

10 March 2016

Basel Committee on Banking Supervision
Attention: Basel Committee Secretariat
Bank for International Settlements
CH-40002 Basel, Switzerland

Re: Comment letter on the second consultative document – standards / revisions to the standardised approach for credit risk, issued December 2015

Basel Committee Secretariat,

This comment letter on the above-referenced consultative document (the ‘**2nd consultative document**’) is submitted by the Aviation Working Group (see www.awg.aero, ‘**AWG**’). AWG is a non-profit group comprised of major banking and other financial institutions and manufacturers from around the world, and works on regulations and practices to facilitate international aviation financing and leasing. Its members are from Brazil, Canada, China, France, Germany, Japan, Singapore, the United Arab Emirates, the United Kingdom, and the United States. AWG has status at, and other working arrangements with, several international and intergovernmental organisations, including the OECD (where it works on international export credit financing rules), UNIDROIT (where it was central to the development of an international treaty on security over aircraft collateral and now works on that treaty’s global implementation), and ICAO (the UN body for international civil aviation, where it works on a range of projects).

AWG has followed the work of the Committee since AWG’s first submission in 2001. It made another submission in 2004. AWG has not re-engaged with the Committee since then as its banking members have invariably made use of the IRB approach, with outcomes that have, in parallel (i) been risk sensitive, and (ii) promoted safe and sound lending practices, supporting the substantial lending needs of the international aviation community, a sector of central importance to international trade and economic development.

That framework would be fundamentally and adversely changed by proposals set out in the 2nd consultative document (the ‘**proposals**’), through mandatory capital floors based on the revised standardised approach. Accordingly, AWG comments on the proposals, with references to paragraphs and defined terms taken from the 2nd consultative document, as follows: -

the problem in summary

1. Where aircraft collateral secures non-performance of a loan (on terms set out, *mutatis mutandis*, in para 50, herein ‘**aircraft-backed loans**’) to a special purpose entity, the flat risk weight of 120% is vastly out of proportion with transactional risk and LGD data and estimates determined by the most conservative methods. It would result in a higher capital ratio than for loans to most unsecured corporate borrowers, which, beyond being counter-intuitive, does not accord with empirical data. It would, if adopted (i) result in an increase in capital by 200%-300% compared with current data and experience-based practices, (ii) mis-align capital requirements and risk sensitivity, as the use of special purpose entities insulates the value of aircraft collateral thus reduces transactional risk, (iii) remove the risk weighting-related incentive to reduce transaction risk through transactional structuring, (iv) remove incentives for countries to improve and comply with rules of law designed to reduce secured transactional risk, and (v) have a significant adverse impact on global aviation finance, and, thus, on the transportation sector, with a range of adverse micro- and macro-economic consequences. The reduction to a flat risk weighting for issue-specific rated object financing (a) would not fundamentally redress these problems, as it would not take into account the reduced risk (on account of the aircraft collateral) compared to an unsecured loan to a corporate with the same rating, and, more generally, (b) would apply in few cases given the small number of rated aircraft-backed loan borrowers.

2. A range of factors, including the profile and incentives of, and lending practices to, aircraft-back loan borrowers, has resulted in a scarcity of defaults in aircraft-backed loans over time and across jurisdictions. Probability of default figures do not accord with actual defaults, which are substantially lower. Most pertinently, actual LGD has been low

over time and across jurisdictions. The reasons for low LGD are as follows: (i) aircraft collateral has consistently retained its value, (ii) aircraft collateral, when sold and re-deployed, benefits from a large, global, and liquid secondary market, (iii) transactions are structured to minimise risk, including by use of prudent LTVs, bankruptcy remote structures, and cross-collateral and default clauses, and (iv) the laws around the world permit prompt and predictable realisation of aircraft security. On the last point, and most recently, the success of a global international treaty (the Convention on International Interests in Mobile Equipment as applied to Aircraft Equipment) has further improved such realisation of security, including in the case of bankruptcy, and has done so with express and short realisation timetables powerfully backed by binding, treaty-based international legal obligations.

3. The features in point 2 above led the OECD, in reviewing LGD for aircraft-backed loans, to reach conclusions which are fundamentally inconsistent with those apparently underlining the Committee's calculations related to the risk in aircraft-backed loans. See, in particular, the risk and market reflective pricing under the Arrangements for Officially Supported Export Credits (Annex III, Aircraft Sector Understanding). Such pricing, developed through an elaborate and ongoing data-driven intergovernmental process, acknowledges low LGDs for aircraft-backed loans to all categories of corporates. The Basel Committee and the OECD should align LGD assumptions, which requires conformity by the former with the latter, given the data-based nature of the OECD's conclusions.

4. In sum, aircraft-backed loans, over time and across jurisdictions, are a highly secure category of asset-backed secured loans, with some of the lowest LGDs. In particular, aircraft-backed loans, while having some commonality with transactions backed by commercial real estate, compare favourably with such transactions. It follows, *a fortiori* and from objective criteria, that if real estate-backed transactions are subject to special rules for required capital, then aircraft-backed loans must be as well.

the solution in summary

5. The Committee should develop a more risk-sensitive approach which produces materially lower risk weighting for aircraft-backed loans than apply (all else equal) to (i) unsecured loans to corporates, and (ii) object financings, in each case as currently set out in the proposals. That would, in turn, provide risk management incentives.

6. There are two means by which the Committee can effect the foregoing: -

First, by a table of sliding risk weighting, primary driven by LTVs, conceptually similar to, but not the same as, that applicable commercial real estate. That table should have sufficient granularity to accurately reflect changes in transaction risk and LGDs corresponding to changes in LTVs (and avoid 'cliff effects' in moves between LTV groupings).

Secondly, by permitting aircraft collateral to be used in credit risk mitigation calculations.

next steps and further data and information

7. AWG stands ready, and would welcome the opportunity, to provide substantiating and (LTV-related) valuation data to, and otherwise to consult and engage with, the Committee as thought helpful and requested upon review of this comment letter.

Sincerely yours,



Jeffrey Wool
secretary general
Aviation Working Group

CC: Messrs. Claude Brandes, Airbus, and Daniel da Silva, Boeing, AWG Co-Chairmen