposal by the German Banking Industry Committee

Risk sensitivity might be achieved by a further subdividing of the retail exposure class into SME/commercial customers (risk weight 60%) and private customers (risk weight 75%) (see Fig. 2).

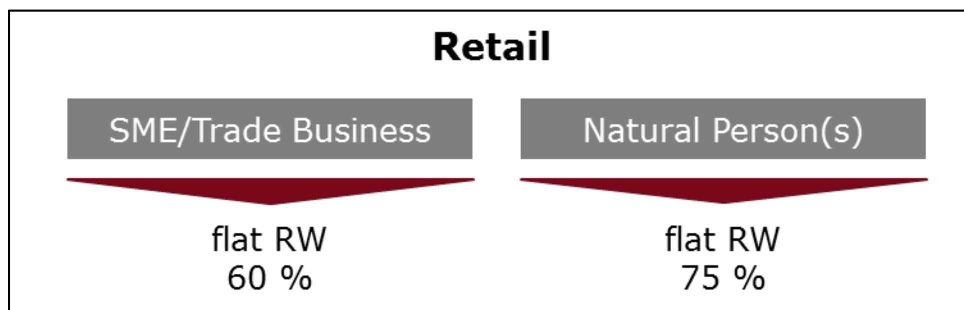

Fig. 2: Alternative proposal for the retail exposure class

In addition, a risk weight of 50% might be possible and desirable for secured motor vehicle financing and leasing. This is a rather conservative value which might be empirically proven in the further course. In the past, the losses incurred in the secured motor vehicle financial leasing and lending business were throughout relatively low. This is in particular true for the car financing and leasing business with private customers. Willingness to pay is very high in this area, as the vehicle is urgently needed to keep the customers mobile. A risk weight of 75% substantially overemphasises the actual risk.

Because of the accompanying increase in complexity, we do not believe that any additional, differentiated consideration of product categories would make sense.

The introduction of additional risk drivers contemplated by the Committee appears difficult. While, e.g., the income available for credit repayment definitely is a criterion for a debtor's creditworthiness, inclusion of a debt service coverage (DSC) ratio into the risk weighting for the capital requirements is not expedient. In the paper, the Basel Committee basically emphasises that the banks' individual internal approaches shall not be applied in the CRSA. However, there is no globally uniform approach to the calculation of this ratio – and cannot be due to national differences, among other things.

Especially in the retail business, the cost component is of major importance. Therefore, the intended refinements result in a multiplication of the work on site: obtaining documents, documentation, handover to the reporting systems, plausibility checking, clarification of delimitation issues etc. Therefore, we suggest to allow continued application of the current simple approach. With a view to the further clustering of the exposure class, we object to a mandatory application of the granularity criterion (0.2% of the entire supervised retail portfolio). In particular for smaller banks with a small retail portfolio, the criterion would mean a very low maximal amount of credit, which would result in considerable impairment of competition. For example, in the case of a portfolio size of EUR200 m, the maximal amount of credit would be EUR400,000. Especially lending to SMEs would suffer under such a regulation. As a consequence, lending to SMEs would become substantially more expensive or be substantially reduced. Therefore, we suggest to require proof of diversification of a retail portfolio not by means of a mandatory check of the granularity criterion, but to allow other methods as well. Moreover, as described in the Basel paper, there are cases that require national discretion as to the determination of the granularity criterion and the application of the retail business. This should continue to be the basis for handling, especially for the small banks.

Moreover, a “pollution quota” of 10% corporates should be permitted in the retail segment if the corporates are decided on in the retail process. Due to the rather low volume of lending, balance sheets that would enable calculation of the required indicators are usually not available for these enterprises. The additional requesting and evaluating of the balance sheet entails disproportionate expenditure where the lending volume is low. A higher flat weight of 100% should apply to these loans.

Exposures secured by real estate

We assume that positions which hitherto were assigned to the residential or the commercial real estate exposure class will remain in these categories when the revised CRSA comes into force.

The LTV ratio results from the relation of full exposure amount and value of the real estate. It is unclear whether the term "full exposure amount" refers solely to the loan secured by real estate or whether it means the entire liability of the customer to the bank.

