



HELLENIC BANK ASSOCIATION

Comments on:

***THE NEW BASEL
CAPITAL ACCORD***



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SECTION I

Comments on Consultative Document “The standardised approach to credit risk”

PART A: Risk Weights

1. Paragraphs 11,18: For reasons of fair competition, all claims on eurozone countries should be assigned a 0% risk weight.
2. Paragraphs 24, 25: Linking the risk weights for banks to those for sovereigns, does not allow much differentiation for banks within the same country, that have a different credit risk. In addition, with respect to the treatment of low-rated (B- and below) borrowers and unrated borrowers, the fact that risk weights are more favorable for the unrated borrowers will lead those with a low rating to give up their solicited rating.

Accordingly, the second option which bases the credit risk weighting of a claim on an institution, on external credit assessment, should be the only one to be adopted.

3. In paragraph 39 it is stipulated that ‘in countries where corporates have higher default rates, supervisory authorities should increase the standard risk weight for unrated claims, where they judge that a higher risk weight is warranted by the overall default experience in their jurisdiction’. The document should benchmark what constitutes a higher default rate.

The same paragraph notes that supervisors may also consider whether the credit quality of corporate claims held by individual banks should warrant a standard risk weight higher than 100%. It is not clear whether this sentence concerns supervisors in countries where corporates have higher default rates or all countries. Also it appears that the document proposes that in case of unrated corporates, in effect the supervisors are free to supply their own rates, if they think that corporate claims of an individual bank are of a lower quality than BB-. It is also not clear whether they will be free to require from a bank to rate by a coefficient that is higher than 100%:

- all of its unrated exposure or
- selected corporates within its portfolio.

Moreover, in these instances the supervisory authorities will play the role of ECAs. This is equivalent to giving unsolicited and undisclosed to the general

public ratings. ECAIs assessments should be publicly available and ECAIs are required to meet certain eligibility criteria, which might not be met by the supervisors who in this instance in effect substitute them.

4. Paragraph 69: More consideration and discussion is needed regarding the issuer –versus- issue assessment. In particular, when a company with a risk weight of 50% issues unrated debt, will that lead the borrower to assign a 100% capital requirement for that specific exposure?
5. Paragraph 75. Unsolicited ratings might be used by ECAIs to pressure entities for solicited ratings or even to pressure entities that would be rated below B- to try by various means to suppress these ratings. The local authorities should closely examine the motives of an ECAI, if it publishes unsolicited (and therefore unpaid) ratings each time such an instance occurs, especially if the rating published is of a quality below B-.

PART B : CR Mitigation

6. Paragraph 111 states that equities that are included in a main index are eligible for recognition as collateral in both the simple approach and the comprehensive approach. The definition of a main index is not supplied.
7. The formula for the adjusted value of the collateral as stipulated in paragraph 123 gives equal weight to the haircut appropriate to the exposure and to the haircut appropriate to the collateral. While this might be sensible if $E=C$, it is not sensible if $E \neq C$. In the case that $E=C$, one might argue that there is the possibility that at the time of default the value of the collateral might appreciate to: 100% of the initial value calculated for the collateral + its haircut percentage; therefore the formula takes that fact into account.

However, if the collateral is larger than the exposure, then the weight of the exposure haircut in the denominator should be reduced to the ratio of 'exposure / collateral'. For instance if a bank repos out \$1,000 worth of 10 year AAA rated sovereign securities (haircut = 4%) to a finance company and receives \$5,000 in cash (haircut = 0%) collateral, the adjusted value of collateral according to the proposed formula would be $\$5,000 / (1 + 0.04 + 0 + 0)$. The reduction in the adjusted collateral appears to be too much. A more equitable formula would use 1/5 of the exposure haircut, since exposure is 1/5 of the collateral.

8. Paragraph 134 states that the haircut applied to eligible mutual fund units is the highest haircut that would be applicable to any of the assets in which the fund has the right to invest. An alternative solution would be for a bank to calculate

the haircut, given the actual breakdown of the mutual fund, publicised quarterly by the fund.

