The Chief Executive Officer

Basel Committee on Banking Supervision,

Bank for International Settlements,

CH - 4002 Basel (Switzerland)

Brussels, July 28th, 2003

Dear Sirs,

Comments on the third consultative paper on the New Basel Capital Accord (CP3)

We are pleased to send you the official position of the Belgian Bankers' Association (Association Belge des Banques – Belgische Vereniging van Banken, in short ABB-BVB) on behalf of the new federation of which it has become a member , i.e. Febelfin (Fédération Financière Belge – Belgische Federatie van het Financiewezen, or Belgian Finance Federation), concerning the third consultative paper presenting the final draft Capital Accord of the Basel Committee (the "CP3" document).

First, we confirm our agreement with the aims and general methodology of the Accord as expressed already as from September 1999. The current version is the result of an impressive effort which has resulted in a considerable improvement of the previous papers. Nevertheless, we would highly appreciate if the Accord takes over the following remarks, which fundamentally deal with some major issues as well as with a number of related technical aspects.

1. The level playing field for competition - a fundamental aspect of the Accord - calls for

- a very concrete organisation of the convergence between the prudential rules (in spite of the national options) and practices, especially as for the application of 'Pillar 2', by means of bodies offering a sufficient degree of efficiency needed for achieving a truly international and transparent system, which more particularly excludes regulatory arbitrage ;

- an adequate spreading of competence between the home and host country authorities, the former being recognised as co-ordinating institutions at the highest level of consolidation.

2. The system of incentives should be more significant :

- there is a need for stronger incentives promoting more advanced methodologies ;

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- the parameter calibration should be fine-tuned further during the three years preparatory period by means of supplementary simulations (even if these may prove rather hard to achieve before 2007), in order to make sure that the incentives are portfolio-oriented and specifically aimed at each type of activities instead of being of a general kind ;

- Pillar 2, which takes into account the individual risk profile, must not be used as a compensation for structural shortcomings of Pillar 1, which specifies the general calculation of the capital requirements.

3. The system should offer sufficient flexibility for making adaptations which are difficult to assess before the first experience has been gained as for the application of the Accord (e.g. for trade and equity finance).

4. Some specific aspects are particularly important :

- the pro-cyclical effects of the Accord should be compensated for by a higher flexibility of several rules ;

- Pillar 3 stills contains a number of inadequate requirements such as the disclosure of data destined for the supervisory authority ;

- technical improvements would have to be made as for some parts of the system concerning issues which will have a positive effect on the matters of principle mentioned above.

These issues are explained in the enclosure. Its annexes (Nos. I to VI) contain a number of proposals described more into detail as well as technical reactions on some specific parts of the CP3 document.

Moreover, we would like to draw the attention on the fact that ABB-BVB agrees with the position of the Fédération Bancaire Européenne (European Banking Federation), to which we have contributed together with its other members. We consider its reactions to be consistent with ours, even if some priorities can be different and if some issues are not systematically the same in both documents, which in fact complete one another.

Of course, we shall be pleased to give you any further explanation on these positions.

Sincerely yours,

G. Ravoet

FUTURE BASEL ACCORD : FINAL CONSULTATIVE PAPER « CP 3 »

GENERAL POSITION OF THE BELGIAN BANKERS' ASSOCIATION

The Belgian Bankers' Association (ABB-BVB, i.e. Association Belge des Banques – Belgische Vereniging van Banken) gives the following official answer to the final consultation by the Basel Committee concerning its second Accord (i.e. consultative paper « CP3 » released on April 29th, 2003).

The ABB-BVB is a member of the European Banking Federation (FBE, i.e. Fédération Bancaire Européenne) and, as such, agrees with its general position. Nevertheless, the ABB-BVB has its own opinion and priorities which are presented here in two parts : essential general positions on matters of principle and, as an enclosure, technical aspects which are all related to these matters.

1. Complexity and Accuracy versus Flexibility

The consultation within the "Accord Implementation Group" (**AIG**) (see CP3 document *Overview*, §§ 60 and 66) apparently will not be sufficient in order to achieve the aims of the Accord (level playing field, etc.), considering the nature of many problems to be solved. It is quite necessary to provide a procedure which is suitably flexible and efficient altogether, **in order to define common interpretations** of the Accord by involving existing working groups of the Basel Committee or, depending on the kind of matters to be dealt with, the Committee itself. An appropriate consultation of the institutions controlled or the bodies representing them should be part of such a procedure. See also no. 15 below (on Pillar 2), as well as no. 2 and 15 (on national discretion).

2. Level Playing Field

The **same rules** should apply for the **same activities and risks** to **all of the financial institutions**, including smaller and less complex banks, as well as all of the investment firms and investment services. It is necessary to ensure adequate application of the Accord in different countries, especially in the USA, in so far as **international banks are present in local activities.**

National discretion should be **reduced as much as possible** right from the beginning of the application **and should decrease** over time. See also no. 1 and 15.

There is the **danger of arbitrage between categories with or without floor** (see for instance section 6 below on "Retail and SMEs"). Therefore, the **floors must be transitional** (until 2008 and subject to reassessment at that moment).

The **home country supervisor** takes the final decision as for the required level of **consolidated** capital and top-down allocation. In co-ordination with the host country supervisor, the former has the option to ask banks to calculate at sub-consolidated or stand-alone level. See also no. 15.