Should the latter be the case, there probably is a problem if the real estate does not secure the customer's entire liability and hence possible additional credit lines etc. have a liability-increasing effect. This results in a detrimental development of the collateralisation level and hence a worsening of the risk weights. We agree with the statement made in the consultation paper that the credit risk is the higher the lower the LTV ratio. However, we believe the real estate loan splitting method commonly used in Europe is sufficient to properly reflect this fact. Real estate loan splitting means the splitting of the total loan into a secured and an unsecured part. This can solve the problem mentioned above.

In actual fact, real estate loan splitting automatically causes the average risk weight of the total exposure to increase – the more so, the smaller the real estate loan share (with an LTV of e.g. ≤ 60%), which is privileged with a risk weight of 35%/50%, is compared to the total loan. Paragraph 72 of the Basel II framework also does not rule out tranching. This makes the definition of six different LTV buckets unnecessary.

Should it be found in the context of the QIS that exposures secured by real estate have insufficiently capital requirements, it would be better in terms of method to vary the amount of the real estate loan share, i.e. the percentage of the LTV ratio specification. However, the data gathered so far each year in the context of the hard test[4] do, in our opinion, not allow the conclusion that the credit risks were underemphasised in this segment. Rather, recent years have confirmed the appropriateness of the approaches used.

Without real estate loan splitting, there would be various technical problems. For example, it is unclear how an assignment is to be made to the respective LTV classes if several mortgages exist for the benefit of the same bank or how the ranks of the mortgages are reflected. Moreover, it is unclear how securitisation with a wide statement of collateral purpose is taken into account, where several loans granted to a customer are secured by real estate, so that no one-to-one relationship can be derived.

The Basel Committee proposes to assign exposures secured by land charges on unfinished real estate to the retail or the corporate exposure class. These exposures should instead be assigned to the exposure class "exposures secured by real estate", because the loan is paid out as a rule based on construction progress, so that a recoverable collateral exists. In addition to this, the financing banks already at present expect proof of appropriate advance letting or advance selling quotas of about 50% prior to disbursement of the loan.

Residential real estate

Q10. Do respondents agree that LTV and/or DSC ratios (as defined in Annex 1 paragraphs 40 and 41) have sufficient predictive power of loan default and/or loss incurred for exposures secured on residential real estate?

Q11. Do respondents have views about the measurement of the LTV and DSC ratios? (In particular, as regards keeping the value of the property constant as measured at origination in the calculation of the LTV ratio; and not updating the DSC ratio over time.)

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[4] See footnote 59, bullet 4, of the consultation paper

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We believe the risk weights proposed are too high. For example, in case of a 100% financing of a piece of real estate (LTV = 100%), a risk weight of up to 100% would result depending on the DSC ratio. Despite securitisation by a land charge, this would be equal to an unsecured exposure and indisputably overemphasises the credit risk underlying the secured exposure. The new draft intends to define the risk weight in a range between 25% and 100%. In general, therefore, a higher risk weight has to be expected. The historical loss rates of comparable exposures show that an increase of the risk weight is not necessary by any means. From our point of view, there is no need here to generally eliminate the flat risk weight of 35% for the secured part of the loan.

We basically find the risk driver "LTV ratio" makes sense. However, since the TLV ratio changes over time due to repayments, these updates would need to be taken into account.

The DSC ratio also is an important criterion for credit rating. However, as already explained at Q9, this ratio as well is subject to change, both positive (e.g. pay rise) and negative (e.g. loss of job). The heterogeneity of determination (no worldwide standards) outlined in Q9, however, makes central specification not appear reasonable as an objective criterion. In this respect, there is in particular the danger of compromise solutions regarding definition which in many cases would inevitably deviate from the procedures used in the lending processes and cause high formality expenditure. Examination of the debt service ability is rather a topic for the second pillar of the Basel framework and should remain there.

The DSC ratio is calculated as the quotient of the annuity and the borrower's income. We are critical of the design of the DSC ratio. In our opinion, a problem is created by the fact that, on the one hand, "[...] all of the borrower's financial obligations known to the bank [...]" are to be included, but, on the other, only the customer's net income is included, without rental income ("[...] without providing any recognition to rental income derived from the property collateral. [...]"). The result of this is that for all customers who have income property (which is usually 100% financed) in their portfolio in addition to private property, the debt service ratio per se is above 35% and hence at least a risk weight 30% applies.

Moreover, borrowers who have a high redemption component at the start of the loan period are placed at a disadvantage compared to borrowers who redeem little or nothing. As a consequence, a bullet loan would be privileged over an annuity loan, although the total exposure and hence the bank's risk is gradually reduced in the latter case.

