

Ms Grainne Nevin
 Senior Examiner Banking Supervision Covered Institutions
 Central Bank of Ireland
 PO Box 559
 Dame Street
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10th July 2013

Dear Grainne,

I refer to the consultation paper on the Management of Country Risk by Credit Institutions issued by the Central Bank of Ireland (CBI) on the 12th June and our meeting in respect of same on the 1st July. CBI has requested that any submissions on this paper be forwarded by the 12th July.

Background

The CBI is proposing to introduce a Policy on the Management of Country Risks by Credit Institutions in order to enhance the sound prudential regulation and supervision of banks and to have appropriate oversight of the risks associated with banks' international lending. We note this facilitates CBI's ability to comply with international best practice i.e. the Basel Core Principles for Effective Banking Supervision dated September 2012 ("The Basel Principles") and specifically Principle 21 of this document.

Bank of Ireland has in place a Court approved Country Risk Policy which sets out the broad parameters within which the Group wishes to carry on its international credit risk and investment activities and outlines the core principles that govern the manner in which country risk is approved, managed, and reported, including the setting of limits for Country and Sovereign risk. The policy is subject to annual review.

Bank of Ireland (BoI) Comments

We believe that BoI Group Country Risk Policy is broadly consistent with the proposed CBI Policy. With regard to the CBI document we would make the following observations:

At a high level we see somewhat of a mismatch between the overarching principle set out in section 1 of a Board satisfying itself as to the applicability of the CBI policy with regard to the reference to size and complexity in section 3.2.3 vs. the prescriptive language used in the provisions set out in the rest of section 3 which would appear to constrain the institutions ability to exercise discretion. A strict interpretation/ application of these provisions could have unintended consequences, particularly for more domestically focussed institutions.

Definitions of Country Risk: We note the definitions and categories of country risk set out in section 1.3 of the document, and the requirements under section 3.2.3 to have in place policies and procedures for managing such risks, and to give consideration under section 3.6.6 to putting in sub-limits for each category. We agree that institutions should be aware of the different types of country risk to which they may be exposed and that they tailor their risk governance accordingly. However the differentiation and quantification of Transfer Risk and

Contagion Risk (as main categories) and Currency, Indirect, and Macroeconomic Risks (as other categories) will be challenging to implement at a transactional level (and at a portfolio level as a result), with the use of assumptions in measuring such risks potentially diluting any intended regime the CBI is trying to introduce. Whilst being mindful of such risks when assessing the credit worthiness of borrowers and country limits, we do not believe that the policy should be any more prescriptive beyond that.

Supervisory Approach: We note per section 2 that the CBI will have regard to the size and complexity of a credit institutions international lending and investment activities and other factors set out in the policy in considering whether the credit institution has appropriate systems to control Country Risk and maintain adequate provisions for such risk. Greater discussion on how this approach will apply to BoI would be welcome.

Limit Approval: It is unclear from the document what discretion can be applied by more domestically focussed institutions regarding the prescriptive nature of some of the requirements in section 3 e.g. section 3.6 states that country limits should be approved by the Board annually, with no qualification with regard to materiality. This could have unintended consequences e.g. an inability to respond to requests for the provision of trade finance facilities (of a non-material nature) to customers exporting to emerging markets where new country limits can require approval at very short notice.

Loan Classification: Sections 3.2.3 and 3.5.2 state that credit institutions should integrate the Country Risk rating system with their loan classification framework. The document does not state whether it is intended that all IRB risk rating models in use should therefore specifically incorporate Country Risk factors, or whether there is capacity to have regard to the scale and complexity of an institution's operations in determining whether more qualitative approaches would be appropriate.

Policies and Procedures: Under section 3.2.3 there is a requirement that the policy should include, inter alia,

- clear lines of authority for approval of international lending and investments and the limits allowable for exceptions
- types of criteria for acceptable collateral and guarantees, financial instruments and hedging strategies
- the minimum standard terms and conditions to be incorporated in loan documentation in accordance with the legal requirements of each country
- the process for evaluating the legitimacy of documentation and perfection of collateral
- procedures for dealing with deteriorating situations in a country, including contingency plans and exit strategies
- types of management reports on Country Risk

As a broad principle we do not believe procedural matters should be incorporated in policy. An institution's risk governance framework may set out direction on some of these, but in our view the more prescriptive matters should be more appropriately addressed through detailed procedures, as would be the case for domestic lending, which can be tailored/ amended on a more frequent basis as the need arises. The concept of 'limits allowable for exceptions' also requires further clarification.

Country Risk Analysis: Section 3.4.8 states that credit institutions should maintain Country Risk analysis files which are held at head office. We fully endorse the need for Country risk files to be maintained on a centralised basis but do not believe the location should be specified.

Systems and Controls: 3.6.6 sets out that limits may be broken down into sub-limits with examples being the types of risk, product, secured and unsecured, insured and uninsured, region etc. Given that a number of these sub-limits would appear to be directed towards

institutions of large scale and international diversity it is not clear how this is to be applied to the more domestically focussed banks.

Provisioning; Provisioning is referenced in a number of sections – section 2 re Supervisory Approach; 3.2.3 Policy and Procedures; 3.4.10 Country Risk Analysis; 3.5.2 Country Risk Ratings; 3.11 Provisioning Policy and Approach; and sections 5.1/ 5.3 Disclosure and Regulatory Reporting.

Principle 21 of the Basel Principles states that there are different international practices that are all acceptable as long as they lead to risk-based results. These include:

- (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate.
- (b) The supervisor (or some other official authority) regularly sets percentage ranges for each country taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures.
- (c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.

The CBI document as set out would be suggestive of a more high level approach to Country provisioning whereas we would recognise country risk in assessing impairment and determining specific provisions where required, at individual borrower level. It is not clear as currently drafted whether this approach would be acceptable.

Stress Testing: The application of the requirements for stress testing under section 3.9 would benefit from some context, in consideration of earlier points made regarding scale and complexity of domestically focussed institutions.

In summary, BoI is in broad agreement with the new CBI guidelines but believes there could be interpretation issues arising from full implementation of the currently drafted guidelines, which would run contrary to the overriding principle that regard should be given to the scale and complexity of an institution's international lending and investment activities. We would request that the points above are considered and reflected by CBI in the next iteration of the document and we look forward to continued engagement with CBI prior to publication of the final document.

If you have any further queries in this regard please do not hesitate to contact me.



Tom McGivney
Head of Credit & Market Risk – Corporate & Treasury