3. Incentives towards advanced approaches

Restrictions such as floors run counter to the principle that institutions should be able to split up their ratings into relevant pools as accurately as possible (e.g. as for retail transactions and transactions with SMEs). Such provisions should be removed as much or as soon as possible.

4. Scope of Application

The main level is the **highest consolidated level** of the predominant banking group. Therefore, the calculation of sub- or non-consolidated ratios should be no more than flexible accessory verifications (as described in § 15 of CP3).

This means that the **capital** should be **applied top-down.** The suitable breakdown of capital between the entities of the group according to their individual risk exposure will be controlled by the supervisory authorities on the basis of the elements provided by the entities for the calculation of the group capital. All this should be achieved at the satisfaction of the home country supervisory authority, whereas the host country authority will cooperate by means of local contributions and will be duly informed of the result (see below : application for specific risks, e.g. section 11 on operational risks). A bottom-up process would boost capital excess to a large and economically very dangerous level.

5. Standardised Approach

The Public Sector Enterprises (**PSE**) need a treatment which ensures a level playing field. This does not seem to be the case : the treatment could be different from one country to another. There is no strong definition of a PSE (note 14 : "… for instance by focusing on …"). A **common list** should be made, certainly in Europe but also at least in all countries of the Basel Committee. Relevant databases could be interconnected, even if it may prove rather difficult for national authorities or the Basel Committee to create such a system or to have it created.

In fact, this is a general remark for **all counterparties with a particular weighting.**

6. IRB Approach

The concept of **non-significant** (§ 228) should be **extended to non-feasible**, especially for structural reasons (e.g. the impossibility to assess a PD in developing countries in a turmoil).

The conditions of the **use test** (§ 233) call for a **planned transitional period** in IRBF as well as in IRBA. It will be impossible for some banks (if not many) to start drawing statistical series over a 7 year period at the end of 2006. It will take some years to gather these data. A planning should be laid out following a dialogue between the bank and the supervisory authority and in accordance with an organised international convergence of this practice.

7. Retail and SMEs

Although this is more of a general remark, it is especially important for retail transactions. The restrictions imposed on them (e.g. mortgages floor LGD 10 %, all retail floor PD 3 bp) could be harmful, in some cases, for markets such as the Belgian one. It is quite feasible for an institution to isolate certain segments with a lower risk within the framework of an internal rating. However, **it runs counter to the general philosophy to require that institutions be able to split up their ratings into relevant pools as accurately as possible.** If it can be shown that this kind of restrictions is harmful, the supervisory authority must take this into account.

Another general remark is especially important for retail transactions. More information should be given by the supervisory authority about the use of the **general provisions** and the accompanying **deductibility of the capital allocation**. A comparison with other countries should be taken into account. **Differences in tax regulations should be reflected** in the capital allocation as much as possible.

A **common definition of SMEs** is important for the level playing field, chiefly in Europe but also in places where banks from other countries compete on the same market.

8. Qualifying Revolving Retail Exposures

In fact, this newly introduced category of Qualifying Revolving Retail Exposures covers credit cards. This is an over-elaboration of the regulations and could bring about an unlevel playing field. In order to avoid unfair competition between products, **a new definition** is necessary, **focusing on the essential feature of "very high future margin income"** and removing the product characteristics (revolving, uncommitted and unsecured) and background (revolving credit cards).

9. Trade Finance

The credit conversion has been adapted, but the **maximum duration** should be **6 months.**

Technical modifications, e.g. as for calibration, should be considered for trade finance in order to **avoid a competitive disadvantage** for banks.

In order to avoid confusion, the Accord should give **a more precise definition of the kinds of letters of credit** which really can be considered as "collateralised" (for the precise definitions see enclosure II).

As for the risk period, the **effective maturity date** should be taken into account for Advanced and IRB Foundation.

These positions are explained in annex II.

10. Equity Finance

The **capital requirement** is **rather high** (and notably higher than the current requirements). This presents a serious danger for certain activities, especially private equity and participations not listed on a recognised Stock Exchange. The fact that diversification with other risks (e.g. interest rate risk) is not taken into account, also increases this level. All this is **a competitive disadvantage** for banks.

Technical modifications, e.g. as for calibration, application of the VaR and more flexible treatment, should be made and some clarifications should be given, in order to improve the provisions concerned as explained in annex III.

11. Credit Risk Mitigation

Flexible and convergent application of the mitigation conditions - These conditions seem to be appropriate but there is a problem, i.e. the danger of applying them too strictly. If one looks only at the complete fulfilment of every condition independently, one partially insufficient condition out of five for example may totally exclude the mitigation. This would be excessive. Proportionality is needed and can be carried out by adding some levels between the full mitigation (100 %) and no mitigation (0 %, i.e. no risk transfer), e.g. 80 % and 50 %.

Exclusion of CRM during the last year in case of maturity mismatch - The system described in the draft (§§ 114 and 549, taking into account §§ 172-174) is a classic and sound rule for guarantees, yet insignificant and needlessly burdensome as for transactions with another bank or with a special purpose enterprise because, in those cases, the maturity has no relation with that of the underlying transactions.

Securitisation - The Supervisory Formula in the IRB Approach for securitisation is too intricate and at the same time insufficient. There are too many different kinds of transactions with specific features.

These positions are explained in detail in annex I.

12. Operational Risks

- Different or even incompatible interpretations can be given at a number of points, sometimes concerning very important topics. The **interpretation must be uniform and clear.** It is neccesary to clarify all these issues in all countries concerned **by means of an adequate convergence of Pillar 2.** The technical enclosure deals with these cases.

