eurofinas

SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

Basel Committee on Banking Supervision

Brussels, 27 March 2015

Re: *Consultative Document on Revisions to the Standardised Approach for credit risk*

Dear Sir/Madam,

Eurofinas, the voice consumer credit at European level, welcomes the opportunity to respond to the Basel Committee on Banking Supervision's (BCBS) consultative document on revisions to the Standardised Approach for credit risk.

Eurofinas brings together associations throughout Europe that represent consumer credit providers. The scope of products covered by Eurofinas members includes all forms of consumer credit products such as personal loans, linked credit, credit cards and store cards. Consumer credit facilitates access to assets and services as diverse as cars, furniture, electronic appliances, education etc. By providing access to finance to individuals and households, consumer credit supports the social and economic well-being of millions of consumers across Europe. It also benefits manufacturers, motor dealers and retailers as a key tool for their sales. It is estimated that together Eurofinas members financed over **321.7 billion Euros worth of new loans** during 2013 with outstandings reaching 827.9 billion Euros at the end of the year.

The Federation supports the objective of the review to ensure that the standardised approach is appropriately calibrated to reflect the riskiness of credit exposures. We are however concerned by the potential detrimental impact certain recommendations could have on specialised credit institutions that Eurofinas represents.

Basel requirements are primarily designed for internationally active institutions. These requirements may not all fit smaller-sized institutions or specialised business models.

Consumer credit providers/asset financiers across the European Union (EU)/European Economic Area (EEA) encompass a diversity of organisations of different legal nature (i.e. specialised banks, finance houses) and with various operational characteristics (independent companies, subsidiaries of banks, captive finance companies of manufacturers). All share a very high degree of specialisation and have a very limited mix of business activities compared to traditional mainstream banking organisations. In jurisdictions, such as in the EU/EEA where Basel standards apply to a wide range of firms, the impact of the review will be much more significant for specialised institutions.

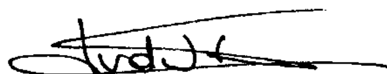
In line with the BCBS's principle for the review of the standardised approach, we believe the **various requirements should be simple and suitable for a wide range of institutions**. In particular, we are concerned by the potential limitation of the use of external credit ratings. While we agree that different techniques and tools for risk assessment can be promoted, technical abilities and resources of credit institutions vary. We disagree that reliance on ratings necessarily result in insufficient due diligence.

From the preliminary feedback received from member firms, we understand that the proposed risk weights will imply an important increase in capital requirements**. Recalibration and fine-tuning of the standards are needed** to avoid a disproportionate impact on firms and ensure consistency with the review's objectives. We are concerned that the transition to the proposed methodology would most likely increase capital requirements of standardised banks for most credit exposures, widening the gap between standardised banks and IRB banks, raising serious competition issues for smaller or challenging banks. The outcome of these changes is to likely push more lending towards IRB banks as they have less onerous capital requirements.

We would strongly advocate for **a better recognition of physical collateral** in the BCBS's review of the standardised approach for credit risk. Consumer credit providers and asset financiers that Eurofinas represents have specialist expertise, perform prudent collateral valuation and have in-depth knowledge of their customers with which they manage the risks that are part of their business. Their specialised nature means that they have a unique understanding of their clients and asset markets and are able to track the level of risk they are exposed to very carefully. The lack of recognition of physical collateral places specialised providers at a disadvantage compared to other market players and has a significant impact on their ability to fulfil their role of support to the real economy. We would welcome a clarification from the BCBS on this point.

I remain at your disposal, should you be interested in discussing any specific issue. Alternatively feel free to contact my colleague Alexandre Giraud (a.giraud@eurofinas.org - tel: + 32 2 778 05 64).

Yours sincerely,



Tanguy van de Werve
Director General

Exposures to banks

Q.1 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?

As a general observation, we believe that the Common Equity Tier 1 (CET1) ratio is a selective figure. It is a key figure in the rating methodologies of most rating agencies. However, we do not consider that, taken individually, the CET 1 ratio is a better indicator of risk than a bank's credit rating. Rating agencies assess banks' exposures using a mix of indicators including macroeconomic factors, business position, profitability, capital structure, risk position funding and liquidity. We believe it is going to be very difficult, in particular for smaller institutions, to obtain the data required for the risk drivers. We therefore advocate maintaining the current approach for exposures to banks.

