

ATTENTION: BASEL COMMITTEE SECRETARIAT

Dear Sir/Madam,

I would like to make a comment on the proposal for a New Basel Capital Accord, in particular relating to the application of "Haircuts" to Collateral.

The common definition of a Haircut is that this is a "buffer" which is applied to the market value of collateral in order to protect against the price volatility of the securities. The haircut is expressed as a percentage of market value, representing a worst-case market movement (with 99% confidence level) over a given (usually 10-day) holding period. The market value of the collateral is reduced by that percentage to arrive at an "adjusted" (or "cash equivalent") value of the collateral.

Hence my surprise at your formula to determine the adjusted value of collateral (paragraph 85):

$$Ca = C / 1 + He + Hc + Hfx$$

In my view this should be:  $Ca = C \times (1 - [He + Hc + Hfx])$

For example, a haircut of 20% on collateral worth \$400 should mean that the "adjusted" value of collateral is \$320, i.e. 80% of market value. Collateral deemed ineligible would effectively have a haircut of 100%.

Your formula returns an adjusted value of 83.33% for a haircut of 20%. Note also that with your formula it is impossible to arrive at an adjusted value of 0. Even a haircut of 1000% would still produce an adjusted value of 9.09%.

I hope you understand my point of view, and look forward to your feedback.

Yours faithfully,

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