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Basel Committee on Banking Supervision

Bank for International Settlements

Basel, Switherland

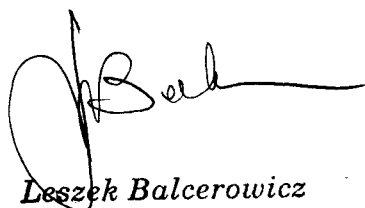
Dear Sirs,

Please find enclosed the Comments by the Commission for Banking Supervision (Poland) on the second Consultative Document „The New Basel Capital Accord”.

The issues of the new capital adequacy proposal were widely discussed in the Polish banking industry, including banks' representatives, the Polish Bankers Association and the supervisory society. Some of the views expressed in the text seem to represent wider context of transitional and developing countries concerns.

We dare hope that the Comments will contribute to enhancing the final version of the Document.

yours sincerely



Leszek Balcerowicz

COMMENTS
on the second Consultative Document
“The New Basel Capital Accord”
issued by the Basel Committee on Banking Supervision

If not stated otherwise, numbers of provisions quoted in the text refer to the main consultative document “The New Basel Capital Accord” (the Consultative Document)

GENERAL COMMENTS

1. The overall direction of the changes undertaken in “The New Basel Capital Accord” is a very positive development. It constitutes an attempt to account for the progress observed in the international banking system after the implementation of “The Basel Capital Accord” of 1988 (especially in the field of banking activity globalization).

The second consultative document introduces a series of changes in relation to its first version, published in 1999. However, we regret to note, that the modifications do not address the principal reservations expressed by the Commission for Banking Supervision in March 2000, concerning unfavorable treatment of countries constructing modern economic systems and undergoing systemic transformation.

2. The New Capital Accord treats unfavourably countries carrying out systemic transformation, such as Poland, Czech Republic and Hungary. The substitution of the OECD membership criterion by that of external rating will lead to paradoxical results: while, due to introduction of reforms, the economic standing of those countries continues to improve, the demand for capital will rapidly increase due to the change in the methodology of credit risk weights calculation. Normal markets must interpret this as a rapid deterioration of the financial condition of the countries’ banking systems and their economies.

3. The proposed approach will result in fostering or even deepening of the division into highly developed and underdeveloped countries, both with respect to external funding and capital costs. In this context, the situation of the less developed countries, despite of their OECD membership, gradual improvement of their economic situation or anticipated UE membership, will undoubtedly become less beneficiary than at present (although their actual standings will remain unchanged). The recently observed progress of countries - applicants for the UE membership will be curbed by the increase in cost of funding. This will in turn negatively affect their chance of being assigned higher ratings. It may not be possible to break this feed-back.

4. In countries mentioned above, as well as in many others countries less advanced in the process of economic restructuring, only a few economic entities (excluding some listed companies) are assigned trustworthy external ratings. This is because the lower level of economic development results in the low level of attendance of reputable external rating agencies. Thus, those countries will be forced to use less beneficiary techniques for credit risk assessment, which has to be interpreted as a lack of level playing field in relation to the developed countries.

5. A serious concern arises about the introduction of the possibility to assign entities higher weights than those assigned to the country. Seemingly, this “relaxation” points in the right direction. However, having in mind the conservatism of the rating agencies, one should expect that in the low rated countries the agencies will assign higher ratings only to strong internationally active firms. Such a scenario is highly probable, and its realization will introduce additional disadvantageous differentiation of entities operating on the same markets.

6. The approach proposed in the Consultative Document does not solve or even address the issue of:

- a) unification and verification of methodologies used by rating agencies,**
- b) availability of data making for a trustworthy rating assignment,**
- c) responsibility of the agencies themselves.**

In the context of recent experience (Mexican, Asian, Russian crises), which questions the reliability of the methodology used by rating agencies and their assessments, the above issues should be addressed with more precision.