9. Paragraph 159 states that for a zero w to apply to repo style transactions, the documentation covering the agreement should be standard domestic market documentation for repo style transactions in the securities concerned. As such standard documentation is lacking in the Greek market, it would be to the interest to all banks in Greece if the Union of Greek Banks organised a banking committee to produce standard domestic documentation.
10. Paragraph 208 stipulates a formula for proportional cover, where secured and unsecured portions are of equal seniority. The formula stipulated for the bank getting the cover results in exactly the same credit protected exposure with the case of the tranché cover, where the bank transfers the credit risk on junior tranche.

In other words, if the loan to be protected is 1.000.000 and the cover is 400.000, no matter if the collateral provides proportional cover or junior tranche cover, the risk-weighted asset is 728.000. The formula does not take into account the fact that if the borrower in the end repays only 600.000,

- in the case of proportional cover: the bank will be able to appropriate only 40% of the cover, i.e. 240.000
- in the case of credit protection for the junior tranche: the bank will be able to appropriate all of the collateral. i.e. 400.000

11. Paragraph 212 stipulates that the bank providing protection for a junior tranche must deduct the amount of the junior tranche from its capital. This treatment
 - is not symmetrical with the treatment for the protection obtainer, whose relief is exactly the same with the relief that he would get for a proportional cover.
 - is equivalent for the bank giving the protection to the treatment of a bad debt for which one would have to make a 100% special provision.
 - is so severe that the bank giving the protection would require less capital if it had provided cover for the whole loan. Let us assume a bank has total risk weighted assets 15.000.000 and capital 2.000.000. If this bank has also provided a cover of 400.000 for a loan of 1.000.000, if the cover is proportional and we use a simplified formula (no haircuts, etc), then the CAD ratio would be $2.000.000 / 15.400.000 = 12,99\%$. If this cover is deducted from the capital, then the CAD ratio would be $1.600.000 / 15.000.000 = 10,67\%$. The bank would be better off, if it had provided cover for the whole loan i.e. for 1.000.000. In this instance its CAD ratio would be $2.000.000 /$

16.000.000 = 12,50%, although it is evident that the risk to the bank would be greater.

The proposal tries to incorporate the increased risk that the protection provider has because he 'guarantees' the riskier portion of a loan. An alternative that would take this into account, would be for the protection provider when calculating his exposure for the protection provided, to increase the risk weight of the obligor for whom he provides cover to the next risk scale i.e. from 50% to 100%, from 100% to 150%. (In this instance, it could be stipulated that the ceiling would always remain 150%, as this is the higher risk category that is recognised).

12. Paragraph 213 proposes that the bank obtaining the protection for a senior tranche would deduct the junior tranche from its capital. This will prove to be a major disincentive to receiving such a protection, as the CAD ratio will be higher for an unsecured loan to a loan for which the risk for the senior tranche is transferred. Assume that a bank covers the senior tranche of 600.000 of a 1.000.000 loan (protection provider risk weight: 20%). Also assume that the bank has remaining risk-weighted assets of 15.000.000 and capital of 2.000.000. The risk weighted asset for this loan would be 192.000, while the capital of the bank would be adjusted to 1.600.000. The CAD ratio would therefore be $1.600.000 / 15.192.000 = 10,53\%$. If the loan was not risk protected, then the bank's CAD ratio would be $2.000.000 / 16.000.000 = 12,5\%$.
13. Paragraph 214 on the treatment of the senior tranche amount for the bank providing protection is vague: the bank 'will hold capital against the full amount of the underlying assets less the amount of the junior tranche'. Does this mean that the senior tranche for the protection provider will have a 100% weight and thus the capital that must be held is 8% of the amount or that the capital that must be held is 100% of the amount? The next sentence reads 'the total capital requirement including the capital deduction [which capital reduction? this was not mentioned in the paragraph] will not exceed that on an otherwise identical loan on which there is no credit protection'. The bank providing protection for the senior tranche has less risk than a bank providing proportional cover or even full cover. The risk would not warrant a reduction from the capital. Is it possible that paragraphs 213 and 214 have been mixed up and the last sentence of paragraph 214 refers to the bank obtaining protection?
14. Paragraph 221 stipulates that 'maturity-mismatched hedges of less than one year residual maturity, which do not have matching maturities with the

underlying exposures, will not be recognised'. The rational of this approach is not obvious and it seems that it is just penalising short-term exposures.

