Annex
REVISION OF THE BASEL CAPITAL ACCORD AND EUROPEAN CAPITAL ADEQUACY RULES
DETAILED ANSWER OF THE ABB ON THE CONSULTATION

The following comment elucidates the basic points of view of the Belgian Bankers' Association (ABB). More detailed explanation on various technical aspects will be given in a document which will follow.

A. General comment

1. The ABB **agrees with the underlying philosophy** of the drafts, as before. These drafts are a notable progress as compared to the 1999 documents and take into account, to a rather large extent, the remarks made in March 2000. Some passages come very close to adequate rules. The explanatory aspect of the Basel Committee documents is highly appreciated.

2. The rules for capital requirements will have to be **applied from an economic and pragmatic point of view**, instead of the strictly legal application that has been followed hitherto. This is the main reason why a substantial number of passages in these drafts need further **considerable improvement**, as explained below and described further into detail concerning some issues in a future document. Both the Basel Committee and European drafts still need extensive harmonisation.

3. Due to the **time schedule**, it is not possible to make a proper analysis nor to formulate concrete proposals as asked in the drafts, before the results of the simulations are known. When these results will be available, this position will be completed and the same will have to be done, following a more flexible procedure, for the additional texts the Basel Committee intends to provide in the course of the following months.

B. Level playing field

4. Options taken by the national regulators could seriously affect the level playing field, which is one of the goals of the Basel Accord. The **weightings** must be imposed **by the Accord**. If not, regulatory arbitrage will become common practice given the opportunities for delocalising activities. The application on investment firms in Europe lies at the basis of a strong discrimination. Pillars 2 and 3 must be compulsory everywhere on identical terms.

5. A single national authority must not impose an **increase of capital** to an international group by means of pillar 2. The Accord should lay down a framework for a **consultation beforehand between the authorities** concerned and enhance the convergence between practices which would be organised, but only a posteriori, by the European project.

6. An existing or still to be created **acknowledged supranational body** should make it also possible that the **local recognitions** are **internationally accepted** and disclosed. It should be possible to consult this body, which should be given the ability to take a sufficiently authoritative point of view in those cases where there is a need for arbitration between several national control authorities.

C. Gradual and fragmented implementation of the new system

7. One goes **too far by imposing a general application of an IRB approach for the capital requirement** in one bank or institution, if need be following a tight time schedule. This would be too cumbersome : it is not enough to mitigate it by means of the materiality of the different portfolios, a concept which is too vague; one should rather stimulate flexible partial developments per activity, portfolio and entity, whether big or small, of a group. If these parts are economically significant, there will be no cherry picking and the competition between these parts could have a positive effect. Excluding any kind of return to a method which is less complicated could be counter-productive, because this would discourage investment, for new situations (merger) or strategies (activities becoming marginal) may justify opting for a method that is less complicated and more expensive as for capital requirements; no supplement should be added by pillar 2 to this financial burden; the sole obligation for banks should be to ensure the stability of their choices, as customary for valuation rules.

8. The time schedule for the coming into effect of the IRB approach is very long, with statistical series having to be achieved over a period of at least 7 years. The gain in capital requirements should be **progressively taken into account in order to reach the level resulting from the IRB approaches**, to the extent that these approaches will be confirmed by the facts and become more refined, with the observation periods becoming increasingly longer.

9. The **incentive** to switch to the IRB approaches is very **insufficient**. The internal ratings in the foundation approach would reduce the level of capital by no more than 2 or 3 % as compared to the standard approach. Moreover, a high capital level for the operational risks is added to this. The economic credit risk is clearly lower than calculated according to the regulations. The calibration is too cautious, but as long as the results of the simulations are not known, it is not possible to make any concrete proposal. What is most important now, is to simulate switching from the standardised approach to the IRB approach, for even small banks will be able to do this; the incentives should be increased precisely in this respect.

D. Accounting and tax aspects

10. The **incompatibilities with the IAS standards** must be removed through adaptations of the Basel draft or a modification of these standards, especially in order to define the debtor’s default and the elements of the capital. The concept of fair value and its consequences for capital, provisions and results, pillar 3 and the different time schedule (2005 for IAS) also call for a harmonisation of the international and national framework of standards [1].