- It is especially unclear in the draft that the **capital required is the consolidated regulatory capital**, which could also be the sum of the regulatory capital of the consolidated entities (bottom-up). This sum can be higher, something that would not be acceptable (even without considering the fact that this difference can be substantial). Moreover, it would not be in line with the rationale of the Accord.

- A simple provision, open to evolution, should be applied in order to **take into account the correlations** which are a **major element of the AMA incentive structure** (see § 629 (d)).

- Banks should be allowed to apply a **fairly high threshold to the credit loss**, before an operational risks analysis takes place (see § 633 (5)).

- **Risk mitigation should not be limited to insurance products.** In the future, financial market products could easily be introduced with a return when operational events do not materialise. The regulatory framework should be explicitly open to this kind of developments (see § 637).

- The criterion of **insurance contracts maturity is not appropriate.** These contracts are negotiated once a year. This rule should be applied only when there is a chance that the contract will not be prolonged (see § 638).

- The general principles governing the splitting up of the competence between **home and host country supervisors** should also be applied very explicitly to operational risks (§ 677).

- It is very important to recognise explicitly that banks calculate operational risk **capital at group level** and allocate it per jurisdiction (using a risk-sensitive allocation key as far as possible) (§ 677).

- Under Pillar 2, an **additional capital** amount could be allocated **to an AMA bank** for operational risk. This is not adequate : Pillar 2 must not be aimed at improving Pillar 1, it is a fundamental principle. (§ 677).

Broader explanations are given in annex IV, along with more technical issues.

13. Procyclicality

The situation

- The new regulations could lead to swifter and more far-reaching adjustments of the risk profile of banks and hence, they could have an amplifying effect on the economic cycles. In order to avoid procyclical effects, the Accord will impose on banks the obligation to have additional capital as a “buffer”.

- Rating agencies will have to adapt their rating systems to the new environment. Higher volatility will probably require higher levels of “buffer” capital.

Modifications to be made in the draft text

- A strict and **mechanical alignment** of credit risk may have an **amplifying** effect on **the economic cycle** and lead to a contraction of the banks’ credit activities at times when companies badly need credit. The current proposal based on “through the economic cycle” series and stress requirements will not prevent banks from adopting a “stop and go” attitude.

- Bigger and swifter fluctuations in the risk profile of banks may lead to **higher volatility of their stock prices** and consequently an investors’ demand for higher return. In its turn, this phenomenon either could lead to **higher costs for banking services** or force banks to reduce costs by means of redundancies, each of these having negative macro-economic consequences.

- Although most banks currently have excess capital as compared to the minimum regulatory requirements, a general increase of this minimum level could force the **banking industry to raise new capital** with all its financial consequences for the banks’ shareholders, clients and employees. One must not forget that banks compete with all other companies on capital markets for equity and should be competitive in terms of return for investors.

- It could be more appropriate to point the provisions of the Accord to the minimum **capital level needed in low phases of the economic cycle.**

- **Rating agencies would not be able to adapt** their rating criteria accordingly, as is necessary, if the new Basel Accord is not very clear in this respect.

14. Calibration

The only formula **to be modified**, though fundamentally, is the **“Supervisory Formula” for securitisation** in the IRB Approach as mentioned in § 11 above.

There is one remark to be made on the **quantification of parameters in “CP3” on the basis of the “QIS3”** simulation. Many banks consider that the results of this exercise may be seriously insufficient because of the importance of hypotheses which, moreover, often will not be very compatible between banks. Even if this may prove rather difficult, **there is a need for a “QIS4”** exercise **scheduled by the Basel Committee** for instance in 2005 at the request of the industry by taking into account the fact that it will be possible to use IRB models within banks. It will be much easier to provide appropriate figures and there should be **enough flexibility** in the procedures of the Basel Committee to adapt calibration in due course, taking into account the fact that such simulations still could be necessary in the future, even after 2007.

Moreover, a new simulation would give the supervisory authorities an interesting possibility to test the models at the same time.

Calibration should provide consistent and sufficient **incentives** towards more advanced approaches.

15. Pillar 2

- Pillar 2 does **not** imply a structural **increase** in comparison with **Pillar 1.** The Pillar 2 add-ons concern individual risks only. Application of a **consistent approach** both within a country and across different countries should ensure a ‘level playing field’.

- Transparency and accountability call for the supervisory authorities to **publish in advance the criteria** to be used for a revision of the banks’ internal capital assessments, or banks will make their own judgment beforehand and be subject to reassessment by the supervisory authorities afterwards.

- **National discretion**

The basic guideline when drafting and implementing the regulation should be the single financial market principle. This means that, especially within the EU, national discretion should be reduced as much as possible.

The interpretation made by the supervisory authorities should be consistent, co-ordinated and transparent.

- As for **coordination between regulators**, the **AIG** is a major step into the right direction. Nevertheless, if AIG recommendations have no legal nor regulatory basis, significant differences may subsist as for interpretations or choices made by local regulators. This should be avoided. Indeed, it would be difficult for banks to understand a situation where regulators could agree on common rules and regulations but not on their own interpretation and/or implementation.

- A system should be created in order **to define common provisions in case of divergence between** home and host country **supervisors.**

The **home country supervisor should act as leader** and co-ordinator and should take on the primal and overall responsibility for the entire banking group. The host country supervisor should be in charge of local supervision under the co-ordination of his home country colleague.