7. The proposals for credit risk measurement, even in their simplified versions, are excessively complex. The use of numerous reductions, haircuts, add-ons, options and exceptions, as well as highly complicated calculations diminishes the transparency of the proposed Methodology. These complications cause the capital ratio to measure not only the real risk level of a bank, but also the level of sophistication of the adopted methods. Furthermore, the complexity of proposed solutions may result in having to treat the individual claims on a case-by-case basis. This may turn out to be impracticable, especially in the case of small retail claims.

8. The requirements for the application of more sophisticated methods will constitute serious barriers for banks in developing and less developed countries for a longer time. This results from the necessity to develop and implement methodologies of risk assessment for each particular exposure. A serious problem in this area would be to ensure fair and proper functioning of these systems in banks, as well as to decide who and how should verify and approve them.

9. The New Capital Accord changes the place and role of the banking supervision. The imposition of obligation to assess the banks’ risk management systems on the supervisors, will require deep changes in supervision itself in the area of resources, organization, qualified staff and training. It also seems that the responsibility of the banking supervision for the systems’ assessment is highly questionable. As a rule banks are independent entities and should be solely responsible for their activities and effects. Thus, the transfer of responsibilities from banks to the supervisors should be avoided, also in the field of internal risk assessment systems. Additionally, this responsibility may result in possible material claims in the case of bankruptcy and court cases. Rather, the option of the assessments being carried out by e.g. specialized agencies at an adequate charge should be considered.

10. The New Capital Accord assigns a great significance to the supervisory review process. Its full implementation will contribute to early detection of problems in the area of risk management, capital adequacy and will allow to take supervisory interventions at early stages. This may prevent the deterioration of the situation of a given bank or banking group, and the dispersion of the detected problems in the supervised banking system as a

whole. However, it should be stressed that it will be necessary to develop the II Pillar methodology. The lack of clear and understandable international standards will make the cross-country comparisons of the banks impossible. In addition, the methodology should establish proper balance between supervisor's and bank's respective responsibilities. The lack of balance may lead either to unintended transfer of responsibility for risk management from the bank to the supervisor or to undue pressure on the bank from the supervisor.

11. The provisions of the I and II Pillars proposed in the Consultative Document may lead to the conflict of interests in the supervisory agencies. The establishment of the catalogue of recognized agencies by the domestic supervisory body will require setting up a certain procedure of granting "licenses" to those agencies and ongoing verification of their "recognized agencies" status. It will constitute an additional range of activity for supervisors, resulting in their unintended assumption of responsibility. Then the same supervisor would carry out the supervisory review process and the assessment of the bank's risk management system. The assessment would require the review of the data sources used by banks, including the "recognized agencies" indicated by the supervisor. A much safer solution would be separation of those two functions through employment of external consulting firm in the systems' review.

12. The determination of the operational risk capital requirement as an international standard is premature. The considerations formulated by the Committee in the Consultative Document, concerning the methodology of operational risk quantification, seem to justify this thesis. The proposed profit/income-linked measure of the operational risk and the requirement for it to constitute at least 20% of regulatory capital is an issue of particular concern. Operational risk has not been recognized adequately yet, even in banks attempting to manage it. The data submitted by them, which is the base for assessment of risk magnitude, is heavily biased.

It seems that the treatment of operational risk should be developed in two stages

- in the first stage supervisors should be encouraged to find out their own solutions and obligated to reveal the adopted approaches. This would allow to review the applied methodologies of operational risk measurement in a wider international context and to review their efficiency. Less advanced countries would surely follow the best solutions developed by more advanced supervisors.
- in the second stage, the Committee could try to unify the standard to be applied at an international level, given the availability of the relevant historical base.

13. Setting out the scope of reporting to be disclosed to the market should be recognized as an attempt to set out the reporting standard. However, its usefulness will depend on the consistency of accounting standards adopted in separate countries. Additionally, the proposed structure of the data to be revealed is far too detailed, which may cause the data to be misunderstood by the bank's clients.

