Bank of Thailand

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FACSIMILE TRANSMITTAL SHEET

TO : Secretary General
Basel Committee on Banking Supervision
ATTN : Mrs.Daniele Nouy
DATE : 30 July 2003
FAX NO. : +41 61 280 9100
NO. OF PAGES : 6
(INCLUDING THIS PAGE)
FROM : Mrs. Niramon Asavamanee
Senior Executive,
Capital Policy and Management Division

MESSAGE :

Dear Mrs. Nouy,

The attachment is the comments on New Basel Capital Accord (consultative paper 3) from Bank of Thailand. The official letter will be sent by mail directly to the Chairman.

Best regards,

N. Asavamanee

(Mrs. Niramon Asavamanee)

Bank of Thailand

30 July 2003

Mr. Jaime Caruana
Chairman of Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Mr. Caruana,

No. BOT. FPG ๓๔๗ /2546 Re: Comments on New Basel Capital Accord (Consultative Paper 3)

We refer to the third consultative paper on the New Basel Capital Accord issued by BCBS for comments by 31 July, 2003. We are pleased to submit our comments as attached herewith which are the outcome of a series of meetings held by a working group comprising representatives from Bank of Thailand and the Thai banking industry.

We appreciate the opportunity to comment on the document and look forward to seeing the final version of the accord.

Yours sincerely,

(M.R. Pridiyathorn Devakula)
Governor

Enc.: Comments on New Basel Capital Accord (Consultative Document Issued April 2003)

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Comments on New Basel Capital Accord
Consultative Document issued April 2003 for comment by 31 July 2003

Overall comments

Views shared by the Bank of Thailand and Banking Industry

The Bank of Thailand and the Thai banking community have agreed to the general principle of the new accord which would make capital requirement more risk-sensitive and, in the process, help to focus financial institutions' attention on improving their risk management capability. However, implementation of the new accord would likely result in an increase in the overall level of regulatory capital for financial institutions in developing countries. For those countries, in the early stage of recovery from recent economic crises, flexibility on certain issues should be permitted so that national supervisors could set the requirements that are appropriate to country-specific needs and stages of development.

Views of the Banking Industry

The new capital accord should be more precise and comprehensible. CP3 should benefit from a more simplified format and structure. It should also include more details and definitions to facilitate the implementation. The followings are some suggestions:

- Due to different background of the new capital accord users, incorporating a Glossary to precisely define many technical terms (such as, write off, charge off, average economic loss, loss coverage target, servicer, etc.) would be helpful.
- Clarification is needed in some areas. For example: "Supervisory slotting criteria" should be specified and explained in more detail. Also on securitisation, the term "Bank" should be identified clearly whether it refers to originator or investor.
- For the Pillar 3 part, the disclosure guideline is quite specific and rigorous. The BIS should instead allow flexibility for national supervisors to set the requirements in accordance with local market conditions.
- The new capital accord should be made self-contained with no need to refer back to the previous accord. It should contain the underlying rationale for the capital requirement calculation, the assumptions of risk weight functions for each type of exposure, and the derivation of various coefficients in the equations, etc., so that readers can better understand the rationale and principles.

CP3	Views / Comments
1) Calculation of capital requirement for credit risk under the Standardized Approach	
1.1 Claims secured by commercial real estate: Under exceptional circumstances for well-developed and long established markets, 50% risk weight may be applied for the tranche of secured loan that does not exceed the lower of 50% of the market value or 60% of the mortgage lending value. The unsecured portion will receive a 100% risk weight.	***Views shared by the Bank of Thailand and Banking Industry*** Unsecured claims should receive risk weight based on credit rating by external credit assessment institutions rather than receive a 100% risk weight. This would make it consistent with treatment of other types of unsecured claims.

CP3	Views / Comments
1.2 50% risk weight applied to the portion of claims secured by commercial real estate	***Views shared by the Bank of Thailand and Banking Industry*** The risk weight on this type of claims should be reduced as it is already subject to a strict condition on what constitutes a well-developed and long established real estate market. Besides, under the Internal Ratings Based Approach, claims secured by commercial real estate has the value of LGD of only 35%. Since this is the same type of collateral as under the IRB Approach, the risk weight should be reduced accordingly.
2) Credit Risk Mitigation	
2.1 Hedges of less than one-year residual maturity, which do not have matching maturities with the underlying exposures, will not be recognized.	***Views shared by the Bank of Thailand and Banking Industry*** Hedges of less than one-year residual maturity should be recognized to accommodate the relative scarcity of long-term hedges in developing markets.
2.2 Physical collateral under credit risk mitigation	***Views of the Banking Industry*** Given the widespread use of physical collateral in countries where financial markets are not well-developed, physical collateral should be recognized as credit risk mitigation at national discretion under strict criteria to ensure the quality of collateral.
2.3 When the maturity is mismatched between the exposure and collateral, the value of collateral will be adjusted by multiplying the residual maturity of the credit protection/the residual maturity of the exposure and uses this adjusted value to deduct from the amount of exposure for capital requirement.	***Views shared by the Bank of Thailand and Banking Industry*** The calculation should be based on the actual maturity of the collateral without weighting. The residual maturity of exposure that is not covered by collateral should be treated as exposure without collateral.
3) Calculation of capital requirement of credit risk under Internal Ratings Based Approach (IRB)	
3.1 Under the foundation IRB approach, guarantors who are unrated companies but are internally rated and associated with a PD equivalent to A- or better are recognized for credit risk mitigation.	***Views of the Banking Industry*** A PD equivalent to BBB- should be recognized as it is still an investment grade.