The home country supervisor must see to it that the qualitative and quantitative criteria governing eligibility for an approach are met, as well as approve the methodologies, tools, models and processes, and establish the validation processes. The home country supervisor should also have the final word on the overall capital requirements. The home country co-ordinator may delegate, under his control, part of the reviewing or approving to the host country supervisor.

- One should absolutely **avoid redundant work and reporting** due to differences in the field of regulations, interpretation and implementation.

- The **supervisory authority’s resources** should be adequate for taking on increased responsibility on a timely basis.

See annex V for full details of the comment.

16. Pillar 3

- It is **illogical to ask for explanations about differences with the IAS** figures : in fact, the disclosures must be produced according to the IAS rules themselves.

- The provision of Pillar 3 stating that **participations in insurance** companies must be disclosed because they are not deducted, is inconsistent with the deduction laid down in Part 1 (section D, p. 2). The treatment of insurance subsidiaries is inconsistent. Whereas deduction is imposed by Part 1 (section D, p. 2), Pillar 3 requires identification of insurance subsidiaries which are not deducted (table 1, p. 158).

- CP 3 still includes **too much qualitative and quantitative disclosures** on credit risks for portfolios subject **to IRB approaches** (cf. table 6 - p. 162).

Technical information about PD, LGD, EAD should be given only to the supervisory authorities.

It would be **premature** to disclose this kind of information from the very outset. If required by the market, this information could be provided progressively after some time (which is comparable with the implementation dates of Basel 2 + 3 years).

- Back testing results of the credit risk model as well as qualitative and quantitative disclosures on credit risks for portfolios subject to IRB approaches should be made available **only to the supervisors**, under Pillar 2 (see table 6, f, p. 162, etc.).

See annex VI for full details of the comment.

TECHNICAL ISSUES : ANNEXES

I. Credit risk mitigation (see § 11 above)
II. Trade Finance (see § 9)
III. Equity Finance (see § 10)
IV. Operational risks (see § 12)
V. Pillar 2(see § 15)
VI. Pillar 3(see § 16)

FINAL DRAFT BASEL ACCORD (CP3) : OBSERVATIONS OF THE ABB-BVB

ANNEX I : DETAILED OBSERVATIONS ON THE CREDIT RISK MITIGATION

The Belgian Bankers' Association (Association belge des Banques – Belgische Vereniging van Banken, in short ABB-BVB) puts forward the following detailed observations concerning the Credit Risk Mitigation (CRM) provisions, essentially on guaranties and collateral as well as on securitisation. These observations mainly deal with principle aspects and with securitisation.

1. Flexible and convergent application of the mitigation conditions

- These conditions seem to be appropriate but there is a problem, the danger of applying them too strictly. If one looks only at a complete fulfilment of every condition independently, a partially insufficient condition out of five for example may totally exclude the mitigation. This would be excessive.

- This is in fact a new – yet obsolete - organisation of the market, based on the specific rules of the housing mortgage loans since tenths of years, instead of a regulation supporting the sound development of new financial instruments. This is contrary to the quick and flexible evolution the Basel Committee rightly wishes to launch as for the banking regulation in the future. And it seems that this market will develop strongly in the coming years.

- This fairly general aspect of the draft accord as for guaranties and securitisation can be especially cumbersome for e.g. the currency mismatch, the credit derivatives, the synthetic securitisation (which is the biggest part of the market), and the liquidity (with a double requirement as for the liquidity line as well as the liquidity risk).

- Proportionality is needed and can be carried out by adding some levels between the full mitigation (100 %) and no mitigation (0 %, i.e. no risk transfer), e.g. 80 % and 50 %.

- This is a field where the current supervisory practice can be very different from one country to another. Some control authorities could evolve towards a very strict application ; others may maintain a too flexible application. A level playing field requires clear general principles and a specific convergence effort, which should be given special attention by the Accord Implementation Group (AIG).

2. The Supervisory Formula in the IRB Approach for the Securitisation

- A single “Supervisory Formula” (SF) for all kinds of transactions (§§ 589-599) is too intricate and at the same time insufficient. There are too many different kinds of transactions with specific features (perhaps ten up to twenty main kinds). A single common framework is not possible except for a list of essential or other elements to be used normally.

- The SF would be a black box for many banks or transactions. In that case, it can open the possibility of applying to the elements the figures needed for preconceived results. In order to avoid this, the SF requires an extremely cumbersome and expensive auditing effort as for the elements to be used in the formula whenever the pool level or definition is not applicable. In particular, the draft recognises a pool only if it is very homogeneous ; but certain transactions cannot fulfil this condition, e.g. receivables, where a pool can cover thousands of transactions. All this would increase the operational risk while penalising the banks with good monitoring procedures.

- The prudential advantage of the SF seems to be very limited, and out of proportion with the efforts and costs for the banks. The administrative procedures needed would prove to be unfeasible. It would be very difficult to apply internal and external controls to such a system.

- Banks should be allowed to use their own formulae putting their transactions concerned into several big categories. This is not very difficult for them and fairly transparent as for the control by the supervisory authorities. Otherwise, banks will prefer the much more simple approach based on the agencies' external ratings ; this would be contrary to the evolutionary process the Basel Committee tries to trigger.

- It means that, essentially, this issue should be transferred from Pillar 1 (defining the parameters necessary in general) to Pillar 2 (organising the agreement of the banks' formulae).

