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

Comments on the Third Consultative of the New Basel Capital Accord

Dear Sirs,

We are pleased to summit our comments on the Third Consultative Document with respect to the New Basel Capital Accord as published in April 2003.

Our comments about CP3 could be summarised as follows:

1. According to paragraph 422, indirect costs should be taken into account in estimating LGD. However, the allocation and recognition of indirect costs is quite difficult in practice. In our point of view, Basel could offer more practical definition or some examples, or allow the national supervisors to have discretion to exercise with reasonable flexibility according to the principle of materiality.

2. According to paragraph 434, data interval of LGD estimates must be no shorter than a period of seven years, for grasping a full business cycle from the trough to the peak. We would like to know whether an alternative suggestion could be applied, such as using stress tests, scenario test or other mapping method with countries of well-established data. Though the data used is shortened, the spirit of employing business cycle remains considered.

3. According to paragraph 450, credit derivatives can be mitigation for credit risk.

Furthermore, according to Statement 133 of FASB and IAS 39, economic hedge is an efficient method to reduce risks and should be recognised. For example, derivatives about currency rate could reduce the sovereign risk. Could we recognise the mitigation of derivatives with practical effects as long as it meets the definition of "Hedge Effectiveness" in Accounting?

4. According to paragraph 484, one of the standards for recognition of other collateral is the existence of liquid markets for disposal of collateral. However, some collateral do not have well-established formal markets but their replacement cost and appraisal cost could be easily got. For example, banks take cars (trucks…) or vessels as collateral. Could we recognise these as qualified "other collateral" in foundation IRB?

Should you require further explanation on our point of view expressed in this letter, please do not hesitate to contact us.

Yours Sincerely,

Steven Ching
Leader of risk research team
Joint Credit Information Center