It seems that the informative function of the risk taken could be fulfilled sufficiently, and perhaps in a more transparent way, by more aggregate or synthetic indicators, such as total diversified and non-diversified VaR for the bank's trading book, the amount of duration for investment portfolio or sensitivity of interest income or bank's net value for the assumed interest rate changes scenario.

14. Full implementation of "The New Basel Capital Accord" proposal means the need for full consolidation, as well as the need for creation of the adequate legal

framework to share information among the banking supervisors on the international basis. In the case of Central and Eastern Europe countries this would require relevant changes in the legal structure, allowing for the supervision on a consolidated basis and entering into agreements on cooperation ensuring an effective information sharing with foreign banking supervisors. In this context, due to the ongoing compliance works in both respective areas, it is expected that certain developing countries will seek for the 3 year transitional period stipulated in the “New Basel Capital Accord” draft.

15. Just as in the Capital Accord of 1988, the wording of proposals presented in the Consultative Documents is highly unclear. The basic deficiency of the proposal is the lack of definitions of basic notions (such as risk, exposure), the lack of even most general algorithms of the proposed methods, or formal mistakes (detailed examples are discussed in Section on Specific Comments).

SPECIFIC COMMENTS

Definitions and terminology

16. Pt. 19 and 20 of the Consultative Document clarify the most general structure of the capital adequacy measurement. This section should include the clarification of the most general notions used in the Consultative Document and the rules of the calculation of basic categories, e.g.:

- a) we suggest to include in this section the definition of the **credit exposure** (e.g. nominal value of the claim against the counterparty) and the definition of the **credit risk** (e.g. potential loss on the credit exposure in the case of the counterparty’s default). It seems that these two categories constitute the basement of the First Pillar. The expressions “exposure” and “risk” are used in the Consultative Document interchangeably or sometimes jointly, e.g. in the expression “risk exposure”. The notions of “capital charge”, “capital requirement” and “capital ratio” are treated similarly. The lack of consistency in the usage of terminology is one of the key difficulties while analyzing the Consultative Document.
- b) it would be worth including within this section, the definitions of such general terms as: **economic risk** (its relation to risk) and **economic capital** (relation to regulatory capital and own funds).
- c) the issue of the **calculation of credit risk exposure on the net basis** (net of loan loss provisions) is mentioned only in a few scattered provisions related to some specific problems. Such requirement may be found in e.g. pt. 39 of the Consultative Document in the context of the claims past due more than 90 days. It is also clearly formulated in pt. 229 in the context of corporate exposures measurement in IRB method. This rule was also mentioned in pt. 485 (sovereign exposure) and pt. 501 (bank exposure). But in the analogous pt. 435, there is no such requirement in the context of retail exposures as well as in the context of other methods. It makes an impression that the mentioned rule is not of a general nature but is obligatory only in the narrow ranges of “The New Basel Capital Accord” (the issue of the exposure measurement will be discussed in more details in the next comment).

- d) in the Consultative Document **unprecise expressions** are sometimes used, e.g. “reasonable time”, “sound transaction”. Lack of the definitions of these terms will lead to misinterpretation.

In the important definition of “default” (pt. 272 of the Consultative Document) the term “it is unlikely to” is used. Non-precise meaning of this term will cause the benchmark definition of “default” to be very wide, including events both “impossible” (zero probability), as well as “less possible” (without any level of probability set).

The proposed definitional or explanatory section would considerably unify the approaches adopted by supervisors, and it would facilitate understanding and implementing solutions proposed in the Consultative Document in less developed banking systems.

17. The introduction of the benchmark definition of default and the determination of its role in the capital adequacy measurement system should be considered as an approach which should be applied in other parts of the Document.