3. Exclusion of CRM during the last year in case of maturity mismatch

- The system described in the draft (§§ 114 and 549, taking into account §§ 172-174) is a classic and sound rule for guaranties.

- This does not cover the situation of the transactions between banks (or between a bank and an SPE collateralised e.g. with cash) where the maturity has no relation with that of the underlying transactions. Typically credit default swaps (or credit-linked notes) and synthetic securitisations enter into that category. In such products, the credit risk mitigation mechanism (i.e. protection payment) often applies in case of default of the obligor not on one specific underlying obligation with a single maturity (e.g. the reference obligation), but on a whole category of obligations (e.g. borrowed money) with different maturities. So the maturity mismatch between the CRM and the underlying transaction is fairly theoretical. Therefore, the adjustment of risk weights for maturity mismatches described in §174 should also be applicable for CRM with a residual maturity of less than one year.

FINAL DRAFT BASEL ACCORD (CP3) : OBSERVATIONS OF THE ABB-BVB

ANNEX II : DETAILED OBSERVATIONS ON SHORT-TERM SELF-LIQUIDATING LETTERS OF CREDIT

The Belgian Bankers' Association (Association belge des Banques – Belgische Vereniging van Banken, in short ABB-BVB) puts forward the following detailed observations concerning the treatment of short-term self-liquidating Letters of Credit in the "CP3" draft document.

Summary

A. In order to avoid confusion, **a stricter definition** should be used as for the kinds of L/C's which really can be considered as "collateralised", i.e.

1° all import L/C's banks issue payable at sight and against marine bill(s) of lading or with the goods consigned to the issuing bank or a third party acting on instruction of that bank ;

2° all import L/C's opened on a back-to-back basis on an existing export L/C;

3° all confirmed export L/C's payable at sight against (a) marine bill(s) of lading.

B. As for the risk period, the **effective maturity** date should be taken into account in the IRB approaches.

A. Definition of collateralised L/C's

Paragraphs 58 and 284 of CP3 mention a 20% Credit Conversion Factor for self-liquidating letters of credit. In order to avoid different interpretations by banks, the aim of this document is to define more clearly what could be considered as self-liquidating in order to get a uniform definition.

One of the most fundamental characteristics and advantages of L/C's indeed is the fact that payments by a bank are made against documents which cover a deal in goods. These goods become an asset of the buyer who uses them for processing (i.e. on-sale to the retail business or the final consumers) or for trading (i.e. on-sale to third parties without any processing).

Finally, the proceeds thereof are an indirect guarantee that the L/C will be reimbursed by the buyer to his bank. As such, every commercial L/C can be considered as self-liquidating.

However, within the framework of a more stringent approach, most banks internally follow a stricter definition we propose to be used.

We consider as "collateralised" the following types of L/C's :

a) <u>all import L/C's payable at sight against documents including a title of goods such as marine bill of lading or consigned to the bank or a third party instructed by the bank</u>

Every applicant must sign an application form which includes always a clause stipulating that the issuing bank is entitled, as a pledge, to the underlying documents, goods and (if any) the proceeds of the transport insurance policy. If the import L/C requires a marine bill of lading (i.e. document of title on the goods) as transport document, direct access to the goods will be given to the bank.

Goods shipped by air or by road normally are delivered directly to the buyer, so, if need be, the issuing bank has no direct access to the goods, unless

1° the airway bill is consigned to the issuing bank (in which case this bank can monitor the goods),

2° the goods are to be delivered to a third party acting as receiver (and safekeeper) of the goods on instruction of the issuing bank.

b) <u>all import L/C’s opened on a back-to-back basis and related to an export L/C</u>

This technique is often used for pure trading. As such, the documents presented by the supplier to the issuing bank will be paid by this bank via the proceeds of the export L/C in favour of the trading company. The issuing bank has no economic credit risk vis-à-vis its applicant (although it bears some operational risks, which should be covered through the treatment of operational risks). The tenor of the L/C is not relevant.

c) <u>all export L/C’s confirmed by us payable at sight against documents including a title of goods such as a marine bill of lading</u>

If the beneficiary of a confirmed export L/C presents the documents required, he will be paid by his confirming bank. The latter sends the documents to the issuing bank for reimbursement. If the issuing bank cannot honour its reimbursement obligation, it must return all documents. If this includes the full set of marine bills of lading, the confirming bank can recover the goods from the carrier (although this may involve some logistical risks, which however should be covered through the treatment of the operational risks).

Remark : no distinction should be made depending on the nature of the underlying goods and connected services and costs (such as montage, freight, insurance). However, L/C’s for 100 % services (which are very rare) cannot be considered as collateral.

General remark : Standby L/C’s (which, in fact, are guarantees in the form of a L/C) can never be considered as collateralised for the issuing or confirming bank.

If the abovementioned definition of “collateralised” is accepted, we assume that all L/C’s beyond this scope or definition, will keep a 50 % CCF.

B. Impact of the risk period as for trade finance L/C’s

Concerning the impact of the expiry maturity date of short-term trade finance (as in §§ 288 up to and including 292), we draw the attention on the following facts :

a) <u>most (i.e. 75 % or more) of all commercial L/C’s have a short lifetime, i.e. less than 3 to 6 months.</u>

The arithmetical average of a representative number of L/C’s is 93 days for import L/C’s and 124 days for export L/C’s. These short lifetimes are due to the short business cycle of most of the goods involved (and, as such, are a proof of the self-liquidating nature of L/C’s).

b) <u>L/C’s very rarely exceed 1 year.</u>

Consequently, most banks make their credit lines for issuing or confirming L/C’s subject to a maturity which must not exceed 12 months (in some cases 18 months). Longer periods are evaluated on a case-by-case basis and with a higher risk.

