**Financial Supervisory Service, Korea**

## 1. General Issues

1) While the Basel Committee's explicit intention is to level the playing field cross the countries, the Accord is unlikely to achieve the level for Korean banks in general due to the new capital charge for operational risk. It will offset any reduction in capital under the standardized approach.
Any resulting effects from increasing capital requirements would potentially disadvantage Korean banks and could impose strain on the economy, still recovering from the financial crisis.

2) It is very difficult for market participants to compare the relative strength of banks using different approaches; standardized approach vs. the foundation IRB approach vs. the advanced IRB approach under the New Accord.

In order to enhance market discipline on the basis of the New Accord, the Basel committee should suggest comparison methodologies and ways of understanding, by market participants, of the results calculated by various approaches under the New Accord.

3) Implementing the New Accord will require extensive work by national supervisors and banks in the period leading up to 2004.
Especially in the emerging markets, a grace period must be given, because it takes time to establish infrastructures such as data collection and credit ratings systems in those markets.

## 2. The Standardized Approach

4) The Basel Committee hopes that all banks adopt the New Capital Accord in 2004. But even the standardized approach in Pillar 1 may be too complicated and costly for some smaller and regional banks.
Therefore, a more simplified model is needed, in order to apply to these banks.

5) Under the standardized approach, the 150% of risk weight is too excessive.
The claims with lower ratings are subject to higher provisions. For example, the expected losses from the lower rating assets are to be realized on banks' capital as higher provisions and the resulting unexpected losses may be smaller than those of higher rating assets.
Therefore, placing lower risk weight on assets with lower ratings, eg. 100% risk weight on unrated claims, is requested.

6) The Committee is requested to clarify whether domestic currency ratings can be used for domestic currency obligations of sovereigns.

7) Under the New Capital Accord, the risk weight on residential mortgages will rise sharply from 50% to 150% once they are past due for more than 90days. This means

that no allowance is given for the fact that the loans are secured by residential properties.

This equates the default risk of residential mortgages with that of unsecured corporate loans past due for more than 90 days and does not take the low risk of residential mortgages into consideration.

Therefore, a lower risk weight than 150% must be introduced for the loans secured by residential properties past due for more than 90 days.

8) It is not acknowledged that real estate collateral, though a common form of collateral for most banks in Korea, should be recognised for the purpose of credit risk mitigation under the standardized approach.

Therefore, it would be more appropriate to apply appropriate haircut to the value of real estate collateral than to disregard the value of the collateral entirely, if the collateral subjects to the liquidation process and the objective and conservative valuation criteria set up by national supervisor's discretion.

**3. The IRB Approach**

9) Banks having intentions to implement the IRB approach in 2004 will only be required to have a minimum data period of two years.

This short data period will not be enough to capture the default data during a full credit cycle and will impose difficulties for supervisors to validate banks' estimates of PD.

In practice, some Korean banks which are recently designing the internal credit rating system have intentions to adopt the IRB approach.

There is a concern that estimation errors may arise from the relatively short length of historical data which does not reflect a full credit cycle.

Therefore, the Basel Committee is requested to provide a longer preparation period for banks that intend to use the IRB approach.

In the meantime, the committee is also requested to provide detailed guidance to supervisors on the methodology of validating the IRB approach during the transition period.

**4. Operational Risk**

10) As the business activities conducted by most banks in Korea are conventional in nature, such as commercial lending and retail banking, their operations are less complex than those of internationally active banks.

In regards to this, the burden of a 20% capital charge for operational risk is considered too heavy for Korean banks.

Therefore, a lower capital charge for operational risk should be adopted.