Verband der Privaten Bausparkassen e.V. · Bundesgeschäftsstelle Landesbausparkassen

Klingelhöferstraße 4 · 10785 Berlin
Telefon 030 / 59 00 91 500 · Telefax 030 / 59 00 91 501
Postfach 30 30 79 · 10730 Berlin

Friedrichstraße 83 · 10117 Berlin
Telefon 030 / 2 02 25-411 · Telefax 030 / 2 02 25-135
Postfach 11 01 80 · 10831 Berlin

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Opinion of the German bausparkassen on the Third Consultative Document on the New Basel Capital Accord

The German bausparkassen welcome the improvements made so far which are reflected in the Third Consultative Document. Nevertheless, the current Basel documents still contain a number of inappropriate barriers which make it difficult for the institutions to apply the IRB approach and thus take away their incentive to improve risk management accordingly.

With respect to the Basel recommendations on the minimum capital requirements (first pillar) we would like to comment as follows on behalf of the bausparkassen:

Re I. Calculation of minimum capital requirements

Point 23 – Capital floor

For credit institutions using an IRB approach for credit risk, a single capital floor is to be stipulated for the first two years following implementation of the New Accord.

In our opinion, it is possible to rule out the minimum capital of credit institutions dropping undesirably steeply after the New Accord has been implemented for the first time in view of the Basel impact studies and the precautionary parallel calculation of the minimum capital requirements using the former and the new rules in 2006. Rather, it can safely be assumed that the minimum capital required in future will basically be commensurate with the risks. This is why there should be no stipulation of a capital floor.

If the Basel Committee nevertheless adheres to a capital floor, we believe that sentence 2 requires further clarification according to which the floor will be based on “calculations using the rules of the existing Accord”.

If the minimum capital requirement were to be calculated for two years using a parallel approach based on Basel I and on Basel II, this would produce a disproportionately high organisational and system-related expenditure. This should therefore only be required in individual cases upon request by the national banking supervisory authorities if during these two years great changes are recognisable in the risk assets and/or in the liable capital.

If the capital floor is to be maintained, we request that the minimum capital requirement calculated for the end of 2006 according to the first Basel Accord be used when stipulating a capital floor.

Re II. Credit Risk – The Standardised Approach

Point 44 – Exposures included in the regulatory retail portfolio

The maximum aggregated retail exposure to one counterpart is not to exceed an absolute threshold of € 1 million.

We request that you ensure that the planned upper limit is applied at the level of the individual institutions. Aggregating all exposures at Group level would be associated with an inappropriately high level of expenditure.

Furthermore, in view of the fact that credits given special treatment in risk management are not to be assigned to retail business anyway, we consider it advisable to substantially increase the upper limit.

Re III. Credit Risk – The Internal Ratings-Based Approach

Point 199 – Definition of retail exposures

It is to be possible to assign credits extended to small-sized companies to the retail portfolio if the entire commitment of a banking group to a small-sized company is less than one million euros and the procedure adopted for extending credits is the same as that used in the retail segment.

In our view, however, the credit exposure of the institutions with respect to small- and medium-sized companies, which is given the same treatment as in the retail segment, should be able to be classified as a retail exposure by an individual institution up to a threshold of one million euros. Small credits extended by bausparkassen to their customers could otherwise be given a risk weighting which is not commensurate with the actual credit risk of this low-risk retail business.

Aggregating all credits at group level would also be associated with an inappropriately high level of work and expenditure.

We therefore request that the threshold is also applied at the level of the individual institution, as we proposed for the standardised approach.

Furthermore, in view of the fact that credits given special treatment in risk management are not to be assigned to retail business anyway, we consider it advisable to substantially increase the upper limit.

Point 228 – Application of the IRB approach to asset classes; individual exposure in non-significant business units and asset classes

The Basel Committee permits a permanent exception from the application of the IRB approach only for individual exposures in non-significant business units and asset classes (or sub-classes in the retail business) that are immaterial in terms of size and perceived risk profile.

In our view this should be better clarified to read "exposures .... that are immaterial in terms of size or perceived risk profile".

This applies in particular to bank and sovereign assets of the bausparkassen. These asset classes are immaterial in terms of their risk profile. By contrast, their volume will be significant in several cases.

We would therefore request you to facilitate in principle a permanent parallel application of IRB approach and standardised approach in the case of corresponding asset classes irrespective of their size and their risk profile and irrespective of the size of the credit institution.

The qualification for an IRB approach would be made more difficult by the demand for its comprehensive use in cases in which legal entities of a banking group do not satisfy certain minimum requirements for advanced assessment procedures or if they are the only ones to satisfy these requirements. The subsidiary of a group must be able to use a different approach than the parent company.

We request you therefore to provide for appropriate exceptions.

Point 232 ff.– Transition arrangements

232 – Parallel calculation for banks adopting the advanced approach

Banks adopting the IRB approach will be required to calculate their capital requirement for the year before Basel II comes into force according to Basel I and also Basel II.

This provision would in fact shorten the time remaining to the institutions up to the first time application of Basel II to the end of 2006 by one year. This shorter period to satisfy the minimum requirements for the IRB approach and in particular to provide all necessary data together with the implementation of all IT components required for notification would be associated with a disproportionately high level of work and expenditure.

We therefore believe it suitable to refrain from making this parallel calculation mandatory. It should at least be possible to make a simplified first-time calculation of the capital requirements according to Basel II.

235 – Retail exposures secured by residential properties

LGDs for retail exposures secured by residential properties are to be set to a minimum of 10% in every sub-segment during the transition period.

This LGD floor would appear to be exaggerated in view of point 430 in which a safety allowance for an economic slump is demanded for the long-term average LGD, and in view of point 435 in which a conservative estimate is demanded specially for retail exposures.

Added to this is that according to point 463 et seq. the regular validation of the parameter estimate is called for anyway. In many sub-segments the risk would be substantially oversubscribed by the minimum LGD.

We request you therefore to refrain from the introduction of an LGD floor.

236 – Equity exposures

It is to be possible for bank supervisors to exempt certain equity investments "held at the time of the publication of the New Accord" from the IRB treatment for a maximum of ten years.

In our view, this transition arrangement (Grandfathering clause) should refer to the coming into force of the new Accord as for the other planned transition periods.

Point 297 et seq. – Risk-weighted assets for retail exposures; residential mortgage exposures

There are to be three different risk-weighted functions for retail exposures including a special risk-weighted function for residential mortgage exposures.

However, a separate treatment of these exposures would make the approach unnecessarily complicated and has no justification from the point of view of risk in our opinion.

Rather, the function for "other retail exposures" should also be applied to residential mortgage exposures.

Under the Basel recommendations on the supervisory reveiw process (second pillar), we would like to remark with respect to the interest rate risk in the banking book (point 720 et seq.) that the Basel provisions do not give appropriate consideration to the special circumstances of bausparkassen. In particular, the supervisors of banks feeling the impact of a standardised interest rate shock on more than 20 % of capital, should be attentive to adequate capital (point 722).

In view of the given substantial interest rate shock we believe this “outlier approach” to be inappropriately restrictive. The bausparkassen should similarly be given the opportunity to demonstrate that the interest rate risk is adequately monitored and that there is an appropriate level of risk accommodation.

VERBAND DER PRIVATEN BAUSPARKASSEN

BUNDESGESCHÄFTSSTELLE LANDESBAUSPARKASSEN