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

Dear Madame Nouy,

We welcome this opportunity to provide initial comments on the proposals published by the Committee on January 16th last. However, the level of complexity of the new proposals, combined with the short timeframe for consideration and the wide range of issues that remain open, means that our comments are necessarily confined to the major issues as we see them. Moreover, as industry too is faced with a deadline of May 31st for comments we have not been formally informed of their final position. Therefore, some of the comments outlined below are based on the initial, tentative reactions from industry as they were aired in our consultations with them as well as on our own consideration of the proposals. We will, of course, be in continuing dialogue with industry as well as being closely involved in the continuing discussion and negotiations in the European Union.

At the outset we want to make it clear that we welcome the extensive proposals, which seek to better align regulatory capital and economic risk. They represent a genuine advance on the current regulatory framework and, if properly implemented, will lead to more stable and secure banks and contribute greatly to financial stability generally. In particular, we welcome the proposed three-pillar approach. Capital requirements based on sound qualitative and quantitative criteria, together with ongoing supervisory oversight and market discipline, should ensure a more complete and better informed assessment and analysis of the real risks to which individual banks are exposed as well as the way they manage those risks.

We are also fully supportive of the proposed "menu approach" to capital requirements and agree that the one-size fits all approach is no longer valid. Nevertheless, the present capital accord and the proposed new framework are both targeted at internationally active banks. We recognise that the Committee acknowledges that many countries apply the capital accord to domestic banks.

However, we have doubts that the objectives for the new framework, which state that the accord "should be suitable for application to banks of varying levels of complexity and sophistication" can, in fact, be achieved.

Moreover, although it is not intended to raise the overall levels of capital within the system and that no additional burden will be created, as a consequence of the varying levels of complexity the distribution of required capital may change considerably from bank to bank. We would be concerned to ensure that the redistribution of capital would not be unfairly weighted against certain small or specialised institutions. In this regard, while we agree with the menu approach and the incentives to move to more advanced risk measurement and management systems, we are unsure whether the right incentives are provided. For example, the internal measurement approach for the calculation of operational risk may not be achievable by the widest range of institutions even in the longer term. Similarly, the additional costs of detailed risk analysis, reporting and disclosure requirements which will be required in order to benefit from the more advanced approaches, may not be economically viable for a wide range of less sophisticated institutions.

Conversely, whereas the proposals should lead to greater risk sensitivity of capital requirements, by ensuring that banks which take on greater risks also hold additional capital to cover these risks; this may well not work in practice. For example, we are concerned that there is an incentive for smaller, less sophisticated banks to absorb the lower quality credit risk in the system and be, relatively, undercharged for this in regulatory capital even in the revised standardised approach. Potentially, the banks least capable of risk management may well be holding the greatest proportion of low quality assets in the financial system.

There is scope for significant variation in the way these proposals are implemented, particularly in the supervisory review process. While we acknowledge that there is a reasonably consistent approach to the supervision of the major internationally active banks, it is not clear that, in practice, the same principles will be applied across all institutions by all supervisors.

Similarly, as the proposals increase the scope for discretion at the national level in the implementation of the three pillars and, especially, in the way in which they interact there is a need to ensure competitive equality. There will be a need, therefore, for enhanced convergence in supervisory practices. While this issue is already being addressed in the European Union through the auspices of the Banking Advisory Committee and the Groupe de Contact, we are concerned to ensure that a similar approach is adopted on the wider international stage. This is an issue that should, perhaps, be included in the new framework.

On timing, we are concerned that, while implementation is anticipated sometime in 2004 to facilitate European and national rule-making procedures, this time frame is still too short given the range of information not yet available. For example, some aspects of the proposals are unclear. Besides the obvious overall calibration difficulties, the calculations on operational risk remain vague. The Committee has, as yet, not released any detail on the treatment of project finance and equity portfolios and the treatment of interest rate risk is not yet clear. Furthermore, the proposals do not sufficiently address retail banking. We are concerned to ensure that the legitimate concerns of industry and supervisors alike, which have emerged in the course of the consultative process, be adequately addressed and that all have an equal opportunity to properly respond to the final proposals. Therefore, we feel that the time frame for publication of the final Accord i.e. before the end of 2001, is too short and should be put back until such time as the detail of the proposals is known and, more importantly, the outcome of the quantitative impact studies on the proposed credit risk and operational risk changes is assessed.

One final point we would wish to make is the potential resource problems that the new rules may give rise to. This is not solely a matter for emerging market economies but is clearly of considerable concern to a wide range of supervisory authorities, and indeed, supervised entities. Considerable expertise will be required to ensure, given the degree of complexity of the proposals, that supervisory authorities are sufficiently trained and adequately resourced to police and enforce the proposed framework. It is equally important that institutions do not move too fast towards adopting the more advanced framework without adequate expertise, resources and data (for example, it appears from initial survey findings that banks have insufficient historical data to implement much of the internal ratings based requirements). Although a transitional period is suggested it would be better, in our view, to concentrate on agreeing clear and meaningful principles at this stage and then allow more time for greater consideration of the detail by both industry and supervisory authorities even if this results in a later implementation of the new rules. In this way, not only would concerns over reliability of data be addressed but also other issues, in particular operational risk figures, could more accurately be dealt with. Clearly, it would also allow for a more reasonable legislative time frame and allow for a more wide-ranging discussion of all the issues.

Yours sincerely

Adrian Byrne
Banking Supervision