The short tenor of this risk, in combination with the self-liquidating nature, is one of the reasons why the actual loss ratio for L/C’s with all Belgian trade finance banks is so low.

So, the effective L/C maturity should be taken into account :

a) in the IRB Advanced approach, the carve-out allowed for trade finance with an effective maturity of less than 3 months should also be granted for risk periods between 3 and 12 months (or even totally deleted) ;

b) in the IRB Foundation approach, the standard rule should also make it possible to use the effective maturity or risk period for this type of transaction ;

c) the CP3 formula (§ 241) makes, *ceteris paribus*, very little difference between the risk of a L/C with a maturity for instance of 3 months and a maturity of 12 months. Since this does not correspond to generally accepted principles for trade risk evaluation, we propose a more substantial differentiation in the weighting of the effective maturity of 3 months up to one year.

FINAL DRAFT BASEL ACCORD (CP3) : OBSERVATIONS OF THE ABB-BVB

ANNEX III : DETAILED OBSERVATIONS ON THE EQUITY FINANCE

The Belgian Bankers' Association (Association belge des Banques – Belgische Vereniging van Banken, in short ABB-BVB) puts forward the following detailed observations concerning the equity treatment in the "CP3" draft document.

The capital requirements resulting from the new approaches are rather high (notably in comparison with the current "Basel I" approach), especially for private equity and participations that are not listed on a recognised stock exchange. The high new capital requirements represent **a serious danger for certain activities.** The fact that **diversification effects with other risk types (such as interest rate risk) are not included**, adds to this concern of high capital requirements for equity.

Par. 328 : **A more harmonised treatment for interest rate risk and stock market risk** should be organised. Therefore, the materiality level for equities under Pillar 1 should be increased to 20 % from 10 %, more closely aligning with the level of materiality of interest rate risk in Pillar 2.

Par. 321 : As for diversification effects in the PD/LGD approach, losses may be compensated by profits on other investments in a diversified equity portfolio. Therefore, the risk weightings of the PD/LGD approach for equity exposures should consider the **(partial) compensation of unexpected losses through the upside** of other investments in the same asset class. A solution could be to decrease the LGD below the proposed level of 90 %.

Par. 322-323: **The minimum risk weight floors** for PD/LGD and for the market based internal models approach **should be lowered** to 100 % and 200 %, from 200 % and 300 %, so as to provide an incentive to move from the standardised approach to more sophisticated models for equities. Apparently, in the PD/LGD approach, it is not useful to differentiate capital gain and «long term customer relationship / non capital gain» positions.

Par. 280-287 : The question remains **how to treat undrawn equity commitments** (such as for private equity) in a market based internal models approach, in a PD/LGD approach, in the simple market based approach. We understand that it is currently foreseen to use a 100 % credit conversion factor for undrawn (private) equity exposures. **Banks should be permitted, subject to supervisory approval, to use internally determined credit conversion factors.** Leaving open this possibility could help to more accurately model the effective risk posed by such undrawn commitments.

Par. 315, 322-323 : Are **investment funds** not traded on a recognised stock exchange considered as **listed or unlisted** ? **If** their underlying investments are mostly listed and if they provide shareholders with the possibility to get reimbursed on a regular basis, they should be considered **as listed.**

Par. 330 : Investment funds can be either treated as **a single investment based on the majority of the fund's holdings, or** as **separate investments based on a "look-through" approach.** The most practicable seems to be the treatment "based on the majority of the fund's holdings". However further clarification is needed about the implementation of such an approach, especially when the fund's instruments are in majority debt instruments.

Par. 317 : As for the implementation of a VaR method, the notion of 'excess return over an appropriately defined risk free rate' appears in the CP3 document. This would thus require not only the collection of historical securities data, but also the **linking of those returns with risk free rate considerations per market observed.** The question is what is a risk free rate. The following aspect can also be considered as disturbing : given the (sometimes strong) movements of interest rates, there is a clear volatility impact stemming from the risk free rate when one considers excess returns instead of absolute returns. Interest rate volatility and equity risk volatility are being "mixed together" via such a concept of **excess return.** Therefore, the following question should be considered : why should one have to look at quarterly excess returns over an appropriately defined risk free rate computed over a long term sample period instead of **absolute returns**, in order to fix the VaR at a 99th percentile level ?

Par. 490 : **Is it necessary in terms of VaR analysis for equities to adjust for the dividends (net or gross?).** As "internal models must adequately explain historical price variation", one could conclude that total return data are not a strict requirement, despite the fact that the Basel Committee has relied on total return indices when it reviewed the risk weights for the simple market based approach. The technical difficulties of obtaining total return data for individual equities (working in split-adjusted dividends at certain dates or over certain periods) represent a challenge for long term data. Since the detaching of dividends provide for further volatility and a lower absolute return, **adjusting the historical data for dividends should not be mandatory** (not adjusting them can be cosidered as a conservative approach).

