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INSTITUT MONDIAL DES CAISSES D'EPARGNE
W E L T I N S T I T U T   D E R   S P A R K A S S E N

E U R O P E A N   S A V I N G S   B A N K S   G R O U P
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WORLD SAVINGS BANKS INSTITUTE
AND
THE EUROPEAN SAVINGS BANKS GROUP

STATEMENTS ON

THIRD CONSULTATION PAPER
OF THE BASEL COMMITTEE ON
THE REVISION OF THE BASEL ACCORD

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Profile European Savings Banks Group

The European Savings Banks Group (ESBG) represents 25 members from 25 countries (EU countries, Norway, Iceland, Bulgaria, Czech Republic, Hungary, Latvia, Malta, Poland, Romania, Slovak Republic) representing over 1000 individual savings banks with around 66,500 branches and nearly 770,000 employees. At the start of 2002, total assets reached almost EUR 4160 billion, non-bank deposits were standing at over EUR 2012 billion and non-bank loans at just under EUR 2095 billion. Its members are retail banks that generally have a significant share in their national domestic banking markets and enjoy a common customer oriented savings banks tradition, acting in a socially responsible manner. Their market focus includes amongst others individuals, households, SMEs and local authorities.

Founded in 1963, the ESBG has established a reputation as the advocate of savings banks interests and an active promoter of business cooperation in Europe. Since 1994, the ESBG operates together with the World Savings Banks Institute (WSBI, with 109 member banks from 92 countries) under a common structure in Brussels.

Profile World Savings Banks Institute

The World Savings Banks Institute (WSBI) is one of the largest international banking associations and the only global representative of savings and retail banks. It carries the voice of around 1150 financial intermediaries in nearly 90 countries. At the start of 2002, total assets of member savings banks reached almost EUR 7 700 billion, while non-bank deposits were around EUR 5 000 billion and non-bank loans at just under EUR 4 500 billion. Altogether, the banks represented by member organisations have around 200,000 branches and nearly 2,5 million employees.

WSBI members are in general regulated financial institutions that are in the first instance committed to the mobilisation of savings. Some are private banks, other public: there are postal savings banks, savings banks owned by municipalities and financial institutions with a co-operative ownership structure or owned by foundations. Principal clients of member savings and retail banks are private individuals, microenterprises, SMEs and local authorities. All member banks are characterised by large distribution networks to reach out to clients nation-wide. Thanks to their decentralised nature they can address the needs of the people locally and use mobilised resources to invest in the local economy. Savings banks fight against financial exclusion and are committed to the society they operate in which is apparent in the distribution of their profit.

The WSBI's mission is to influence the standing, development and strength of all WSBI member banks, so that they are perceived both domestically and internationally as integral to the financial community, and operate as proficient, efficient banking institutions, actively co-operating with other WSBI members in business opportunities.

The WSBI provides a unique worldwide platform for cooperation and acts as a centre of knowledge for the retail banking sector. It shares a common secretariat in Brussels with its sister organisation, the European Savings Banks Group (ESBG).

INTRODUCTION

The decentralised savings and retail banks of the World Savings Banks Institute and the European Savings Banks Group appreciate the opportunity afforded by the Basel Committee to comment on the revision of the Basel Accord as it currently stands. In particular, the WSBI/ESBG welcome the refined treatment of retail and small business exposures to reflect the low level of loss volatility experienced in these assets; As the primary banking partners of individuals, local government and SMEs the Joint Office has a great interest in the successful revision of the international capital adequacy framework.

Though the interests of the savings banks across the globe may vary according to the environment in which they operate, the WSBI/ESBG has developed this list of statements which reflect those areas of common conviction with respect to the implementation provisions and the substantive measures of the revised Accord.

IMPLEMENTATION ISSUES

- As a working rule the adoption of the Accord should be adopted internationally on a parallel basis in letter and in spirit.

- The Accord should incorporate a sufficient degree of flexibility for it to be implemented in an efficient and equitable manner.

- The scope of implementation, subject to the minimal application of the framework to the international 'Basel banks', is a decision to be adopted by the relevant supervisory authorities in conjunction with the Basel Committee.

- Supervisors and other relevant authorities such as the Basel Committee should endeavour to establish initiatives which would enhance the convergence of supervisory practices and minimise the supervisory compliance burden of groups operating on a cross border basis.

- There should be an additional QIS 3.5 (actualisation exercise similar to QIS 2.5) if significant changes are introduced as a result of the third consultation exercise. Beyond that, the WSBI/ESBG supports the commitment of the Basel Committee to a QIS 4 in 2004, wherein the issue of procyclicality, in particular, may again be assessed.

SUBSTANTIVE ISSUES

In spite of progress made, especially with respect to middle-class credits, significant concerns remain in relation to certain provisions and continuing inconsistencies. The WSBI/ESBG would like these issues to be addressed prior to the final implementation of the Accord.

The WSBI/ESBG makes the following comments on modifications included in CP3:

- Having regard to the proposed changes to the treatment of Qualifying Revolving Retail Exposures (QRRE), the WSBI/ESBG agree with the assertion that the current treatment provided an incentive for banks to structure their products as QRRE and that a measure aimed at removing this was welcome. The modifications made are therefore welcomed. Concern remains however with respect to the severity of the criteria for qualification as a QRRE, in particular, the requirement that exposures be unsecured and that the Future Margin Income should cover the sum of expected losses and *two standard deviations* of the annualised loss rate on the sub-portfolio. The WSBI/ESBG also consider it necessary to comment on the danger of tailoring regulations to apply to specific financial product markets.