11. The Basel Committee should **point out the tax implications** of the Accord to the government authorities. This is a determining factor for the transparency of the regulations, the efficiency of their application and the level playing field of management conditions and of competition. One should have a clearer view on the tax consequences of the expected loss as covered by means of specific pro-

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[1] It should be stressed that the concept of fair value is not acceptable in full for banks. Its application to financial instruments as well as to the banking portfolio would cause severe damage, more particularly by running counter to a proper application of the risk management tools.

visions and of the unexpected loss as covered by means of capital. The Committee cannot ignore the tax aspect, in the same way as it had to take an interest in the accounting matters despite the impossibility of doing so in 1988. Thanks to the importance it has taken since then in the eyes of governments all over the world with respect to financial stability, it can now make its statement in a way which is much more authoritative.

E. Scope of application

12. As for **calculating the non-consolidated ratios**, there should be no obligation to deduct consolidated shareholdings in banks and financial institutions from the capital (possibility provided by the 1989 European directive on the definition of own funds).

F. Pillar 1 : standardised approach

13. The **preferential weighting** of short-term exposures denominated in local currency must be extended to all currencies for counterparties with an investment grade rating.

14. **Short-term** should mean a residual maturity of one year (very common parameter) and apply for all kinds of counterparties (including enterprises).

15. Only option 1 must be imposed for **bank claims**.

16. The **external ratings** must be treated in an equivalent way. The authorities should take care of registering the agencies and the mapping tables, updating this registration and keeping it at disposal.

17. **Retail banking** must include very small enterprises.

G. Pillar 1 : internal ratings based approach

18. **Retail banking** must be defined pertaining to customers to whom scoring can be applied (as opposed to the individual rating). There must be a possibility to split up these activities in order to make it possible to apply the IRB approach to them as much as possible. The benchmarking of the probability of default keeps the capital level too high as compared to the standardised approach; bigger risks are penalised too heavily. Risk mitigations is too limited, especially with the IRB approach; the foundation approach excludes too many risk mitigations (e.g. a lot of SME guaranties) and does not take into account the breakdown of credits into different parts for a single borrower.

19. As for **off-balance sheet activities**, a 75 % ratio, which is rather rough and the origin of which is not explained, is applied to commitments, regardless of their maturity, as compared to the 0 up to 50 % figure in the standardised approach.

20. **Granularity** must not lead to an overlap with the rules for risk concentration. The explanation of how the degree of granularity is calculated for each of the subportfolios in comparison with an overall granularity factor is not clear in the Basel draft.

21. The advanced method must **validate the internal ratings based approach**, when it can be proved that its parameters are consistent with the external rating systems.

H. Pillar 1 : other aspects

22. All techniques which lead to **risk mitigation,** should be allowed in this respect. A guarantee is taken into account as substitution but not as a supplementary guarantee. The haircuts and the floor (w-factor*)* are often penalising. Securitisation and derivatives is insufficiently dealt with; the capital requirement for credit derivatives is too high. Guarantees from insurance companies are not taken into account, in spite of the fact that these companies must comply with precise regulations and are subject to external control; in this respect, they must be put on an equal footing with bankers.

23. Including the **operational risks** into pillar 1 does not seem to be acceptable without a profound improvement of the mechanisms proposed. The definitions given by the Basle Committee and the European Commission are different one another and lack precision, and the same goes for some of the concepts that are used (to be described by giving examples). There is no objective basis for a supplementary 20 % capital requirement, which is excessive. The techniques already used by banks for managing and mitigating these risks, more particularly by means of procedure organisation and providing hedging by insurance, are not sufficiently taken into account. The specific capital requirements for these risks should be a floor and must not be added to the capital used for hedging other risks, for the correlation between these two categories of risks is small.

I. Pillar 2

24. The **criteria** must be the same for all authorities and must be disclosed except for their individual aspects; if not, a really prudent bank will be considered to be an outlier if its domestic market is very conservative. Definitions must be based on the IAS; the earnings at risk e.g. could require increased capital up to the point of creating a tendency to modify the proportion between shares and bonds held in portfolio. One should especially try to avoid that some authorities start tending to cover their responsibility by an improper increase of capital.

J. Pillar 3

25. The number of obligatory **disclosures** is too high and these are too delicate. The European draft goes into the direction of an adequate solution in that it imposes the obligation, by means of a directive, to provide core disclosures. There is a need for consistency with the IAS and the national standards.

K. European provisions

26. The European **directive** should have a **general** character and leave the **technical aspects to comitology**. This would make it possible to give a more precise description of the technical contents and to adapt it, in a way which is most favourable for adjusting the regulations and the quickly evolving needs of the institutions, transactions, markets and customers.