Furthermore, we believe reference to the net income is meaningful just to some extent in the debt service coverage ratio, because there is not reference at all to the available income. The Basel Committee on Banking Supervision justifies this by saying that the different definitions of "available income" in different jurisdictions make comparability difficult, but the meaningfulness of the indicator is significantly reduced by this simplification. For example, at identical net income and amount of credit, a single household and a family household would receive the same risk weight, although indisputably the relative burden of the real estate loan on the family household is higher.

At the moment, the consequence of the new regulation will be that in future, real estate loans can be treated with a risk weight at today's level only if they have a maximal LTV ratio of 60% and a DSR ratio ≤ 35%. In all other cases, higher risk weights will be shown in the future. This reduces to absurdity the sustainability of real estate valuation in Germany according to conservative valuation standards, because the mortgage lending value will usually be more conservative than the current market value and hence, for higher amounts of loan, cause a worsening of the risk weight, although the risk has already been accounted for by the conservative valuation.

If the LTV ratio is calculated just once, the indicator has just limited predictive power in terms of loan default or amount of loss, because redemption payments would change precisely that ratio significantly over time. In Germany, strict requirements are made on real estate loan privileging. This includes regular valuation of the property. To not take into account the newly determined value and the reduction of the balance by redemption payments will, therefore, be to the detriment of the indicator's meaningfulness. However, the respective expenditure for continuous updating of the indicator bears no proportion to the gain of knowledge and is, therefore, not expedient.

Due to the significant conceptual disadvantages of the DSC ratio, but also the LTV ratio, we suggest to link the risk weight table of paragraph 38 to fulfilment of the hard test. The line "Loans to individuals with [DSC ≤ 35%]" would then be replaced by the condition "hard test fulfilled" and receive a risk weight of 35% irrespective of the LTV ratio. The line "Other loans" applies in cases in which the hard test is not passed or not carried out. At any rate, collateralisation must not cause application of a risk weight higher than would be the case for an unsecured position towards the respective debtor.

Commercial real estate

Q14. Which of the two options above is viewed as the most suitable for determining the risk-weight treatment for exposures secured on commercial real estate? Q15. What other options might prudently increase the risk sensitivity of the commercial real estate treatment without unduly increasing complexity?

Option A (paragraph 44) which in footnote 59 contains the exception for well-developed and long-established property markets, i.e. the preservation of the existing rules under more specific application preconditions, appears to be the more reasonable variant of the two proposals of the consultation paper. It should be combined with the table contained in paragraph 46 regarding option B, i.e. if a hard test is passed, a risk weight of 50% would be applied irrespective of the relevant LTV ratio. After all, especially the hard tests show the actual losses and enable adequate specification of the CRSA weight. If the hard test is not carried out or not passed, the table with the risk weights is applied based on the LTV ratio.

Treatment of commercial real estate without the exception described in footnote 59 is not proper and in no way corresponds to the underlying risk of (hitherto) privileged commercial real estate. The historical loss rates of comparable exposures show that an increase of the flat risk weight of 50% is not necessary by any means.

The requirement of cash flow independence in footnote 59, bullet 2, should be deleted, because it is proven by means of the hard test (described in footnote 59, bullet 4) that a well-developed and long-established property market exists and appropriate maximum loss limits are not exceeded. Thus, the hard test is used to prove cash flow independence.

With respect to the alternative "continued privileged treatment with risk weight 50%", we ask for clarification that the risk weight is defined in accordance with the requirements for the retail or the corporate exposure class only for that tranche of the loan which does not belong to the secured part of the real estate loan with an LTV ≤ 60% and is weighted at 50%.

With respect to option B, we share the concerns already mentioned at other questions regarding the risk weight tables (instability due to just two factors, arbitrariness of the factors, etc.). Here as well, it becomes clear that the table only increases the risk weights. This does not reflect the constancy of the absolute capital requirement intended by the Basel Committee. Rather, the range of the risk weights should also be extended towards the bottom, i.e. risk weights below 50% on commercial real estate loans.

Exposures with currency mismatch

Q16. Do respondents agree that a risk weight add-on should be applied to only retail exposures and exposures secured by residential real estate? What are other options for addressing this risk in a simple manner?

