FAX COVER SHEET

BANK OF MAURITIUS, P.O. BOX 29, PORT LOUIS, MAURITIUS, FAX: (230) 208-8569

DELIVER THIS PAGE PLUS 6 FOLLOWING PAGES TO

NAME : Bank for International Settlements
LOCATION : Switzerland
FAX : 0041612809100

SENDER : Bank of Mauritius
OFFICE : Banking Supervision
PHONE NO. : 208 4164
FAX NO. : 208-8569

4 June 2001

Re: A New Capital Adequacy Framework

Please find annexed comments on the above by all domestic and offshore banks in Mauritius.

Regards

Bank of Mauritius

ANNEXURE

I GENERAL COMMENTS

1. Capability of Regulator

The new regulations will require a substantial input from the regulator. The capacity and capability of the regulator will therefore have to be of a standard that allows compliance within the framework of the Accord. In countries where the required skills are in short supply, the ability of the regulator to meet these standards may be constrained.

2. Competitive equality

Although the Accord aims at "competitive equality", the bigger and more advanced banks may have access to options that will give them a market advantage, whereas the smaller banks may find it difficult to afford the necessary infrastructure and resource investments.

3. Too much discretion to Regulators

The Accord leaves too much discretion to local regulators. Local regulators, therefore, have a collective responsibility to act in concert with banks to ensure that the proposals in the accord are implemented in such a way as to keep the additional burden to a minimum. This will be both in the interests of bank customers who ultimately bear the costs of regulation, and will help to maintain the competitiveness of banks vis-à-vis non banks. Keeping the cost burden down will have the added advantages of shortening the necessary time period for implementation and motivate banks to move to an internal ratings-based approach more quickly.

National supervisors will exercise broad discretion on a wide range of issues in implementing the raised Accord. Inconsistent approaches and standards applied by national supervisors will result in an unlevelled playing field among banks and between banks and other non-bank competitors.

The broad discretion to be exercised by national supervisors under Pillar 2 will undercut efforts to improve management accountability and govern corporate governance standards. There is a risk that national supervisors will become intrusive in areas which should be left to management and boards.

4. National regulators v/s lead regulator of banking group

Banks hold the view that all national regulators should accept the principle of deferring to the lead regulator of a banking group that is subject to multiple regulatory jurisdictions, or else consult with the lead supervisor and agree on a common approach. This will avoid the significant additional costs of multiple interpretations that are, of themselves, likely to produce at best marginal risk management benefits.

5. Costs of implementing the Accord

The Basel proposals will result in significant additional costs for most banks. The costs will only be justified if there are significant benefits from improved credit risk management practices.

6. Small banks/non-internationally active banks

The ability of small banks to implement the new Accord is limited compared to large and international banks. It is therefore felt that it would be more appropriate for Regulators to adopt a 2-tier approach, whereby:

(i) the large, international banks implement the Accord in accordance with the envisaged time, and

(ii) the current system be maintained for the small, non-internationally active banks, with some modifications and improvements.

7. Time frame

The January 2004 time frame to implement the Internal Ratings Based approach is not realistic for most banks in Mauritius as the final Accord will not be published until end 2001 but will require a minimum of 2 years of data to be held as of January 2004.

It may prove impossible to commence capture of all required data from January 2002 for all 6 asset classes when the requirements will only become due from late 2001 and even then may undergo further refinements between publication of final Accord and January 2004.

8. **Pronounced effect on borrowers with deteriorating risk profile**

It is recognised that banks, by and large, manage capital on a forward looking basis with adequate cushion to absorb down-side risks. However, it is felt that the implementation of the accord might have an adverse effect on individual industries and individual borrowers with deteriorating risk profiles in the event that all lending banks limit their exposure to them simultaneously. As a result, the situation of the sectors concerned may be exacerbated.

9. **Facilitator**

In view of the complexities inherent in the new Accord, banks have expressed the view that an operating body be set up to facilitate interaction in order to remove all the hurdles in the implementation of the Accord.

The tasks of facilitator would be assigned to regulators/supervisors.