SECTION II

Comments on Consultative Document ‘ The Internal Ratings-Based Approach’

GENERAL COMMENTS:

- The Basel proposals state that PD estimates should represent a long-term average based on the last five years of history. This could however produced unintended results , as the last five years have been the most unstable in global economic history.
- BIS in recognition that concentration of exposures increases the bank’s risk profile proposes the incorporation of a granularity adjustment. The application of a granularity index does not however evaluate whether the risk of default from the borrowers in a portfolio is diversified across industries or countries. What is of paramount importance in assessing the risk of any portfolio is the degree of correlation among the individual constituents. By ignoring such correlation the granularity index does little to improve the accuracy of capital calculation and could in fact lead to significant miscalculation of risk. Furthermore, assembling the data necessary to operate the granularity index may prove extremely costly, in terms technological investments for all banks without materially improving insights into risk.

SPECIFIC COMMENTS:

1. Paragraph 10 states that some exposures in non-significant business units that are immaterial in terms of size and perceived risk profile may be exempt from the above rule, subject to national discretion. The committee should set clear rules that would define immateriality in terms of size, either in relative or absolute terms. Also it is not clear how one would both define and determine immateriality in terms of perceived risk profile.
2. We have not found in the document a clarification on whether probability of default is calculated as : a) the number of defaulted customers to the total of customers, b) the number of defaulted facilities to the total of facilities c) the value of total defaulted customers exposure to total exposure or finally d) the value of defaulted facilities to total exposure.

3. In paragraph 26, it is stipulated that for the foundation methodology all transactions not covered by financial collateral, commercial or residential real estate collateral are viewed as unsecured for the regulatory purpose of LGD. Since the committee already recognises the external ratings of rating companies that meet certain requirements, it could recognise other types of collateral, if these are valued by properly qualified expert valuation firms. This is particularly important for the small and medium size enterprises as these are more likely to be unrated (and thus penalized under the standardised approach) or have a lower rating and pledge collateral that does not conform to the strict proposed standards. The existing framework could well produce a disincentive for banks to lend to small and medium size companies with several consequences for the financing of the entire sector.
4. In paragraph 63, the Committee voices its concerns that the maturity dimension could render the foundation approach too complex or impose additional costs on banking systems. Consequently, it assumes that the average maturity of all exposures is three years. It then however wonders whether explicit maturity adjustment should be an option that some supervisors could implement for banks in the foundation IRB approach. It does not clarify whether supervisors would offer this option to the banks or whether they would have the option to demand from all of the banks in their country to add the maturity dimension in their calculations. In each country there exist banks that are obviously concentrating on short or long term lending. It is worth considering whether the central bank could categorize the banks in three categories of maturities (1, 3, 5 years) based on financial reports they receive (e.g. liquidity reports) and give the option to the banks either to accept the said category or if they feel it is advantageous to them opt for the addition of maturity in their calculations for capital adequacy. However, in order for the banks to decide this, the committee should provide them with the formulas they would use if they had 1 or 5 years of average maturity in their portfolios. Would they be the same with the one provided in paragraph 159 ?
5. In the foundation approach a commercial or residential real estate given as collateral decreases at best the probability of default only by 10%, an extremely conservative approach. In paragraph 94 it states that exposures with a ratio of CRE or RRE collateral value to the nominal exposure below a threshold level of 30%, would receive the appropriate LGD for unsecured exposures or those secured by non recognized collateral of 50%. The rationale behind this is explained in paragraph 95, in which it is argued that if a bank does not have a meaningful amount of collateral, it may not make sense for the bank to sell the collateral, as the benefit may be lower than the expenses

incurred in the sale. It could be argued however that it is not correct to judge by the ratio of collateral to exposure but rather by the absolute value of the collateral and its nature.

It is nonsensical to claim that a CRE collateral valued at EUR 1 million covering an exposure of EUR 4 million should be deemed as nonexistent, while the same collateral would be acceptable for an exposure of EUR 2 million. It is evident that the expenses incurred in liquidating the collateral would be the same in both instances, and that the bank would show the same interest in liquidating EUR 1 million of collateral, irrespective to the amount of exposure covered by it.

The expenses incurred in liquidating a building where we have prenotation and auction expenses would not be more than 7% of the value of the building. If on the other hand the collateral is either in a distant place or will involve litigation to acquire the proceeds of its sale because its titles of ownership are not clear, then this of course is of such a shady nature that it should be deemed unacceptable anyway.