Nevertheless, we would like to draw the attention of the Committee to review the need of including the event of specific provision creation in the definition. The requirement to create specific provisions is highly differentiated across supervisors. In regulatory systems allowing for discretion in creation of specific provisions, the proposed definition of default may encourage avoidance of the creation of specific provisions, even in the situation when the quality of the asset decreases. It seems that better solution would be the inclusion of the event of reclassification of the asset in the definition, instead of the event of specific provision creation. The requirement of asset classification is more common and uniformly applied in regulatory systems.

Alternatively we would propose to give up this criterion, as most of the classification and provisioning systems are based on the servicing timeliness criterion, which is already included in the definition in the form of 90-day limit of delay in payment. Thus the proposed definition would not lose too much of its severity.

Relation between provisioning system and capital adequacy framework

18. We uphold our concern about the relation of the specific (loan loss) provisioning systems and capital adequacy methodology which was expressed in the Comments to the first Consultative Document.

Both the present “Capital Accord” and “The New Basel Capital Accord” systematically discourage the creation of adequate loan loss provisions, because of the requirement of expressing the numerator and denominator of the solvency ratio in their net values (net of specific provisions). To be exact, this requirement is not clearly formulated in the Accord as a general rule, although it is commonly applied by banks and examined by supervisors. Those doubts are reflected also in the Committee’s consideration presented in pt. 185–188 of the supplementary document “Internal Ratings Based Approach”.

Out of two banks showing the same asset quality structure, the one that created lesser provisions will have a higher level of the solvency ratio. This explains the small popularity of the rigorous provisioning systems to the advantage of the more liberal or even quite voluntary ones (e.g. the Polish supervisor uses a rigorous system with the regulatory required levels of: 20% - substandard, 50% - doubtful, 100% - lost claims).

Specific provisions, charging the bank’s profits, “freeze” part of the profit, making it unavailable for investors through profit distribution (in general, they lower the future capital

base available to cover other types of risk in subsequent periods). In the long run the requirement to create specific provisions can be treated as a requirement to cover anticipated losses on classified assets by the capital charge. Bank that holds such capital protection against anticipated losses is additionally subject to the capital charge equal to 8% of the amount of a claim not covered by the provision (in calculation of the capital adequacy requirements).

Rigorous provisioning systems are more often used by developing banking systems and play an important protective role. Having established such a system, the Polish banking sector did not suffer significantly from the Asian or Russian crises. It seems to be valuable to support and strengthen such systems. "The New Basel Capital Accord" seems to ignore this aspect in the suggested solutions, as the construction of the capital ratio implies two disadvantageous effects:

- a) reduction of the ratio through provision creation (lowering the numerator and denominator by the amount of the provision),
- b) double capital charging of the exposure (by provisioning and by the capital requirement on the remaining exposure).

These effects could be eliminated from the methodology in two ways:

- a) by means of calculation of the capital ratio in gross terms (inclusion of provisions in the numerator and denominator of the capital ratio) – it would immunize the level of the ratio to the differences in provisioning systems,
- b) by means of exclusion of claims subject to provisioning (with provisions higher than 8% of the claim) from the calculation of the capital ratio – it would mean admitting that the provision created releases from the obligation to maintain an additional capital to cover loss that has already been secured.

These rules should be clearly formulated in the introductory and most general description of the methodology (e.g. in pt. 20, where the general definition and methodology of capital ratio calculation are presented).

Normalization of risk weight scheme

19. Up to now the capital requirement is calculated within the framework of the two-step process:

- a) assignment of risk weight r (0% – 100%)
- b) application of capital ratio k (8%)

Capital requirement ratio c is defined as a product: $c = r * k$. Interpretation of the coefficients r and k is rather unclear, but it seems that within the existing framework the acceptable explanation could be as follows:

r – reduction of the exposure due to the type of asset / counterparty,

k – rate determining the expected loss on asset to be covered by capital.

The increase of the capital requirement c due to more risky assets can be achieved not only through rising r (e.g. above 100%). The same effect would be attained by k differentiation (e.g. by rising it for certain categories of assets/counterparties above 8%, up to $k = 100\%$ meaning the deduction from capital base), while keeping the present range of weights r .