CP3	Views / Comments
3.2 The credit risk calculation covers only the case where a financial institution has one type of exposure with one client and many types of collateral.	***Views of the Banking Industry*** How should the credit risk calculation be made in the case where a financial institution has many types of exposure with one client and one collateral?
3.3 Definition of default in CP3 is defined by the events that the obligor is unlikely to pay its credit obligations or when the obligor is past due more than 90 days on any material obligation.	***Views of the Banking Industry*** More detailed qualitative and quantitative criteria for determining "unlikeliness to pay" should be provided.
3.4 From Annex3–the IRB risk weights table. At LGD of 45%, capital requirement for corporate exposure is higher than that of residential mortgage exposure except at PD level of 6%-20% when capital requirement for the residential mortgage is higher.	***Views of the Banking Industry*** Given that residential mortgage exposure is classified in the retail group, which should normally carry a lower risk weight than corporate exposure, why is it subject to higher capital requirement than corporate exposure at PD level of 6%-20%?
4) Calculation of capital requirement for operational risk	
4.1 The Alpha and Beta coefficients	***Views shared by the Bank of Thailand and Banking Industry*** Alpha and Beta should be set as a range to allow flexibility for national supervisors to set the requirement appropriate for local market conditions and financial institutions' operational risk management capability.
4.2 Under alternative Standardized approach, the standardized m factor (m) is 0.035.	***Views shared by the Bank of Thailand and Banking Industry*** The m factor should be set as a range to allow flexibility for national supervisors.
4.3 The use of volume-based approach in the calculation of capital requirement for business line: retail and commercial banking.	***Views shared by the Bank of Thailand and Banking Industry*** The volume-based approach should also be used for other business lines such as trading and sales, where the size of trading book might be used as a risk indicator.
4.4 Financial institutions are allowed to recognize the risk mitigating impact of insurance only under the Advanced Measurement Approach.	***Views shared by the Bank of Thailand and Banking Industry*** Insurance should also be recognized as risk mitigation under the Standardized Approach. This would give financial institutions incentive to adopt the Standardized Approach rather than the Basic Indicator Approach. Financial institutions adopting the Standardized

CP3	Views / Comments
	Approach must already have a relatively well-developed risk management system and are able to separate business lines and gross income according to BCBS's requirement.
5) Calculation of capital requirement for securitisation	
5.1 For synthetic securitisation, the eligible collateral is limited to that specific in credit risk approach (paragraph 116 and 117).	***Views of the Banking Industry*** Same comment as 2.2 The eligible collateral should include physical collateral.
5.2 The guarantors should have the rating of A- or better to eligible for credit risk mitigation.	***Views of the Banking Industry*** Guarantors with rating equivalent to BBB- should be recognized because BBB- is still an investment grade.
5.3 The risk weight for securitisation exposure rated BB+ to BB- is 350% while the risk weight for the corporate exposure at the same rating is only 100%.	***Views of the Banking Industry*** The risk weight for securitized assets should be reduced to 100% to be in line with that for corporate exposure. At least, the rationale behind different treatment of these two types of exposure should be given.
6) Calculation of capital requirement for trading book	
6.1 From Paragraph 647 a hedge is a position that <u>materially or entirely</u> offsets the component risk elements of another trading book position or portfolio.	***Views shared by the Bank of Thailand and Banking Industry*** BCBS should issue a clear guideline on what the term "materially or entirely" means in practice, so that national supervisors have a uniform standard to follow. It should also explain the rationale for not recognizing partial and portfolio hedge for trading-book capital treatment.
6.2 Valuation reserve for less liquid positions in the trading book.	***Views shared by the Bank of Thailand and Banking Industry*** BCBS should issue a detailed definition of "less liquid" position as its meaning may differ across countries.

CP3	Views / Comments
7) Pillar 2 – Supervisory Review Process	
General comment	***Views shared by the Bank of Thailand and Banking Industry*** BCBS should give the same emphasis on supervisory transparency and accountability as on other four principles by setting it out as Principle 5.
8) Pillar 3- Market Discipline	
General comment	***Views of the Banking Industry*** 1) Excessive disclosure of highly technical information could be misleading to the less informed public. 2) Information disclosure should not be considered a requirement. National supervisors should have authority to review and set appropriate disclosure policy. 3) Disclosure of quantitative information should be made in summary form. 4) Disclosure about financial institutions' risk profiles as per table 4 onwards, should consist of only the end results. This would help to reduce public confusion and avoid adverse effects to the business from disclosing commercially sensitive information.