We would also like to draw your attention to the following issues:

- The BCBS defines a bank exposure as a claim on any financial institution that is licensed to take deposits from the public. This definition is inconsistent with the concepts used in the EU/EEA jurisdiction where a clear distinction is made between banks/credit institutions and financial institutions. The latter are not allowed to receive deposits from the public. We are concerned that this definition will have a major operational impact on the treatment of credit exposures to EU/EEA financial institutions. The reference to deposit taking in Annex 1, paragraph 2 should be deleted as follows:

"12. A bank exposure is defined as a claim […] on any financial institution that is ~~licensed to take deposits from the public, and~~ is subject to the prudential standards and level of supervision in accordance with the international practices relevant for such an institution".

- We agree that exposures to securities firms and other financial institutions should be treated, as currently is, as bank exposures as long as these firms are subject to prudential standards and the level of supervision equivalent to those applied to banks. It is however important to consider that these firms may be subject to different standards to take into account the specificities of their activities.

  It would not make sense to treat exposures to these entities as exposures to corporates simply because they present a lower systemic risk and, as a consequence, are subject to an adjusted set of rules (for example concerning liquidity requirements). This should be clarified by the BCBS.

Q. 2 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?

We recommend maintaining the current approach for exposures to banks. Should the Committee nevertheless decide to review its methodology, we take the view that the Non-Performing Asset (NPA) ratio should be considered on a gross basis to avoid discriminating

banks that have a large proportion of secured loans or leases. Collateral leads to lower provisions as the loss given default is presumably lower.

When calculating the NPA ratio on a net basis, the holding of collateral will generate a relatively higher ratio even though the actual losses will be lower. The gross NPA ratio is a more precise measure.

Q. 3 Do respondents have views on the proposed treatment for short-term interbank claims?

We see the BCBS's proposal to introduce a minimum 30 % risk weight for short-term interbank claims as punitive. We take the view that claims to banks with an original maturity of three months or less have an extremely low probability of default and carry lower risk. We would advocate keeping the 20% coefficient, at least for short-term claims of three months or less.

Furthermore, we believe that the remaining time to maturity is the appropriate risk figure, not the original maturity. For this reason, we recommend short-term interbank claims to be defined as having a remaining maturity of three months or less.

Exposures to corporates

Q. 5 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?

As for exposures to banks, we think external credit ratings are stronger proxies to assess the creditworthiness and solvency of the exposures to corporates. The methodology developed by external credit agencies to assess corporate exposures uses a blend of metrics and information which are more granular and risk sensitive than the risk drivers currently proposed by the BCBS.

If leverage is to be a risk driver, then it would be better to assess relative leverage: too much leverage can introduce risk but the amount of leverage needs to be seen in relation to the industry, the asset intensity of the firm, its operating model and other factors.

Q. 6 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?

We think the proposed treatment is inappropriate with regard to exposures to SMEs. We are strongly concerned that the new risk drivers will penalise those firms currently not required to file their accounts on public record. Diversification effects should also be taken into consideration regarding SMEs. We therefore suggest introducing a distinction between large and smaller corporates. For smaller corporates, the risk drivers should be recalibrated to reflect the given diversification effects. The proposal that banks must apply a risk weight of 300% to exposures to an obligor that has not provided its revenue and leverage data to the lending bank is disproportionate and punitive. Ultimately, it is also unfair for institutions operating in jurisdictions where such information is not publicly available or not sufficiently detailed. A lower risk weight should be considered (for example a 100% risk weight for SME exposures).

Q. 7 Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity?

Risk sensitivity could be further increased by maintaining the current approach to use external ratings, especially with regard to large corporates where external ratings are typically available. External ratings are much more risk sensitive than the two risk drivers proposed.

Retail portfolio

Q. 9 Can respondents suggest, an 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?

Criteria for inclusion in the regulatory retail portfolio

We agree that small business exposures should remain under the regulatory retail portfolio. SME facilities and commitments are perfectly comparable to exposures to natural persons. This is for example very much the case in the consumer credit market where credit institutions are also involved in the financing of car dealerships and retail businesses. We believe that medium sized businesses should also be clearly included in the **orientation criterion**. Currently, it seems that only small businesses would be included in the regulatory retail portfolio.