The more it is reasonable, that the normalization of weights r within the interval of 0-100% is commonly accepted and understood in the banking practice. The above approach would mean that entities assigned the lowest rating will not receive the reduction due to type of asset/counterparty ($r = 100\%$), while capital ratio assigned to them could be set at higher level (e.g. $k = 12\%$), due to the higher expected losses - in this case capital requirement ratio would be $c = 100\% * 12\% = 12\%$, which gives the identical effect as $c = 150\% * 8\% = 12\%$.

In this context it would be worth considering whether external ratings of country debt could be applied only to increase k , with other elements of the existing Capital Accord generally unchanged. In this way country risk would affect all weighted assets.

As an alternative it is possible to abandon in the Document the separate recognition of weights r (0%, 20%, 50%, 100%, 150%, ..., 1250%) and the capital ratio k (8%). Within the existing structure, the risk weights represent nothing more than just the scaled (by the means of parameter 0,08) capital requirement ratios attributed to specific assets ($r = 12.5 \times c$). Thus, the supervisors could successfully use solely the concept of capital requirements ratios c [$= r \times k$] (0%, 1.6%, 4%, 8%, 12%, ..., 100%), without any attention paid separately to r and k . The advantage would be in the form of undoubtedly transparent interpretation of c – potential loss on the asset. At the same time, it would be justified and easy to increase granulation of the set of capital requirement ratios.

Issues relating to external ratings

20. The solution adopted in the Consultative Document will mean that entities with low creditworthiness will be inclined to avoid the rating assessment, and banks may ignore ratings below BB-, in order to avoid a penalty weighting of 150%. This is because the proposed methodology stipulates that risk weight for not rated entities is the same as for those with ratings from BBB+ to BB- and is lower than the risk weight for the items rated below BB-. It is reasonable to unify risk weights on the level of 100% both for entities having low credit ratings and for those not rated at all.

The increase of the granularity of the weighting scheme r (or capital requirements ratios c) in the presented solutions will eliminate drastic jumps on the borders of rating classes (e.g. duplication of the risk weight from 50% to 100%).

21. The conditions to be met by particular collateral items to be recognized as credit risk mitigation techniques are too restrictive. Especially, pt. 70 of the Consultative Document requires the possession of updated legal opinions for each collateral agreement as far as its enforceability is concerned. Because of the massive character of several collateralized items, it would be reasonable to allow for resignation of this requirement in the case of systemic solutions adopted at the domestic level.

Collateral and guarantees / credit derivatives

22. Location of the claims secured on real estate (pt. 37 and 38 of the Consultative Document) in section “Individual claims” disturbs the structure of this section based on the debtor type criterion (in the event of the mentioned claims, the criterion is rather collateral type).

The construction of those provisions indicates that the Committee intended to charge the claim secured by mortgages on commercial real estate with the weight of 100% even if the debtor had the highest rating (pt. 38). The weights proposed in these provisions should rather be related to the type of collateral, not to claim.

We suggest moving the mentioned provisions to the section “Credit Risk Mitigation in the Standardized Approach”. It seems that mortgage protection should be treated in a similar way as the collateral. At the same time we find that the differentiation of risk weights between claims secured by the mortgage on commercial real estate and on residential property will imply identification difficulties and arbitrage in the case of real estate playing these two roles simultaneously. We would suggest the same level of preferences for both these kinds of collateral.

23. The catalogue of eligible collateral (pt. 76 of the Consultative Document) should be extended. The Document perceives the role of collateral (of different quality) and proposes formulae to account for it in the credit risk exposure measurement. We think there are no obstacles to allow material collateral and mortgages etc. with adequate haircuts (e.g. $H_E = 50\%$). Especially the mortgage should be treated in this section as one of the kinds of credit mitigation technique (not in the section on the types of exposures).

