

# AWG

*Aviation Working Group*

31 July 2003

*Via Facsimile Message and Email*

Basel Committee on Banking Supervision  
Attn: Basel Committee Secretariat  
Bank for International Settlements  
CH-40002 Basel, Switzerland

Re: **New Basel Capital Accord/Third Consultative Document/Aviation-Specific Comments**

Basel Committee Secretariat:

This comment letter on the above-referenced consultative document (**New Capital Accord Document**) is submitted to the Basel Committee on Banking Supervision (**Committee**) by the Aviation Working Group (**AWG**). AWG is a not-for-profit entity comprised of major aviation manufacturers and financial institutions. The statutory purpose of AWG is to consider and develop policies designed to facilitate advanced international aviation financing and leasing.

We submitted comments to the Committee on the second consultative document on 30 May 2001. That comment letter was jointly submitted with the International Air Transport Association (**IATA**), the principal international organisation representing the world's airlines. We understand that IATA is submitting additional comments to the Committee today that are substantially similar to those made in the current letter.

We iterate the basic point made in our earlier comment letter, namely, that there is a sound policy basis for recognising modern aircraft collateral in the credit risk mitigation parts of the standardised and the foundation IRB approaches to the measurement of credit risk. That would be consistent with greater risk sensitivity in determining capital requirements, the fundamental objective of BIS II. Recognition of such collateral for certain specified tranches of senior debt collateralised by such collateral would permit more precise and differentiated pricing by financial institutions unable, or for cost reasons, unwilling, to qualify for the advanced IRB approach. It may also encourage the financial institutions that are regularly involved in the syndication of such debt, but are unlikely to qualify for the advanced IRB, to continue to participate in such syndications.

The cyclicity, volatility, and legal certainty issues which might otherwise be expected to complicate valuations of physical collateral do not detract from our position for primarily two

reasons. First, even in today's down air transport cycle, modern aircraft realise cash-flows and resale values which provide collateral coverage for identifiable tranches of the senior debt secured by such aircraft. Stated otherwise, identifiable tranches of senior debt secured by such aircraft have remained adequately collateralised under the most difficult of market conditions. In short, stress testing of values based on the current down cycle in the air transport sector can be used to identify the tranches of senior secured debt adequately collateralised by such aircraft; these tranches should bear a lower loss given default than currently contemplated by the risk mitigation provisions. Secondly, the legal framework - including the recently adopted Cape Town Convention of 2001 and the Aircraft Protocol thereto (**Cape Town Convention**)- and structured financing practices relating to extensions of aviation credit provide assurances that such values will be available within a predictable and relatively prompt period to reduce loss given default. There is little doubt that this international legal instrument will be widely accepted, will further reduce legal risks involving aircraft collateral, and further differentiates aircraft collateral from certain other forms of physical collateral. Since our last submission, France, Germany, the United Kingdom, and United States, among others, have signed the Cape Town Convention and many States have commenced procedures to ratify it. The Cape Town Convention will enter into force upon only eight ratifications. We anticipate that this will occur well in advance of implementation of the new capital regime.

We remain available, on request, to consult with the Committee on the contents of our submissions.

Since our comments are aviation industry-specific in nature, this letter is being submitted *without prejudice to the positions of financial institutions members of the AWG submitting or associated with broader or more general comments* on the New Capital Accord Document.

Sincerely yours,

**Aviation Working Group**

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