We take the view that the **granularity criterion** according to which no aggregate exposure to any single counterparty should exceed 0.2% of the overall regulatory retail portfolio is too low and should be set at a higher level. This limit could make it harder for smaller credit institutions to compete with larger players. We recommend introducing a higher limit (of at least 0.5%) of the overall regulatory portfolio. Such perimeter would be sufficiently granular while not disadvantaging smaller institutions.

Risk drivers

We support the BCBS's work on the differentiation of risk for retail exposures. However, the improvement of the risk sensitivity should not compromise the simplicity and accessibility of the standardised approach. Against this backdrop, we strongly believe that a default 75% risk weight should be maintained for regulatory retail exposures.

In parallel, we think the extent to which a **lending facility is secured by durable goods** can be a strong factor for a differentiated treatment from other retail exposures. For example, motor finance (loan and lease) could be treated as a specific subcategory in the retail portfolio[1]. Against this backdrop, we would recommend to introduce a lower risk weight for exposures to motor finance (for example a 50% risk weight). Information on the performance of motor finance activities is publicly available and can be collected from rating agencies' pre-sales reports on asset-backed securities auto loans[2].

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[1] Together with our sister Federation Leaseurope, we support a differentiated treatment for asset finance in general.

[2] See for example recent pre-sale reports for RCI Banque by DBRS and Standard & Poors.

We would also advocate for a specific favorable treatment for **loans secured on salaries and pensions**. Such lending facilities currently exist in Italy. They are strictly regulated and provide a valuable set of guarantees such as the direct assignment of one-fifth of the pensions or the salary to cover the payment of the loan instalments, mandatory insurance policies as well as restriction on the availability of retirement indemnities and the possible foreclosure of salaries/pensions[3]. A recent industry survey confirms that default and loss rates for such a product are significantly low[4]. For example, the probability of default (PD) within 12 months is 3.0%, the effective loss rate (weighted-average LGD rate) is 5.8% and the expected loss (EL) is 0.16%.

Accordingly, the theoretical risk weighting (RW) factor, calculated on the retail curve, is 8.4%. We would welcome the BCBS's views on the possible differentiated treatment of this product.

Other risk drivers

As a general remark, we think the introduction of multiple risk drivers should be avoided. We strongly advocate for a default 75% risk weight for retail exposures to be maintained.

We do not think the other proposed risk drivers, such as the maturity of the exposure or the existence of an established relationship between the borrower and the bank are appropriate for consumer credit activities. We think such drivers would benefit larger institutions to the detriment of smaller specialised players. Market characteristics must be taken into account to avoid altering competition and reduce households' access to finance.

The Debt Service Coverage (DSC) ratio would be a particularly inappropriate risk driver for most consumer credit activities. Other criteria such as borrowers' credit history, professional seniority, residential stability as well as type of consumer credit products are better indicators[5].

Q. 17 Do respondents consider the categories for which a CCF is applied under the standardized approach to be adequately defined?

While a Credit Conversion Factor (CCF) of 10% for unconditionally cancellable commitments with regard to consumers seems understandable, we believe that a CCF of 10% for unconditionally cancellable commitments is too high with regard to corporates. An immediate reduction of a commitment is generally very easily enforceable towards corporates. Therefore we advocate maintaining a CCF of 0% for unconditionally cancellable commitments with regard to corporates.

A general increase of the CCF to 75% for commitments which are not unconditionally cancellable is too high. We recommend that the BCBS assesses the possibility of introducing a single CCF for all commitments that are not unconditionally cancellable (as an example, the introduction of a single CCF of 50% could be assessed). Alternatively, the current situation should be maintained.

[3] *Cessione del quinto dello stipendo/pensione* as regulated by the Presidential Decrees 180/50, 895/50 under supervision/instruction of the Ministry of Economy and Finance and the Bank of Italy.
[4] Survey by the Italian Banking Association (ABI). Participating financial institutions (11) provided over 80% of the product in 2013.
[5] Where appropriate, information available from credit bureaus or credit reference agencies can also be used in this context.