II. COMMENTS AND QUERIES SPECIFIC TO THE PILLARS

Pillar 1: Minimum capital requirements

(a) External Credit Assessment Institution (ECAI)

(i) Which ECAIs will be acceptable?

(ii) Will unsolicited ratings be allowed? Public information ratings are considered to be unsolicited. One bank does not support the use of unsolicited ratings.

(b) Treatment of unrated corporations

The circumstances under which risk weights in excess of 100% will be applied to unrated corporations need to be stated clearly and consistently applied by all national regulators.

(c) Treatment of counterparties with weights B- and below

The risk weightings will be based on external credit ratings, with the inclusion of a 150% weighting for those counterparties rated below a B-.

The fact that unrated counterparties will carry a weighting of 100%, but those that are rated B- and below will be weighted at 150% must be also questioned. Will not such counterparties prefer to be unrated in order to be weighted at 100% instead of 150%?

(d) ***150% risk weighting***

Will a 150% risk weighting applied to additional categories of assets such as venture capital, private equity investments?

(e) ***Annual valuation of residential mortgage***

The requirement for annual valuation of residential mortgages is unreasonable and the cost of this is likely to be passed directly to customer.

(f) ***Internal Ratings Based approach (IRB)***

(i) *Lack of resources to implement the IRB model.*

Only global banks have the financial and human resources to implement the IRB system. Smaller banks would need time and would incur huge additional costs to build up the specialised skills in risk management and develop I.T. system in order to implement the IRB model by January 2004.

(ii) *Lack of data*

To move to the IRB approach, banks need to develop and collect data on borrowers' grades, type of collateral, historical loss experience. The data will have to cover an observation period of 5 years.

It is difficult, if not impossible, to build up a reliable database of clients because of inadequacy of information from clients.

The timeframe scheduled by the BIS for the implementation of the Accord will not allow banks to move to the IRB by January 2004.

(iii) *Extension of time frame for implementation*

In view of the implications mentioned at (i) and (ii) above, banks have requested for a more extended time frame for the implementation of the IRB. The extension in timeframe will incidentally allow banks to spread the costs involved.

(iv) *Assistance from the World Bank*

Assistance from the World Bank or any other international financial organisation may be requested for by Regulators, to assist local banks with the relevant package or software.

(v) *Lack of incentive to move to IRB approach*

The proposed Benchmark Risk Weightings (BRW) for IRB act as a disincentive for banks to incur the expenditure to implement it in the January 04 time frame, given that the BRW for higher risk assets are much higher than under the standardised approach. Consequently, banks applying the standard approach will gain a competitive pricing advantage relative to banks applying an IRB approach.

Pillar 2: Supervisory Review

The second pillar confers too much discretion on national supervisors. That discretion may cause some supervisors to become too intrusive in managements' decisions.

Pillar 2 should not be used to impose higher capital charges on a bank that is otherwise managing its credit risks and capital prudently merely in order to exact a penalty for not moving to implement an IRB approach within a time frame arbitrarily defined by the supervisor.

While additional capital requirements are not in all cases the appropriate solution to address deficiencies in the risk management processes of banks, banks disagree with the view taken by the Basel Committee on capital increases, namely to suggest that "*increased capital might be used as an interim measure while permanent measures to improve the bank's position are being put in place*". It should be well understood that capital measures cannot instantaneously be switched on or off without causing potentially severe distortions. Rather, capital is nothing but permanently available liquidity.

Pillar 3: Market Discipline

Pillar 3 disclosure standards for IRB are onerous and counter productive. Instead of improving market transparency, they will confuse market participants with voluminous, complex information that would be difficult to interpret.

The disclosure standards will also require banks to disclose information of a proprietary nature that will put them at a competitive vis-a-vis banks and non-bank competitors. Besides, they will be costly to implement.

It will be necessary to educate analysts and other market participants concerning the correct interpretation of Pillar 3 disclosures to avoid unexpected and uniformed market reactions to this information. Therefore, more consideration needs to be given to a high quality disclosure package that is acceptable to banks.