In paragraph 96 it sets the upper value of recognisable collateral at 140%, stating that such a value represents a suitable balance between risk sensitivity and conservatism. The formula used to calculate LGD, given the ratio of C to E, is already extremely conservative. We have calculated that if one used the formula with no upper limit, a facility would have to be covered by 700%, for LGD to become 0. To summarize, we would request that there is no lower limit of 40% or upper limit of 140% and that the formula itself is more lenient, so that a collateral 3 times the exposure would result in a 0% LGD. If the regulators feel that there might be legal and other issues involved, for which one should never turn LGD into 0 due to CRE or RRE collateral coverage, then they could apply a w factor of 20% in this case as well.

6. In paragraph 134 it is proposed that the definition of effective maturity would not recognise embedded options that might reduce the term of a loan i.e. it would recognise neither a borrower's option to pre-pay nor a bank's option to accelerate scheduled payments. The opposite however, i.e. the ability of a borrower to lengthen the term of the exposure would increase the effective maturity. This is deemed to be extremely conservative. This option is no less enforceable than any other financial option and we do not understand why the Committee would differentiate its position against this option specifically. Also the fact that the committee does not recognise the borrower's option to prepay is not consistent with paragraph 112, in which it is stipulated that under the foundation approach, exposure at default for committed lines which are unconditionally and immediately cancellable by the borrower will attract a zero credit conversion factor.

7. Expected loss and the determination of corporate risk weights.

Paragraph 185 is of vital importance to Greek Banks because it refers to the rationale of the general provisions that are eligible as an element of supervisory capital (within tier 2) and it clearly states that the purpose of the provisions that are eligible for tier 2 capital is to off-set Expected Loss from Credit Exposures. It should be stressed that the committee states that the fact that general provisions are eligible as an element of supervisory capital is deemed correct and will not be amended but will continue as a part of the revised Accord.

Bank of Greece up to now has interpreted the term general provision as 'provision against general banking risks', (i.e. a provision not related to credit risk) a provision that is never made by the Greek Banks. They have therefore not allowed Greek banks to use their general reserves against credit losses as tier 2 capital, only allowing the banks to deduct such provisions from their loans. The capital relief from such a deduction however is insignificant, if compared to the capital relief if these provisions were not deducted from loans but were added back to the capital. This treatment of course would apply only for provisions that have not been created against identified losses, i.e. that are not specific.

We feel that this interpretation along with the 10% capital adequacy coefficient on the fx positions of the banks are the two most important and strict decisions of the Central Bank that place Greek banks at a disadvantage as compared to their EU competitors. This issue is of a more general nature and applies to all banks, irrespective of whether they use the standardised, foundation or advanced method for measuring capital requirements for credit risk.

Alternatively, a process similar to the one applied by the Bank of Greece decision 2442/29.1.99, (whereby all banks are in effect required to estimate expected loss from bad debts for capital adequacy purposes in the same way, using uniform coefficients according to time frames of delay or according to the restructuring of loans) could apply to all countries. Coefficients for delays of more than a given period could reach 100% of the loan. The Bank of Greece currently compares the provisions calculated by this method, with the sum of general and specific provisions for bad debts of the given bank. If the sum is less than the calculated amount, Bank of Greece deducts the excess from the capital of the bank, before calculating its capital adequacy ratio. This is equivalent to obliging the banks to perform special provisions for such loans. This method could be enhanced so that accounting provisions over and above those calculated under such a method would be added back to the capital,

while deficiencies in accounting provisions revealed by this method would be deducted from the capital. Such a technique would ensure those differences in legislation or accounting practices among countries or even among banks in the same country would not influence capital requirements and would solve the problem posed by paragraph 188.

Paragraph 186 further stipulates that in 'certain countries provisions focus primarily or even solely on a concept of estimated but incurred or current loss.' This is 'conceptually different to a reserve that is intended to cover future expected losses arising from a portfolio of loans and which is not linked directly to identifiable instances of impairment of individual loans.' The concept of incurred or current loss, future expected loss (as well as defaulted loan, as mentioned in paragraph 188) must be clearly defined. If a borrower has delayed 100 days in repaying a loan and the bank has provided for this loan under which of the above three categories (incurred, current, future loss) would this provision fall ? As the determination of risk weighted corporate exposure and whether it would encompass EL and UL is of crucial importance, the Committee should provide clear cut definitions and then request new comments on this chapter.