Par. 318 : Clarification or confirmation is needed as for the **application of minimum risk weights at the individual exposure level rather than at the portfolio level.** This rule should apply **only on the floor calculation** for a portfolio or sub-portfolio, possibly then on a line by line basis. **The VaR calculation will thus be made on a portfolio basis (one overall VaR reading generated).**

FINAL DRAFT BASEL ACCORD (CP3) : OBSERVATIONS OF THE ABB-BVB

ANNEX IV : DETAILED OBSERVATIONS ON THE OPERATIONAL RISKS

The Belgian Bankers' Association (Association belge des Banques – Belgische Vereniging van Banken, in short ABB-BVB) puts forward the following detailed observations concerning the treatment of operational risk in the "CP3" document.

Part 2. V: First Pillar – Minimum Capital Requirements / Operational Risk (p120-130)

Reference		**Analysis**		
Paragraph #	Associated reference (other Paragraph, other Basel doc, …)	Issue Description	Proposed solution	Proposed change in the text
610	Overview of the new capital accord $44	Regulators expect international active banks to use an approach in-line with their risk profile. Shouldn't the wording be adapted to avoid level-playing field issues? US regulators force the large banks to go AMA, the same tone seems to be used by the Dutch regulators, what about the other countries…	Adapt the wording to put it in line with the $44 of the Overview document :	Internationally active banks and banks with significant operational risk exposure are expected <u>to adopt over time</u> the more risk sensitive AMA. An alternative can be for large banks to be asked <u>to provide a planning</u> for their compliance with AMA.
612		Incentive structure for moving from Basic Indicator to Standardised is NOT present, as Alpha (15%) is equivalent to the average Beta. In the context of partial use, it allows for regulatory arbitrage	Calibration should evolve according to the progress of the AMA methodologies and the results of possible new QIS exercises. Convincing incentives for moving to more advanced approaches should be managed.	
629 (d)		The <u>recognition of correlation</u> across	The paragraph should be rephrased and	Banks are allowed to use conservative,

		business lines and loss event types is clearly a major element of the AMA incentive structure compared to other approaches. The estimation and validation of correlation should not require a burdensome process that would virtually not be workable in the short term. Indeed, the ability of banks in the short term to 'demonstrate with a <u>high degree of confidence</u> and to satisfaction of the national supervisor that its systems for determining correlation are sound, implemented with integrity and take into account uncertainty surrounding any such correlation estimate (particularly in periods of stress)' is not achievable.	interpreted in a constructive way, taking account of incentives and (data) constraints. Note that the last sentence in $628 (d) opens for such method. We recommend the text to be adapted to avoid a strict and narrow interpretation. A simple provision, and open to evolution, should be applied.	expert-based correlation ratios, which have to be tested and adjusted over time. As a starting point, the correlation ratios across business lines operational risk profile may be approximated, based on the evolution of the key risk indicators. The correlation ratios across loss event types may be estimated using internal or external loss history. The estimated correlation will be validated over time
633 (5)		The recording of all operational risk loss as part of a credit event is much to demanding from an operational standpoint.	Banks must be allowed to apply a threshold (which can be fairly high, e.g. 1.000.000 €) to the credit loss, before an OR analysis takes place.	
633 (5)		To insure consistency, the rule should be extended to cover both credit and market losses. (currently only credit)		Extend text to cover market risk
634 (d)		With external data, disclosing the causes and circumstances of specific losses would breach the confidentiality in the context of pooled data. Moreover, causes of an event may not at all be applicable to another bank while an event is.	The Accord should not be prescriptive and detailed in defining the data the industry should capture.	Remove the line on 'information on the causes and circumstances of the loss event or other information that would help assessing the relevance of the loss event for other banks.
635		The text says: Scenario analysis must be associated to external data.	External data can inspire scenarios, but they cannot provide more information.	Remove 'in conjunction with external data' from the text.
637		Risk mitigation should not be limited to insurance product. In the future, we can	The regulatory framework should be explicitely open to such evolutions	Change the text to allow for the risk mitigating impact of insurance or other

		insurance product. In the future, we can easily envisage the creation of financial market products which have a return associated to the non-materialisation of operational events.	explicitely open to such evolutions.	mitigating impact of insurance or other instruments.
637		The recognition of insurance is limited to 20% of the total operational risk capital charge. Is the 20% taken into account before or after the Credit/Operational floor ? If it is before the floor, the incentive may simply vanish.	These 20 % should increase according to the experience.	Specify that the mitigation effect of insurance can be taken after application of the floor
638		The criterion on the maturity of insurance contracts is not appropriate. Insurance contracts are negotiated once a year. This implies stricto sensu that over a one-year period, a bank doesn't benefit from coverage over the next one-year period. Nevertheless, in practice it is always the case, as contracts are usually renewed/reconducted. This criterion forces the banks to negotiate future contract with insurance companies, which will inadequately support/sponsor the insurance market. The Insurance Industry has to react in order to sell future contracts. The main worry however is whether or not the insurance industry, in the long run, is able to provide the capacity needed. Moreover the level of premiums will not only be determined by the risk itself, but also by the incentive reduction on capital requirements	Remove this as a general criterium. This rule should only be applied when it is probable that the contract will not be prolonged. Alternatively, as under AMA, a model for insurance regnition needs to be developed by the bank and approved by the supervisors, it would be more convenient to transform the entire list of criteria in a set of variables that the model needs to take as input. In such way, the regulatory framework would offer sufficient flexibility for incorporating the reality of the insurance market: contract maturity, claim payment rating, etc.	