- The WSBI/ESBG cannot support the inclusion by the Basel Committee of a provision for the implementation of a transitional (until 31 December 2009) 10% floor on the Loss Given Default (LGD) of residential mortgage exposures. Savings and retail banks do not consider that the apparent data problems, which suggest that insufficient data for the economic cycle is as yet available, to be such that this measure is necessary. The WSBI/ESBG considers that it would be far more appropriate for national supervisors to consider whether such a floor should be implemented on a nation-wide basis according to national supervisory experience of LGD in the residential mortgage market.

- With respect to the new provisions for the treatment of operational risk, the WSBI/ESBG welcome:
  - Provisions whereby banks will be allowed to adopt the Advanced Measurement Approach (AMA) for operational risk on a partial basis;
  - Introduction of a volume-based factor in the basic and standardised approaches (loans and other banking book assets rather than gross income) for retail banking and commercial banking under the assumption that the factors for other business activities would remain unchanged.

In addition to these points the WSBI/ESBG believe that further modifications are required with respect to the following issues:

- The Basel Committee has included provisions for the partial use of the Standardised Approach for certain qualifying exposures. This provision should be extended to all banks on a permanent basis. The WSBI/ESBG appreciate that the concept of permanent partial use has been adopted in the current consultation paper of the European Commission for implementation in the European Union and consider that it should be adopted by the Basel Committee. The WSBI/ESBG remain convinced that it would be inefficient to request all banking institutions to develop internal rating systems for sovereign and institutional exposures. Onerous practical difficulties remain with respect to the data issue. It is important to state at this point that permanent partial use would not diminish the efficiency gains won by the implementation of the internal ratings based systems for the remainder of the credit portfolio - the use of partial use for certain exposures would not preclude the benefit of using internal rating systems as they apply more broadly for determining the banks *economic* capital requirements. In considering these issues, the WSBI/ESBG strongly believe that the so-called permanent partial use option should be available to all banks.

- Though notable improvements have been included in the proposal for a revised Basel Accord in respect of retail and small business credits (new 75% Standardised Approach risk weighting, firm size adjustment in foundation IRB), concerns remain with respect to particular aspects of the treatment of retail and small business exposures. This counts especially for the Retail area. The WSBI/ESBG consider the continued inclusion of a reference to the granularity criteria of maximum 0,2% (exposure to single counterparty may not exceed 0.2% of total retail portfolio) and the so-called “use test” (qualitative criteria for the treatment of SME exposure as retail) to be inappropriate in so far as they set wrong incentives for the internal control of risks.

- Similarly, the definition for the term “default” given by the Basel Committee, which is principally oriented on a credit’s state of default, e.g. 90 days backlog of payments, leads in many cases to an “artificial” rise in the default figures and therefore to a excessive reaction to the actual risk. The WSBI/ESBG suggest that, in order to avoid these consequences and to guarantee the practicability of the default definition’s application, the determination/evaluation of a lower repayment probability, suggesting default, should always be left to the banks’ judgement in compliance with established supervisory standards.

- The WSBI/ESBG are of the opinion that the intention of the Basel Committee to provide a special risk weight function for residential mortgage loans leads to more complexity and is not risk adequate. The higher risk weights for residential mortgage loans are primarily a result of the assumed higher asset correlation. This differentiation is not justified because the borrowers of this sub portfolio are the same as in the other retail portfolio. For this reason, the risk weight function for “other retail exposures” should be applied.

- The WSBI/ESBG believe that certain inconsistencies remain with respect to the credit risk mitigation framework. Inconsistencies appear primarily in the treatment of physical collateral whereby the use of physical collateral is insufficiently recognised and treated in a manner disproportionate to the relative treatment of financial collateral. In particular, it remains the situation, with regard to the IRB treatment of physical collateral, that there is a disproportionate favouring of financial collateral in terms of its treatment as a risk mitigating factor. In calculating the effects of credit mitigation, the Working Document at present follows the Basel Accord which provides that the ratio of the current value of physical collateral to the nominal exposure must be above a certain level before it is recognised at all, not so for financial collateral. If it is not above this level then the LGD is unchanged, i.e. 45% for senior corporate claims and 75% for subordinated corporate claims. The LGD is also subject to a minimum for collateral other than financial collateral (35%). In order to obtain full LGD recognition of physical and real estate collateral a 140% degree of over-collateralisation is required.

  The core factors in assessing collateral – certainty, timeliness of entitlement, liquidity, price availability and stability – should be assessed according to national experience and not according to parameters defined according to an abstract international value. The satisfactory resolution of the treatment of physical collateral is core consideration of the savings banks.

- The WSBI/ESBG believe that a similarly flexible approach should be adopted by the Basel Committee in the treatment of principal only guarantees wherein the risk sensitivity of the framework could be improved by affording greater recognition to regional experience of guarantees and the realisation of collateral.

- The WSBI/ESBG request that the Basel Committee give due consideration to the proper treatment of securitisations in so far as that the risk mitigating features of such instruments should be appropriately recognised in supervisory capital requirements. The current proposals of Basel II's contradict the goal of a risk adequate capital charge: the regulations are excessively complex and the risk weightings, which have been set too high, lead to a situation whereby the systematic capital for securitised exposures is in fact higher after than would be required for the untreated underlying exposures. So as not to threaten the functionality of the securitisation market, we request that the capital requirements of all banks participating in a securitisation transaction are not higher in total than those capital requirements, which would result, if there was no securitisation.

- Regulatory capital requirements should be strictly contained in Pillar I. There should be no additional systematic capital requirements demanded within the Pillar II framework. For instance, the results obtained by stress tests (provided for banks implementing the IRB approach to credit risk) should not be used as an instrument by supervisors to demand more capital at a particular point. Rather, the stress test is to be used as an indicator of the robustness of the banks' levels of economic capital, the results of which should be addressed by modifications to the internal systems.