In paragraph 187 the committee concludes that due to practices referred to in paragraph 186, capital charges will include assessments of both Expected Loss plus Unexpected Loss. Countries however who provide against expected loss and furthermore countries who do not use these reserves as an element of tier 2 capital are clearly penalised. A harmonisation of practices as indicated above would be preferable. If such an approach was to be taken, then weights could cover only unexpected loss.

8. Paragraph 193 states that the minimum requirements for corporate exposures under the foundation approach will be validated by supervisors who will make objective comparisons as well as subjective judgements. The fact that supervisors will use subjective criteria as well and that the appraisal methods will not be uniform, results in the definite risk that different countries will address the same criteria with varying degrees of leniency.
9. Paragraph 202 states that the banks should separately assess inter-related borrowers and assign them to a borrower rating. This is contrary to common banking practice, as usually banks treat affiliated companies as one risk group. It is also common that banks grant overall limits to a group which companies within the group share. This rationale is respected by the authorities, as

evidenced by regulation on large exposures, etc. The reasons for this change in approach are not evident and should be explained.

10. In Paragraph 223 it states that one of the requirements for the PD estimation process is that economic or market conditions under which the historical experience took place, is relevant to current and foreseeable conditions. It is obvious that this requirement cannot be met most of the time as economic conditions do change. Consequently this requirement calls for macroeconomic considerations when the PD is estimated, probably a sound approach but definitely one that has to be either addressed directly in much more detail and precision or eliminated altogether.
12. Paragraph 356 states that the definition of default is the same for bank exposures as for corporate exposures. While for corporate exposures the past due tenor of 90 days is strict and most probably will be the first default term that will be met, for banks it is extremely lenient.

SECTION III

Comments on Consultative Document ‘ Asset Securitisation’

1. In paragraph 15 it is stated that an originating bank providing credit enhancement must deduct the full amount of the enhancement from capital, ‘taking into account the risk based capital charge that would have been assessed if the assets were held on the balance sheet’. This comment is not clear. We hope that it means that a basic rule that will govern the asset securitisation treatment is that the capital charges required for these assets will never be more than the charges that would have been required, if the asset securitisation had not taken place and the assets were still on the books of the bank.

If however the paragraph just means that the credit enhancement will be deducted from the capital and nothing more, then this in most cases will result in higher capital needs than if the bank kept the assets in its books. Therefore the comment that subject to national discretion there may be additional requirements that a credit enhancement must meet, if an originating bank is to be accorded the right to deduct the credit enhancement from its books, as otherwise the bank would not be allowed to remove the assets from the calculation of its risk based capital ratios has no meaning.

2. As first loss positions in traditional securitisations tend to be a multiple of expected losses (see paragraph 78), their capital charges treatment (of deducting the full amount from capital) appears to be very strict. An alternative solution would be to deduct only the expected loss from capital and the remaining multiples to be multiplied by a weight of 150%. However, even this should be limited, so that the effect would not be more to what it would have been had the assets remained on the books of the originating bank.
3. We find the fact that even a second loss credit enhancement by an originating bank may require a deduction from capital very strict. Furthermore, it is not evident why credit enhancements provided have a different treatment according to the role the providing bank has (originating or sponsoring bank). In paragraph 34, which covers credit enhancements provided by sponsoring banks, a first loss credit enhancement will be deducted from capital, while a second loss enhancement will be risk weighted according to the highest weighting of the underlying assets for which they are providing loss protection.

4. Also extremely strict is the solution proposed in paragraph 83e for synthetic securitisation, whereby retained or repurchased senior positions are treated like unrated traditional asset backed security structures and are deducted from capital. Why would these positions be considered riskier to the same positions if they had never left the bank? Instead of penalising a bank that repurchases the senior portion of a portfolio, the committee could state that a bank that has transferred only a small portion of mezzanine risk to the market, will be allowed to reduce its capital requirements by a portion of the capital requirements associated with this mezzanine risk. This could be defined as a notch lower than the underlying assets risk. If the risk of the given portfolio is 100%, and the nominal amount of the portfolio transferred to the market is 12%, then the bank would calculate the capital charge as follows (100% of 100% of the portfolio minus 50% of 12% of the portfolio).