In order to increase transparency and simplicity of the methodology proposed, we suggest to make consistent the treatment of claims protected by:

- 1) collateral,
- 2) guarantees/credit derivatives,
- 3) mortgage – to read more on consistent methodology of mortgage collateral see pt.13.

through the application of the system of differentiated haircuts, reflecting the character of the protection.

Formulae and parameters

24. The formula for calculating weighted value of collateralized asset (pt. 85 of the Consultative Document) consists of two parts:

- a) uncollateralized part is assigned the original weight of the exposure

$$r \times (E - C_A)$$

- b) fully collateralized part is assigned a reduced weight of the exposure (standard reduction of 15%)

$$r \times w \times C_A$$

It should be pointed out, that in the case of fully collateralized part ($r \times w \times C_A$) the collateralized asset type effect and the collateral type effect are accounted for on non symmetrical basis:

- 1) the asset type is reflected twice by means of:
 - a) asset risk weight r
 - b) haircut H_E
- 2) the collateral type is reflected in fact by means of haircut H_C , because the fixed parameter w is insensitive to the type of collateral.

That means that while the parameter w is fixed, the formula is more sensitive to the asset type than to the collateral type.

We believe that much higher sensitivity may be obtained when fixed parameter w is replaced by risk weight of the collateral r_C . Then risk weighted fully collateralized part of the asset would be described by $r \times r_C \times C_A$. Such approach would have following advantages:

- 1) encouragement for taking high quality collateral – the approach would be more prudent in the case of taking collateral rated 100% or higher (the lack of risk

mitigation effect), but at the same time more flexible and sensitive to the collateral risk in the case of high quality collateral,

- 2) the possibility of widening the eligible collateral catalogue by the lower quality collateral with no fear of overburdening the risk mitigation effect (or perhaps rejecting the catalogue at all),
- 3) simplification of the risk weighted assets calculation formula by excluding the supervisory parameter w ,
- 4) simplification of the collateral value verification formula by possibility of excluding the haircuts H_E and H_C (or limiting the reduction exclusively to the settlement date) – taking both weights into account in the formula (r for the asset and r_C for the collateral) reflects the asset type (quality) as well as the collateral. In our opinion, the asset value and the collateral value verification is obtained by the means.

25. Maturity mismatches of the exposure and collateral (pt 148 of the Consultative Document) seem to be improperly reflected. Namely, in the case when the maturities are identical ($T = t$) the formula for t exceeding 1 year reduces to $r^{**} = 1 - r + r^*$, while it should give $r^{**} = r^*$ (we suppose that “1” following the equality sign should be replaced by r ? Similar notice concerns the formula for PD^{**} in pt 192, with the unit to be replaced by PD).

At the same time we notice that formula for r^{**} in pt 148 requires the knowledge of r i r^* , thus the formula presented in pt 85, 134 and 135 should rather express r^* instead of $r^{**} \times E$. We realize that the assumed way of presentation of weight adjustment slightly simplifies the formula, however it may raise problems in calculation of r^{**} .

26. The effect of the asset portfolio diversification should be accounted for in foundation IRB approach, similarly to advanced IRB approach.

27. Symbol „ w ” seems to be used in different part of the Document to denote different parameters (e.g. pt 85, 132, 134). In order to increase transparency of the Document we propose to differentiate the symbols.

28. The function relating the effective loss given default (LGD^*) to the ratio of collateral to nominal value of the exposure is not continuous (pt 212). It seems that this discontinuity is unintended. According to the proposed formulae, oscillation of C/E around 30% would encourage capital arbitrage, as the left limit of the function is equal 50%, while the right limit is 47,86%. To avoid this deficiency we propose to substitute the table presented under pt 212 with the following table:

	Condition	Effective LGD
Case 1	$C/E \leq 30\%$	50%
Case 2	$30\% < C/E \leq 140\%$	$[580\% - (C/E)]/11$
Case 3	$C/E > 140\%$	40%

Similar comments apply to the methodology of calculation of effective LGD_{ph}^* for reduced exposition (pt 220).

