Observations on the Second Consultative Document of the Basle Committee on Capital Adequacy

For credit risks

Some of the underlying principles of the reform can be met with agreement, considering in particular that the reform aims to:

. better measure credit risk using relevant criteria, the main criterion being the probability of default (PD);
. better take into account of securities and other risk-reducing measures;
. gradually move from the standard method to internal ratings – first the base then advanced ratings - which may eventually lead to internal models of credit risk.

Nonetheless, one of the major concerns remains that of avoiding distortions of competition that might have extremely serious consequences.

-With regard more specifically to the standard method, the following points are worth noting:

. Two characteristics of **retail** activities are the small unit amounts and the large number of files per portfolio allowing for an almost perfect statistical spread. As stipulated in the text of the agreement, it is important that the separate treatment granted to retail activities apply to all portfolios where the methodologies implemented to manage the risk follow the same logic of "industrially" processing the files when granting the loan and collecting it.

The application of a 50% discount on average is also proposed and is consistent with the weighting factors used for the IRB approach. For the same level of loss given default (LGD) and an identical probability of default, the equity capital charge is on average two times less for a retail loan than for a corporate banking commitment.

. Operations where **physical securities** are used as guarantees, such as an automobile given in registered pledge or professional equipment provided as collateral, should benefit of a weighting considerably inferior to 100% of the loan.

. As for the treatment of **interbank risks**, national regulators should be allowed to decide whether to apply a weighting corresponding to the most favourable category immediately following the category applicable to the debt of the State where the credit institution has its registered office. Because our members do not take deposits, they have to go to banking institutions, where they are not rated, for much of their refunding.

. Furthermore, we were satisfied to note that for credit lines not exceeding one year the unused fraction is subject to a credit equivalent conversion factor of 0% when the credit line can be cancelled if the borrower's signature deteriorates.

-Regarding the IRB method:

. For retail we agree with the Committee's choice of limiting IRB to the advanced method alone and therefore not keeping the IRB approach for retail banking portfolios. The terms for applying this advanced method could, however, be made more flexible with:

. the adoption of a simple operational criterion for the definition of default: only one criterion, decided by each institution, should be used to define default;
. a segmentation of LGDs that is different from the segmentation of PDs and is representative of the prospects of recovery, with the introduction of additional areas for LGDs alone, notably the type of guarantee (mortgage, deposit);
. an estimate of the LGDs taking advantage of the improvements expected from the processes of recovery.

. The obligation imposed on the institutions of demonstrating that they have been using for at least the past three years a rating system in compliance with the requirements set out in the Basle document (no. 166) cannot be met when the new system is implemented in 2004 (particularly because these requirements will not be approved until the end of 2001 if not the beginning of 2002). This obligation therefore needs to be much more flexible so that the IRB method can effectively be used in 2004.

On the operational risk: the inclusion of this risk is an additional burden and may distort competition between those institutions that are regulated and those that are not.

On market discipline (pillar 3): The Basle Committee's intention of having financial information on the risks of the banks published when the new ratio is implemented can only be approved, but it is important to underline:

. the much higher cost that this new obligation may generate (information on a certain number of points, separate from the existing accounting information system)

. the need for the information to remain confidential and not affect the competitive advantages of the institutions.

Finally, the following remark can be made concerning the European Commission document:

A large number of institutions are subsidiaries of credit institutions and are therefore taken into account in the calculation, on the consolidated basis of the ratio of their parent company.

It appears essential, when they are credit institutions, to continue to allow the Member States to exempt them from calculation on an individual basis in the same conditions as now, rather than having a system of case-by-case exemption by the prudential authority, as is planned. This system looks extremely cumbersome. What is more, in the current system, when the States use the possibility offered them, the prudential authority can always require an institution to calculate on an individual basis, and sin practice serious difficulties do not seem to have been encountered with its application.

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