BANK INDONESIA

No. 3/ /DPNP

Jakarta, 30 MAY 2001

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sir,

Regarding the proposal of New Capital Accord released by the Committee, herewith I intend to raise comments to be addressed in the implementation of the new accord. Those comments cover the following issues:

Pillar I: Minimum Capital Requirements

1. In the standardised approach, un-rated individual claims will be subject to a 100% risk weight while individual claims with B- rating will be subject to a 150% risk weight. This treatment may discourage the implementation of rating based approach in assessing credit risk as applying a lower risk weight for un-rated claims may create disincentive for borrowers to be rated.
2. External rating based assessment will be less applicable in developing economies where the majority of individual claims are un-rated. Therefore, the existing Capital Accord of 1988 is more applicable for these countries. However the dissemination of the external rating approach to the banking sector is necessary as a tool in internal risk management practices for individual bank.
3. The implementation of credit risk modelling still needs further efforts, particularly within developing economies with relatively small banking operations due to limitation of database and skill. Therefore, the implementation for small banks will be costly as the development of database and hiring of consultant will be expensive and take time. However, internal ratings can measure the capital requirements closer to the true risks faced by banks since the model is sound.
4. The uniform standards to assess the quality of banks' internal systems are essential in order to maintain equality and consistency of treatment while assessing banks' risk management capabilities. However, allowing banks to use their own internal systems without appropriate safeguards can create incentives for underestimating risks.
5. The banking supervisory authorities will need skillful staff, as they are required to assess the adequacy of banks' internal credit rating systems. However, this step will take some times and a lot of resources so that the Committee should recognises this and not to apply tight time limit for implementation.

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6. Since the difficulties arise in quantify and apply capital charges for operational, legal and reputational risks, the Committee should recognise the various regulations on specific provisions for those risks.

Pillar II: Supervisory Review Process

7. The supervisors have an overriding role in assessing banks' internal systems for risk management, asset valuation, and capital requirements. Accordingly, this process should become the continuous efforts for banking supervisory authorities.

Pillar III: Market Discipline

8. The Committee should recognise the condition of imperfect and incomplete markets within the banking industry in developing economies in requiring banks to disclose information and financial condition. Full disclosure in imperfect market may create market distortion as result of lack of public confidence to financial system.

Thanking you for your kind attention and please be informed accordingly.

Sincerely yours,

DIRECTORATE OF BANKING RESEARCH AND REGULATION

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