5. For investing banks (paragraph 27) securitisation tranches rated between BB+ and BB- get the same treatment with the unsecured portion of past due assets net of specific provisioning and are risk weighted at 150%. Tranches rated b+ and below or unrated will be deducted from capital. This effectively would prohibit any such activity to occur in Greece and in many other European countries, where not even rating of **firms** is common and therefore we would not expect tranches to be rated. We find the deduction of an investment from the capital an extremely harsh measure for two reasons: first it equates the asset with a non-performing loan for which a bank has created a special provision and second it creates a very small effective limit for such transactions. Taking into account that the risk weights that the committee uses are one notch above the ones used by the standardised credit risk approach, an alternative proposal would be to create a new weight for such cases of 200%. Below you will find a table showing the effect of increasing the risk weight from 150% to 200% and then from deducting the securitised asset from the capital of the bank.

Item	Balance	150%			200%			Deduct from capital	
		Coeff	Weighted Asset		Coeff	Weighted Asset	Balance	Coeff	Weighted Asset
Govt. bonds	2.500.000	0	0		0	0	2.500.000	0	0
Investments	1.500.000	100%	1.500.000		100%	1.500.000	1.500.000	100%	1.500.000
Loans	1.500.000	100%	1.500.000		100%	1.500.000	1.500.000	100%	1.500.000
Securitized	500.000	150%	750.000		200%	1.000.000	0	200%	0
Assets									
Total Assets	6.000.000		3.750.000			4.000.000	5.500.000		3.000.000

Liabs	5.400.000	5.400.000
Capital	600.000	100.000
Total Liabs	6.000.000	5.500.000

Ratio	16,00%	15,00%	3,33%
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6. The committee is too stern with both ends (originators and investors). We get the feeling that at the same time the committee considers the investment to be very risky for the investor, while considering that the risk has been kept by the originator.
7. We also do not understand the reason that would differentiate (up one notch) the weights per grade of these assets from any other investments, if **eligible** ECAs rated them.

SECTION IV

Comments on Consultative Document ‘ Operational Risk’

Definitional issues

The existence of overlaps between credit, market and operational risk areas will result in potential double counting in regulatory capital charges. The inclusion of a factor in the credit risk mitigation area intends to capture operational risk inherent in the documentation. Further examples of overlaps between the different categories of risk include the multiplier of 3 in the Internal Models for market risk which intends to capture, among others, model error risk. In order to avoid overlaps such as those mentioned above, clear definition of the operational risk for regulatory purposes is required.

In addition, indirect losses (i.e. near misses or latent) should not be included in the relative definition, given that it is impossible to assess such losses.

Specific comments

1. In paragraph 23, that covers the setting of the fixed percentage ‘ α ’ in the basic indicator approach, it is stated that it may be desirable to set α at a higher level than 30% of gross income, so that the banks will have an incentive to move towards more sophisticated approaches. However, views are expressed in the document that it is not certain that even these sophisticated approaches will help determine the operational risk of the banks. As it is stated in paragraph 30 the industry has not yet been able to show a causal relationship between risk indicators and loss experience (standardised approach). In addition to that as the committee admits, the state of the industry is far from using advanced measurement of operational risk approaches, even for active international banks. Given this fact, and since it is expected that the basic indicator approach will be used by smaller, domestic banks, it is requested that factor α is not set at a higher level, as this would not accomplish its stated purpose.
2. The standardised approach appears to be the approach that most banks would adopt in the beginning, if an incentive to do so were supplied by the authorities. We fear however that it might result in mathematical and statistical exercises that do not measure correctly the risk involved.

The accuracy or even the relevance of the risk measured by this approach depends on the beta factor assigned for each business line, which in turn depends on the weighting factor (also see 3 below). It is stated in Annex 3 that in order to define the weightings, the authorities have tried to assess the risk involved in each business line. To accomplish this, they have used consultants' databases, internal loss data from sample banks and reality checks by the supervisors themselves. We are not in a position to judge the quality and coverage of loss events of the consultants' databases. It appears however that the internal loss data might not be accurate, as the document states that the sample of the banks is very small, the data is only recent data and the sample consists only of internationally active banks. These are not the banks that will constitute the bulk of the population using this approach in the future. Since no incentive is provided to the banks, which will be using the standardised approach, to assemble and report loss data, we wonder how the committee will be able to further calibrate the β factor. It does not appear correct to use loss data from internationally active banks to determine the β factor for the smaller, domestic banks that will use the standardised approach.