For obvious reasons we are not in the position to check other formulae presented in the Document.

29. The floor for capital requirements calculated under advanced IRB approach (at least 90% of capital requirements calculated under foundation IRB approach during the first two years after adoption of the advanced method) will create too great a burden for banks (necessity to run two systems) and would discourage implementation of a more precise approach. We suggest significant shortening of the transition period, or reduction of the floor.

30. In the case of corporate exposures the benchmark risk weights $BRW_C(PD)$ significantly exceed 100% (200-600% and more) for PD greater than 1%. This may result in the calculated risk weights being much greater than those set out in the foundation IRB approach. This would discourage the implementation of the advanced IRB approach (pt 173-177 and 427-428 of the Consultative Document).

Operational risk

31. In the context of a premature formulation of the standard for operational risk, we note, that the measure proposed by the Committee based on gross income seems to be imprecise and to some extent – penal:

1) weak correlation of gross income with operational risk

- gross income (i.e. the sum of interest and non-interest income) already incorporates and reflects the influence of other risks (market, credit, legal etc.),
- it can hardly be assumed that a bank earning lower income/profits (or even suffering losses) takes less operational risk

As a consequence it may occur, that banks operating efficiently and earning high profits would have to allocate more capital to operational risk than weaker banks. High volatility of this income category would additionally cause significant fluctuations of the capital allocated.

2) the Consultative Document does not determine the time dimension of the proposed approximation of operational risk (yearly, monthly, annualized income). The immanent time dimension of income would in practice require applying:

- current amount (earned from the beginning of the year till the reporting date) annualized, or
- previous year amount.

It seems that much better solution would be to use annualized current turnover, as a factor reflecting the level of operational risk incurred, because it is the number and volume of operations to directly determine bank's losses. A set of other criteria could be also considered to assess the quantity of operational risk, like value of IT equipment, value of licenses possessed, number of credit cards issued, number of employees etc.

3) the operational risk measure should account for the fact that in some countries the financial markets and the IT systems operated by banks are less developed and the level of complexity of financial products is lower, which causes that operational risk exposure is relatively smaller.

4) the proposal to introduce a floor for capital requirement for operational risk, still not determined in the Consultative Document, contradicts the need to develop techniques to protect the risk and the methods to manage it.

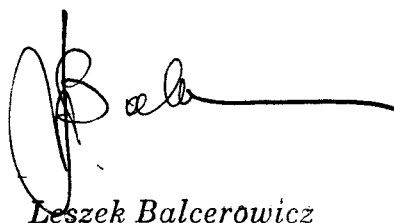
5) from the statistical analysis requirements point of view, the sample of the banks constituting the base to assess the parameters for operational risk, is too small.

- 6) an arbitrary assumption on the capital requirement for operational risk to constitute 20% of regulatory capital raises serious concern and is highly questionable.

Interest rate risk in banking book

32. We suggest cessation of determining the standard interest rate shock of 200bp, being the alternative to shocks determined on the basis of historical sample (pt 81 of the Consultative Document „Principles for Management and Supervision of Interest Rate Risk”). To maintain the precision of the estimation it would be necessary to restrict the options to the 1-st and 99-th percentile of the observed changes in interest rates with the assumed holding period of 1 year (240 days) and observation period of at least 5 years, both for G-10 and non-G-10 currencies. The scenario of 200bp interest shock (increase, decrease) for G-10 countries' currencies seems to be inadequate.

33. In the case of Central European countries, like Poland, where the inflation significantly decreased during recent years, along with interest rates, the assumption of 5-year observation period will lead to overestimation of the scale of interest rate changes. Keeping this in mind we would suggest allowing local supervisors to shorten this period (e.g. to 3 years). Allowing for observation schemes would also be advantageous, as in the case of market risk.



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