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GOVERNOR

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Danièle Nouy,
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH 4002 Basel, Switzerland

Dear Secretary General,

I am pleased to comment on the consultative document on the New Basel Capital Accord, issued by the Basel Committee on Banking Supervision(BCBS) in January 2001. I welcome the Basel Committee's efforts to change the current Accord to a more comprehensive approach to addressing the risks of banks. After reviewing the proposed new Accord, I find there are several specific issues that deserve mention.

1. Risk weight for claims secured on commercial real estate

In contrast to such developed countries as the USA and UK, emerging market countries including Korea still have a large amount of loans secured by commercial real estate, primarily due to the lack of credit assessment techniques.

In consideration of the difference in the credit risk level between unsecured loans and loans secured by commercial real estate, it is inappropriate to apply uniform risk weight of 100% on both of them. Moreover, the criteria set by the Basel Committee for a preferential risk weight of 50% are too strict for emerging market countries to meet.

Therefore, I would like to propose the following alternative;

i) If the criteria set in the Basel Accord are met, the 50% risk weight can be applied.

ii) If not, but the supervisory authority in a certain country considers that the application of a risk weight lower than 100% is appropriate, taking into account the price volatility of commercial real estate and the recovery rate for loans secured by such property, that country should have the discretion to apply a 75% risk weight on a certain proportion of such loans.

However, in such cases, the country must disclose the criteria for the application of the lower risk weight and supply relevant data to justify its policy.

2. 150% risk weighting category

The fact that unrated corporations carry a 100% risk weight while, if rated, some might expect a higher risk weight of 150%, creates an obvious incentive for them not to seek a rating.

Therefore, it is desirable to reduce the maximum risk weight from 150% to 100%.

3. The implementation date

It is known that banks can set aside less capital by using the IRB approach than the Standardized approach. While the large banks in the industrialized nations are well prepared to use the IRB approach, most of the banks in the emerging markets will use the Standardized approach. Therefore, a level playing field is not secured.

I think that the revised Standardized approach, which is more advanced than the current Accord, can be put in place from 2004. However, the adoption of IRB approach should be put off until at least 2006.

4. Operational Risk

Even though I think highly of the Basel Committee's efforts to include operational risk in the regulatory capital framework in order to capture the overall risk profile of banks, it is somewhat

premature to regulate operational risk in that it is problematic to calculate it in an objective manner and we still have a long way to go before we can capture it accurately.

Notably, the Basic Indicator approach is based on the assumption that banks with higher gross income will have more operational risk. However, this is not always true and more research on the area is needed.

Moreover, the banks based in emerging markets, which are still financially weak, will be seriously affected by the New Accord because they will need to raise more capital for operational risk.

Therefore, the regulation of operational risk should be postponed until the revised rules for credit risk settled down smoothly and reliable measurement methods for operational risk have been developed. Failing this, it should be implemented using a step-by-step approach.

I hope these comments will be found constructive and I would like to take this opportunity to applaud your efforts to improve the Capital Accord.

Sincerely yours,

Chol-Hwan Chon