Reality checks finally depend on the supervisory authorities perception of relative risks. It would be advisable that these are made by the local supervisory authorities and that the beta factors are also set by country. These will vary from country to country due to the type of products their banks provide, to the degree of sophistication / innovation in the market, to the legal and tax environment present, etc. Also beta factors might change drastically over time for a particular sector/country, as each time banks in a country start promoting new financial products, there is a higher probability that procedures are not well thought through and that legal and tax issues are not identified / resolved.

3. The weighting factors are not only a function of the degree of risk expected for each business line but also a function of the expected distribution of business lines within the whole banking population. Table 1 of annex 3 that lists the weightings per business line adds up to 100%. Authorities by this method try to fully allocate the 20% of the MRC to the banks. This objective could be accomplished in a relatively correct way, if the local authorities in each country asked two years beforehand from the banks that planned to use this approach in 2004 to give them reports, providing data on the indicators of their business lines. This will accomplish the following:
 - it will take into account the actual business line distribution of the banks that will use this approach in the future,

- the sample will be country specific (e.g. it is expected that British banks will be more active in Trading and Sales, while Swiss banks in Asset Management).
- the weighting will take into account all kinds of banks, as it is feared that the Committee would have access and include in its population only the internationally active banks, a fact that might distort the distribution of business lines.

We believe that the fact that the preliminary findings suggest that some banks would be required to hold more than twice the assumed capital does not necessarily prove that they are in riskier business. Their distribution of business lines could just deviate from the average distribution.

4. The activity groups should be further refined so that the activities within them should have the same indicators or be of relatively the same risk. As examples:
 - We feel that in corporate finance there should be two activity groups. In the second, one would classify underwriting and possibly other activities that should have as indicator the average asset involved rather than the gross income.
 - Trading & Sales traditional products with mature procedures (FX, swaps, etc) should be grouped separately from modern derivatives.
 - Trading involves the payment of huge sums of money, probably more than the payment and settlement section of banking. Should not there be a settlement throughput indicator?
 - The gross income indicator is not appropriate for trading transactions, where the possibility of loss is quite real. For exactly the same transactions, a bank that is not profitable in its trading would be deemed to have less operational risk.
 - By specifying that the indicator for the retail banking is the annual average asset, it appears that there is no indicator for the deposits, which are liabilities. Is this intentional due to the fact that the acceptance of deposits has a lot less operational risk than the granting of loans? If not, maybe these activities should be in separate groups.
5. In paragraph 30 It is stated that the industry has not yet been able to show a causal relationship between risk indicators and loss experience. Furthermore, (paragraph 31) in order for the Internal Measurement Approach to be acceptable, the committee will have to be satisfied that a critical mass of institutions have been able individually and at an industry level to assemble adequate data over a number of years to make the approach

workable. It appears that if a causal relationship will not be proven in the end or a critical mass has not been reached in the future, the approach will not be pursued. Banks wishing to follow this approach will have invested significantly in systems and effort. It would be preferable for such an approach to be proposed only after

- the causal relationship is established
- at least an initial list of banks wishing to try to use this approach has been identified, so that an initial estimate of future critical mass is made.

SECTION V

Comments on Consultative Document ‘ Pillar 3 (Market Discipline) ‘

1. Section ‘standardized approach for the market risk in the trading book’
 - 1a. In paragraph 63 it is mentioned that “for interest rate risk, the risk categories are the distinction between general and specific market risk and the different points on the yield curve. The different components of the capital charge for interest rate risk make use of these distinctions and disclosure of these components can be useful supplementary information.” We are not aware of where the standardized approach uses the different points on the yield curve. A specific reference to the section where this is used would help.
 - 1b. In paragraph 64, it is mentioned that especially for positions, for which the standardized approach is not a very precise risk indicator, disclosure of the daily variability of profits and losses gives important additional information. The committee should specify for which positions it means exactly and should take into account in its requirements that these specific banks are using the standardized approach and therefore do not have the systems to calculate the daily variability of profits and losses. We fear that this requirement will be extremely onerous for these banks.
2. Appendix 3
 - 2a. In the template 3.I.1 - overall credit exposure section quantitative data are requested by
 - total unweighted exposures, before credit risk mitigation
 - total unweighted exposures, after credit risk mitigation
 - total risk weighted assets

