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

Dear Sirs

Barclays' comments to the Basel Committee on third consultative paper on the New Basel Capital Accord.

The Barclays Group welcomes the opportunity to comment on the third consultative paper on the New Basel Capital Accord (CP3). We have worked closely with the British Bankers Association and the International Swaps and Derivatives Association during the consultation process and strongly support the comments submitted by these organisations. In addition, we have submitted separate, more detailed, documents covering the proposals in respect of operational risk and asset securitisation, two aspects of the new Accord that cause the Barclays Group particular concern. The purpose of this letter is to express some high level views on the latest proposals and to highlight aspects of the framework that we believe merit further review by the Basel Committee before the Accord is finalised.

First and foremost, Barclays would like to congratulate the Committee on the progress made over the past four years in shaping the proposals into a much more workable rule set. In our view, considerable advances have been made in refining, for example, IRB risk weightings, notably in the treatment of retail asset classes. We consider that this progress reflects the fact that both regulators and banks are turning their attention to how the Accord will work in practice; and that this perspective is proving valuable in the shaping of more practical and streamlined rules.

Excessive Conservatism

That said, CP3 remains a very lengthy document and Barclays share the views of many in the industry that aspects of the proposed approach are excessively conservative or prescriptive. We highlight three examples:

> **Paragraph 235, which outlines new transitional arrangements placing a floor of 10% on LGDs for retail exposures secured by residential properties for any sub-segment of exposure.**

While we acknowledge that the housing market is subject to long cycles, we also believe that some mortgage assets may merit more favourable capital treatment than that outlined above. For example, mature mortgages where the debt outstanding is low relative to the value of the property. For this reason, we suggest that the transitional floor should reference average LGDs across portfolios, rather than placing a floor across all assets.

Paragraph 373 states that "Banks must take all relevant available information into account in assigning ratings to borrowers and facilities".

As indicated in our earlier response to the QIS 3 Technical Guidance, Barclays' experience is that ratings are more appropriately viewed as a distillation of key facts, rather than an exhaustive credit assessment. We believe it would be hard for any bank to comply with the requirement as it is currently worded. We recommend that the word "all" is deleted from the text.

Paragraph 430 states that "for exposures for which LGD estimates are volatile over the economic cycle, the bank must use LGD estimates that are appropriate for an economic downturn if those are more conservative than the long-run average".

To adjust inputs to the capital calculation in this way will make the pillar I calculation backward looking and generally at odds with other uses of our internal ratings. We understand the desire of the Committee to ensure that institutions do not under-estimate the severity of LGD. However, we believe the onus should be on banks to verify that their assumptions are realistic and that the evaluation of portfolio performance under adverse scenarios is best done in one place under a properly defined stress testing framework, so as to avoid multiplying up the affect of conservative assumptions.

Overall, we recommend substantial re-drafting of Section H of the proposals with the aim of simplifying the requirements. In our view paragraph 379 communicates the essence of the challenge:

"The burden is on the bank to satisfy its supervisor that a model or procedure has good predictive power and that regulatory capital requirements will not be distorted as a result of its use. The variables that are input to the model must form a reasonable set of predictors. The model must be accurate on average across the range of borrowers or facilities to which the bank is exposed and there must be no known material biases."

On a related theme, the proposals as currently drafted place great emphasis on hard evidence to validate ratings as fit for purpose. This poses practical difficulties in asset classes where the incidence of default is low and the sort of validation techniques used in mass markets are inappropriate. The most obvious asset classes where this applies are in lending to Banks and Sovereigns, though it is also an issue in other areas. In our view, it is imperative the IRB approaches for such asset classes are permitted within the Accord. We advocate benchmarking as an alternative to statistical validation in such areas, the challenge to institutions being to demonstrate that their ratings are unbiased and accurate on average (see above).

Treatment of Securitisation

The Basel framework currently proposed could severely damage the securitisation and conduit businesses. Barclays Capital are discussing with the UK Financial Services Authority. We expect to submit more detailed comments on this issue to the FSA in due course.

Pro-cyclicality

The potential pro-cyclicality of the proposed regime is a concern to some observers. However, it is a problem for Financial Institutions under the current rules and will remain so because credit markets have their own cycles. We would counsel against measures within the Accord to attempt to deal with this issue in a formulaic fashion. Rather, we see this as a capital management challenge for banks, solutions to which will no doubt be subject to detailed discussions with supervisors.

Forward Looking Aspects

We note the committee's plans to give further consideration to areas such as OTC derivatives beyond 2006 and suggest that a similarly progressive approach towards credit mitigation and asset securitisation. These areas will, no doubt, continue to develop rapidly in the years ahead as banks better quantify the risk they run and seek to mitigate them. That is, unless unduly harsh or inappropriate regulatory treatment diverts them on to a different course. We urge the Committee to monitor this area of the Accord closely to ensure such a detrimental outcome does not come to pass.

Turning to implementation, we have noted with interest the proposals of US regulators to only adopt the advanced methodologies for operational and credit risk and to incept simplified transitional measures between the Basel I rules and these advanced approaches. With appropriate oversight, Barclays believes that such transitional arrangements would serve well in other jurisdictions, facilitating simpler and less costly implementation of the new regime for banks and regulators alike.

Overall, Barclays welcomes the content of CP3 as a major step forward in banking regulation. We share the view that the extensive dialogue between the Basel Committee and the banking industry has been of great benefit within the Basel II process. We welcome the Committee's plans to continue this dialogue and we agree that it will be essential to retain the flexibility to address unintended consequences within the new framework as implementation draws near.

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