Basically, it has to be said that the value of the real estate does not change in dependence on the currency. Therefore, we believe it is not reasonable to introduce a currency add-on. Moreover, the question is whether the existing standardised approach has shown that the risks presented have hitherto not been covered sufficiently and there is a necessity to increase complexity. In the context of internal credit risk control, banks are already applying a fluctuation add-on of about 20% for an internal risk assessment, which is appropriately extended in critical phases. Therefore, we object to a rigid specification by the supervisory authority.

Credit conversion factors (CCF)

We believe the height of the CCFs is too high altogether. This goes in particular for unconditional loan commitments to corporates which can be unconditionally cancelled at any time, as these are closely monitored and no consumer protection regulations apply. However, we also think the CCF of 75% for loan commitments which cannot be cancelled at any time is too high.

Furthermore, a major part of the off-balance-sheet items probably results from lending to retail customers and SMEs. Accordingly, a strong increase of the CCF will probably have a negative effect on the willingness to lend money or result in stricter contractual terms and conditions for such time-conditioned loan commitments.

Moreover, we point out that an increase of the CCFs has immediate effects on the amount of the leverage ratio and, therefore, ask to have this "side effect" considered.

An alternative would be to define CCFs in dependence on the term – like in the CRR – for credit facilities not drawn on: 50% at original maturity > 1 year, 20% at original maturity < 1 year, both under the CRSA and under the IRB.

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Q17. Do respondents consider the categories for which a CCF is applied under the standardised approach to be adequately defined?

Q18. Do respondents agree that instruments allocated to each of the CCF categories share a similar probability of being drawn and that the probabilities implied by the CCFs are accurate? Please provide empirical support for your response.

Under the pretext of harmonising both methods, the lower CRSA factors are per se increased to the IRBA rates. This procedure must be rejected in principle. Rather, a well-founded analysis should be performed which forms the basis for the definition of reasonable and stable new rates for both approaches.

We cannot comprehend CCFs of 10% for unconditional loan commitments which can be unconditionally cancelled at any time. In the retail business, the credit lines are closely monitored by processes that indicate worsening of credit ratings in due time and then actually result in termination. In the corporate segment, the consumer protection regulations named by the Basel Committee do not exist. Corporates are likewise monitored closely, so that immediate reduction of the credit line can be enforced. We, therefore, continue to regard a risk weight of 0% as appropriate for unconditional loan commitments which can be cancelled at any time.

The clear increase of the risk weights for loan commitments is a substantial tightening of the regulations. For example, a CCF of 75% applies to all credit lines which cannot be cancelled entirely, at any time and without notice. The reason given for this is harmonisation with the IRBA, but exclusively the respective CCFs are aligned, while the PD factors in the IRBA are completely disregarded. The sole harmonisation of the CCF across the entire portfolio of loan commitments without a further specification of the risk content as in the IRBA will insofar result in a clear overemphasis of the risk content. The increase of the CCF to 75% for all loan commitments is clearly too high.

An additional reason given for the increase of the CCF for revocable loan commitments is the allegedly frequently non-existing actual revocability of the commitment. However, instead of removing from the existing regulation those loan commitments with respect to which the banks are de facto compelled to maintain the credit lines due to legal or other restrictions, all such kinds of commitments are burdened across the board. We believe this is not appropriate for several reasons:

On the one hand, it is unclear to what extent these de facto restrictions regarding cancellation of loan commitments do actually exist. In particular in the case of current accounts and credit cards, usual practice has shown in the past that loan commitments can be adjusted to the customers' payment behaviour and income situation at any time. With respect to the adjustment of limits based on the individual borrower's creditworthiness, we also do not see the danger of a loss of reputation, as stated in the justification as an impediment to adjustment. Loss of reputation would possibly have to be feared only in the case of general adjustments that affect entire groups of customers. However, such changes to the lending policy of banks have so far not been the focus of the question of terminability of the limits, because reference was made to the individual contractual agreements with the customers.

On the other hand, we are critical of the fact that in particular in times when cashless payment transaction systems are becoming more and more important, unused credit lines terminable on demand would result in capital requirements without any possibility to generate revenue from them. As a consequence, a clear reduction of the credit lines on current accounts and credit cards would have to be expected if the proposed regulations were implemented.

Past due loans

Q19. What are respondents' views on the alternative treatments currently envisaged for past-due loans?