As supplementary information requested the banks should provide averages of the above figures. It is not evident whether the committee requests average figures for all above categories or only for the total risk weighted assets. For non-sophisticated banks, the average figures requested (any category) would be an extremely burdensome task. Since in the simple approach on risk mitigation technique collateral is marked to market only every six months for simplicity's sake, why should we impose on these banks to keep daily average figures on collateral? An alternative would be for the banks to report these figures semi-annually, on the date they perform the mark to market on their collaterals.

- 2b. It is not evident for section 3.1.2 to 3.1.5 which exposure figure should be supplied. Is it the risk-weighted assets?
- 2c. In the quantitative core disclosures on credit risk it is stipulated that gross positive replacement costs / positive market values should be used. We would need more details on the cases where these figures would be used. A credit default swap with cash settlement for instance, where a seller of credit protection promises to give the buyer a predefined amount of money if certain agreed upon credit events occur, should in our opinion be treated as a guarantee (substitution of the risk by the credit risk of the guarantor or deduction of the guaranteed amount from the loan outstanding, according to the approach the bank has selected).
- 2d. The committee requests data by geographic breakdown. In the second paragraph under the quantitative core disclosures, it states that the bank should provide quantitative information on the cross-border distribution of its credit exposure using the same geographic breakdown that the bank uses to manage its cross border exposures and/or for accounting purposes (e.g. by geographic region, by country, etc). This data would provide users with information on potential concentrations of country/regional risk. Could a bank that does not have cross-border distribution and does not use for accounting purposes the breakdown by region be excused from this requirement? Also it is not clear what is meant by region. From this specific paragraph we are under the impression that it is defined as many countries together and not as a section of a country. If however it is defined as a section of a country, then for small countries (as Greece is) regions might not be a material piece of information and thus we propose that it is not required.
3. Section II. Credit risk disclosures under the standardised approach
- 3a. Table 3.2 requests that the banks disclose the alignment of different alphanumerical scales with risk buckets. In the standardized approach to credit risk, paragraph 63, it is mentioned that “Supervisors will be responsible for slotting ECAsTM assessments into the Standardized risk weighting framework, i.e. deciding which assessment categories correspond to which risk weights...These processes also need to be publicly disclosed“. Due to this fact, we think that it is not needed for each bank to repeat the information already published by the central bank. They might possibly just refer to the day and medium of publication.

3b. Table 3.2 requests that the banks disclose the average default rates experienced by them in each rating category, while 3.II.3 requests that they disclose the cumulative default rates. There appears to be a discrepancy on what it is actually requested. Also, the requested formula for the estimation of the average or cumulative default rates should be given.

3c. The reason given for the listing of the names of the rating agencies used by the bank (i.e. to ensure that reputable agencies are employed) is not acceptable. The agencies to be used are approved by the supervisory authorities. Such disclosures could indeed lead banks to use ratings only from certain well established firms in the market and could strengthen already existing oligopolies / monopolies. Is this something that the committee want to encourage?

3d. If finally banks will be requested to disclose the percentage of their outstandings covered by each agency's ratings, the committee should specify which outstandings (unweighted? weighted? after CRMTs?)

4. Appendix 5

4a. In the quantitative disclosures banks are requested to publish the operational risk capital charge, so that the public can assess the operational risk the bank is exposed to. As it is stated in the operational risk document paragraph 30, the industry has not yet been able to show a causal relationship between risk indicators and loss experience (standardised approach). The annex in the same document states that "For most banks the tracking of risk indicators appears to be in its infancy, and a large number are not tracking indicators of any kind. Where indicators are tracked, the use to which they are put is often unclear for either risk management or economic capital allocation purposes. There are a few banks, which have carried out correlation tests between indicators and actual losses, but the results have not yet been conclusive. " Publishment of information that is based on indicators not proven to have any relationship with risk is misleading. As examples we quote the fact that for trading activities the indicator is the gross income, a figure that depends on whether the trading is profitable and not on the volume or operational of trading activities.

5. Appendix 7

In template 7.1 the term 'carved out option' is used. We would appreciate a definition on this term.