Banco de Portugal

Vice-Governador

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Ms Danièle Nouy

Basel Committee on Banking Supervision

Basel Committee Secretariat

BCBS.Capital@bis.org

Subject: **"The New Basel Capital Accord" (Third Consultative Document) – Comments from the Banco de Portugal**

Dear Sirs,

Please find herewith some general comments from the Banco de Portugal on "The New Basel Capital Accord" (Third Consultative Document).

Best regards,

ANTÓNIO MARTA

On 29 April 2003, the Basel Committee on Banking Supervision (BCBS) issued its *third consultative document* on the New Basel Capital Accord, asking for comments from all the interested parties by 31 July 2003. The present note sets out the contribution of the Banco de Portugal and should be seen in the context of the continuing and parallel involvement in the work carried out at the European Union level.

The Banco de Portugal supports the ongoing efforts of the BCBS to align banks' economic risk and regulatory capital requirements in the New Basel Capital Accord. In general, it remains supportive of the proposed new framework, which can be interpreted as an important contribution to strengthening financial stability namely by enhancing the capital requirements' risk sensitivity, by introducing a set of approaches and by interplaying between the three pillars.

However, the Banco de Portugal would like to call your best attention to the following general remarks:

1. The requirements of the proposed new Capital Accord will apply at all levels of an internationally active banking group. To ensure a fair outcome, it is important that this requirement does not lead to conflicting capital adequacy rules, at a solo level, within a banking group. Therefore, clarification on the notions of «banking groups» and «internationally active banks» seems to be needed.

2. Since within the European Union some further institutions will be covered and will be subject to capital charges, it should be considered to expand the proposed scope of application at the consolidated level of financial holding companies that are parents of diversified financial groups (including banks and securities firms).

3. Since the potential for introducing uncertainty into capital planning is not immaterial, it is expected that many banks will sought to avoid this challenge by opting for the simpler methods. Accordingly, this underlines the need for appropriate calibration of the risk weights under the IRB approaches.

4. Whereas the objective of maintenance of the overall level of capital, the actual capital requirements will vary between banks. In this context, it is important to ensure that smaller banks are not confronted with a disproportionate increase in their capital requirements in comparison with the current regime, possibly due to the new operational risk charges;

5. The spreading in the market of innovative instruments which may be regarded as eligible for regulatory capital stresses the need for to enhance the current definition of regulatory capital.

6. As the calculation of operational risk in the basic indicator and the standard approaches – as well as in the alternative standardised approach – is based on relatively simple indicators, the capital treatment is not directly associated with improvements in bank's internal controls and risk management techniques. Therefore, it could be reinforced, probably under pillar two, that these banks should demonstrate that they are also enhancing their risk assessment in relation to operational risk.

7. The role of provisioning practices should be recognised. In particular, "dynamic" provisioning – where banks were required to assess expected losses with due consideration to the risk profile over the entire economic cycle – would contribute to reduce the cyclical effects over banks' profits.

8. The simplifications introduced under the simplified standardised approach can potentially represent a negative impact over the stated need to develop and to apply the Capital Accord framework in a similar basis in all jurisdictions (albeit probably at different paces).

9. The proposed new Capital Accord provides the possibility of moving from one approach to the other for each exposure class, with the exception of some portfolios. The phased roll-outs/partial use may give rise to level playing field issues, unless there is convergence of supervisory policies and practices. Moreover, the Committee could revisit the possibility of the sovereign and bank portfolios staying permanently in the standardised approach.