Classification of defaulted exposures should continue to be as simple as possible to enable fully automatic support.

Multilateral development banks (MDBs)

Q20. Do respondents agree with the proposed treatment for MDBs?

We believe it is important that especially protected state MDBs continue to have a risk weight of 0%.

Introduction of a subcategory in the corporate segment is acceptable.

Other assets

Q21. What exposures would be classified under "Other assets"? Is a 100% risk weight appropriate? (Please provide evidence where possible).

According to the proposed rules text, the standard risk weight for all other assets will be 100%. Whereas cash as eligible financial collateral is explicitly mentioned and receives a 0% haircut, cash in hand and equivalent cash items that do not serve as financial collateral are not addressed accordingly in the "Other assets" class. Therefore, we strongly propose to include a risk weight of 0% for cash in hand and equivalent cash items. In addition, gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities can be treated as cash and is, therefore, risk-weighted at 0%. In addition, cash items in the process of collection can be risk-weighted at 20%.

It is important to enable banks to continue to determine the rates for other assets in a way which is as pragmatic and simple as possible. In practice, these often are items such as tax refund exposures or commission exposures, so that a rate lower than 100% appears to be justified.

Moreover, the 100% rating of fixed assets (in particular property, plant and equipment) applied hitherto under the CRSA should be questioned. It seems to be reasonable and consistent to include into the CRSA only those items that involve a counterparty risk.

Credit risk mitigation techniques

We reject a general ban on using own estimates and models. Rather, banks which already have approved methods in the context of credit risk mitigation techniques should be allowed to use them also for the purposes of the CRSA, because they are far more risk-sensitive than, e.g., supervisory haircuts. Moreover, the credit risk mitigation techniques should be harmonised between CRSA and IRBA, in particular with regard to application of a floor. For example, recognition of exposures as CRM might be extended to CRSA users, subject to compliance with qualitative and procedural requirements, to avoid overemphasis of the economic loss risk under the CRSA compared to under the IRBA.

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For example, the consultation paper prescribes that banks applying the standardised approach for credit risk (CRSA) should not apply internal models such as the IMM to determine the exposure value of derivatives. In this respect, it needs to be considered that the CRSA serves as a fallback for banks that do not apply internal models to determine risk parameters such as PD and LGD. There is no reason for not allowing banks to determine EaD for derivatives based on internal models such as the IMM if the bank has an approval to do so.

Note that even IRB banks typically incur some exposures to counterparties for which no internal rating is available and thus the standardised approach is applied. In case of derivative exposures, these banks should be allowed to apply the IMM to determine the EaD for derivatives facing CRSA counterparties. If, e.g. for the purposes of a capital floor, it is deemed to be appropriate not to allow for an application of the IMM as part of the CRSA, then this should be clarified as part of the capital floor framework. A general restriction as part of the CRSA is not adequate or required to achieve the stated objectives.

Q22. What are respondents' views on the above alternative ways to define eligible financial collateral?

Selection of just a few criteria creates the danger of insufficient accuracy and high fluctuation intensity. Simple, homogeneous rules should be applied in particular for the simple methods.

Q23. What are respondents' views on the recalibrated supervisory haircuts shown in Table 4? What are respondents' views on how to eliminate references to ratings from the supervisory haircuts table? What could be the implications of eliminating references to external ratings?

The haircuts for high-quality securitisation are clearly too high. With respect to this, simple, transparent, comparable top-rated ABS such as auto-ABS should receive preferential treatment. The criteria for this are at present discussed by the Basel Committee and the IOSCO.

Q24. What are respondents' views on the proposed corporate guarantor eligibility criteria?

The CRSA provides that the better risk weight (of the issuer) may be applied under the CRSA to loans to an issuer that are guaranteed by a better-off third party as regards credit standing.

The paper wants to replace the use of external ratings by qualitative criteria. In our opinion, however, the term "qualitative" is misleading, because ultimately only the eligible guarantors are deleted. For example, companies are as a rule no longer accepted as guarantors.
A reason for this procedure is not given and it suggests itself that this procedure is based on a lack of ideas. Mere elimination is not comprehensible and would have substantial effects on the banks' capital requirements.

Another comment results with respect to the cancellation of the exemption for repo and derivatives transactions shown in section 3.5. The existing definition of the "core market participants" and the corresponding risk weight of 0% play an important part. No reason can be seen why the exemption is to be cancelled.