Companhia Portuguesa de Rating, S.A.’s comments on the following documents:

- “The New Basel Capital Accord”, issued on 16 January 2001 by the Basel Commitee on Banking Supervision (hereinafter called “Document 1”) and appendices; and

- “Commission Services’ Second Consultative Document on Review of Regulatory Capital for Credit Institutions and Investment Firms”, issued on 5 February 2001 by the European Commission’s Directorate General – Internal Market and Financial Services (hereinafter called “Document 2”).

1. Introduction

Following the response of Companhia Portuguesa de Rating, S.A. (CPR) to the first public consultation on the review of regulatory capital requirements for credit institutions (CI) and investment firms (IF) at international level in general and in the European Union in particular, CPR maintains its overall agreement to the essential aims of the two documents now commented. However, we would like to propose a few suggestions regarding changes that could be introduced in these documents in the area of rating (essentially linked to the first pillar referred in Document 1: minimum regulatory capital requirements), so as to improve them, and pre-empt the need for their early or frequent revision, an inconvenient for all parties concerned

2. Preferential Treatment of Non Rated Assets,

Treatment Based on Sovereign Risk

The two documents under analysis propose the following weights for the various assets, according to the ratings assigned:

AAA a AA-

A+ a A-

BBB+ a BBB-

BB+ a BB-

B+ a B-

< B-

No rating

Sovereign risk (1)

0%

20%

50%

100%

100%

150%

100%

CI – Option 1 (2)

20%

50%

100%

100%

100%

150%

100%

CI – Option 2 (3)

20%

50% (4)

50% (4)

100% (4)

100% (4)

150%

50% (4)

Other companies

20%

50%

100%

100%

150%

150%

> or = 100% (5)

(1) In the European Union the ratings used are those in the local currency, for issues in the local currency. Issues in the local currency and financed by debt in the same currency can, at the option of the national supervision authority, receive a weighting that is one category more favourable, under the Basel Committee methodology, and 0%, under the European Union methodology.

(2) Weight based on the rating of the Sovereign State where the CI is registered.

(3) Weight based on the CI's rating.

(4) Claims of an original maturity of less than 3 months would receive a weighting that is one category more favourable than the usual risk weighting of longer-term claims of the same CI.

(5) At the option of the national supervision authority.

This proposal deserves from CPR the following comments and suggestions:

- By establishing lower weights for non-rated assets than for assets with poor ratings, we perceive the intention of not penalising CI and IF of countries (including European Union countries) where the rating activity is not so much divulged and widespread, as explained in paragraphs 36 to 39 of the consultative document "The Standardised Approach to Credit Risk" attached to Document 1. However, this alternative:

· will only help perpetuate the backwardness of such countries, insofar as it encourages the non-disclosure of ratings below BBB- (in the case of sovereign risk), A- (in the case of CI risk – option 1 and of other companies) or AA- (in the case of CI risk – Option 2);

· will encourage the concentration of credit in higher risk assets, as a way of boosting profitability with the same level of capital, insofar as the risk of credit/default rises exponentially with the rating's deterioration. This will inevitably affect these countries' CI and IF's solvency and the strength of their financial systems.

It is therefore CPR's opinion that, to encourage the overall practice of rating assets, the alternative is to penalise non-rated assets, or at least weight them by the highest weighting coefficient established for assets with lower ratings. Moreover, the dissemination of the rating activity as a way to secure the transparency and development of financial markets in countries less advanced in this area should be promoted through legal and/or regulatory channels, as has been happening for a long time and in a widespread manner in the United States of America, and to a lesser extent in other markets (France, for instance). In Portugal, some steps taken in this area were still quite shy. If the policy that may be adopted is not that suggested by CPR, at least the referred policy of not immediately penalising non-rated issuers should be viewed and clarified as being temporary, and a deadline of, say, two years, established, after which non-rated assets would be penalised, or at least weighted by the highest weighting coefficient established for assets with lower ratings, so as to encourage the overall practice of rating assets.

- As a particularly grievous example of the situation referred in paragraph above, we note the weighting coefficient attributed to non-rated issuers and issues classified under CI – Option 2, which means that only issuers and issues rated AAA to AA- benefit from a less detrimental weighting coefficient than non-rated issuers and issues. Hence, in this particular case, CPR suggests raising the weighting coefficient of non-rated issuers and issues under

CI - Option 2 from 50% to 100%, as happens with sovereign risks and risks of other non-rated companies.

- The proposal on CI – Option 1 does not seem to make sense within an overall aim of securing the strength of local and international financial systems. This proposal, based on the rating of the sovereign State where the CI or IF is registered deserves criticisms regarding the following aspects:

· it assumes the support of each sovereign State to the CI and IF registered in that state, when the international trend is for an increasingly lower intervention of sovereign States in CI and IF so as not to upset international competition among CI and IF;

· even though admitting some level of support by sovereign States to the CI registered in those states, the same does not seem plausible in regard to IF in general;

· in either case, when there is implicit support by the sovereign State to the majority of CI and IF registered in that state, this will necessarily affect the rating of the sovereign State itself, penalising its entire financial system and motivating possible registration arbitrages of CI and IF's (who will seek to be registered in lower credit risk countries);

· the proposal benefits CI and IF with poorer credit risk (their debt being favoured by a lower weighting) and adversely affects CI and IF with lower credit risk (their debt being penalised by a higher weighting); this again encourages the registration arbitrage of CI and IF, in this case of those with better ratings, as they will tend to seek other countries to establish their headquarters.