638		This rule and to the deduction of capital are a double exclusion of captive insurance companies altough i) their risks are covered by the consolidated capital and ii) they are submitted to prudential supervision	Captives, which are placed under the bank, should either be recognised as risk mitigation instrument, either as a pool of available capital.	The text doesn't offer enough clarity on the interpretation to be given. It should be clearly stated what is meant under a third party entity. Our own captives are also ranked in this category, although they are managed and supervised by us.

Part 3: Second Pillar – Supervisory Review Process (p138-153)

Reference		**Analysis**		
Paragraph #	Associated reference	Issue Description	Proposed solution	Proposed change in the text
677		The second pillar doesn't cover the home host issues. Home host issues and the collaboration/alignment of supervisors is key for the successful implementation of Basel II. In the 'overview' paper, principles for home host are described: enhanced collaboration between supervisors on a practical basis, supervisors should avoid performing redundant and uncoordinated approval, mutual recognition, … The wording is meant as intentions, more than obligations, which doesn't offer any guarantees to the banking industry. Subsidiaries of ING and AAB in the USA are presently invited by the FED to join regional conferences and both banks said that local regulators are digging into repliance of CPIII under host regulatory influence	Introduce a principle 5 that covers the home/host issues. The wording on the home/host issues should be transferred from the overview paper to the CPIII itself. Moreover, the text should talk about obligations more than intentions for supervisors The general principles of the distribution of the responsibilities between home and host supervisory authorities should be applied very explicitely to operational risks too.	The to-be-published Sound Practices Paper for Supervisors should be a part of the Basel Accord

677		Under home/host considerations, AMA will not be practical without the ability to calculate capital requirements at group level and allocate (downwards) per jurisdiction. Key factors restricting the ability to calculate individual AMA requirements for multiple entities within a group are as follows: • Data insufficiency at the level of individual entities (or, for that matter, groups of entities) will be particularly relevant, given that this is already an issue at group level. • To the extent that there is a failure to recognise the significant levels of risk-diversification that firms achieve excessive capital will result. The sum of the individual-entity capital requirements is likely to total considerably more than the group requirement. • There will be a major and, in a group context, duplicative management burden, if each entity (or group of entities) is required to meet AMA standards in full.	The solution to this issue is to accept that banks calculate capital at group level and allocate per jurisdiction (using as far as possible a risk-sensitive allocation key). This general principle is very important as for operational risks.	The text should mention explicitely that the part of the Accord on operational risks applies at consolidated level.
677		Under pillar 2, an additional capital charge could be allocated to an AMA bank for operational risk. Under the assumption that a bank complies with AMA standards, there should be no ability for supervisors to require an additional allocation of capital for operational risk. The level of capital should be solely set by the approved AMA model under Pillar 1	It is a fundamental principle that Pillar 2 may not aim to improve Pillar 1. Moreover, set a cap (maximum) for the OR capital, which is set at the AMA model output under Pillar 1. This would also facilitate the incentive structure for moving to AMA.	Remove the mention of ‘operational risk’

Part 4. A: Third Pillar – Market Discipline / General Considerations (p154-155)

Part 4. B. 4. iv: Third Pillar – Market Discipline / Disclosure Requirements (p168)

Reference		**Analysis**		
Paragraph #	Associated reference	Issue Description	Proposed solution	Proposed change in the text
771 (table 3)		In the case of Operational Risk, the disclosure of the capital under Basic, Standardised and AMA seems superfluous and time consuming when a bank has selected for AMA. When disclosing AMA capital, the bank should not be forced to perform another calculation under the standardised approach and basic indicator approach	The disclosure should be limited to the main approach (BI, SA or AMA) selected by the bank when partially uses other approaches.	The text should mention it explicitely.

Annex 9: Simplified Standardised Approach (p206)

Reference		**Analysis**		
Paragraph #	Associated reference	Issue Description	Proposed solution	Proposed change in the text
	615	The alternative standardised approach opens the door for <u>regulatory arbitrage opportunities</u>. Has this new method been tested and well calibrated? What about the <u>level playing field</u>, as banks under different supervisions may be treated differently?	This is an important application case of the general principles of the level playing field and of the convergence in the prudential practices. Test as part of QIS 4, the calibration of the alternative standardised approach	

FINAL DRAFT BASEL ACCORD (CP3) : OBSERVATIONS OF THE ABB-BVB

ANNEX V : DETAILED OBSERVATIONS CONCERNING PILLAR 2

The Belgian Bankers' Association (Association belge des Banques – Belgische Vereniging van Banken, in short ABB-BVB) puts forward the following detailed observations concerning Pillar 2 in the "CP3" draft document.

The supervisory review process of the New Capital Accord is intended not only to ensure that banks have adequate capital for covering all the risks inherent in their business, but also to encourage banks in developing and using better risk management techniques for monitoring and managing their risks.

Pillar 2 is the big challenge for the coming years given a) the need for consistency in the implementation process across countries and b) the need for adequate human resources on behalf of all of the institutions falling under this regulation and on behalf of the supervisory authorities as well.

Positive aspects

- Increased profile for risk management and faster improvement of risk management practice in combination with investments in risk management systems and data infrastructure ;
- Better adjustment of risk, finance and strategy functions allowing for self-assessment as for Pillar 2.

Concerns

1. Application of consistent approach both within a country and across different countries in order to ensure a level playing field in competition.

1.1. National discretion holds a risk of inconsistency. As a consequence, regulatory arbitrage could become a common practice given the opportunities for delocalising activities.

Pillar 2 must be compulsory everywhere upon identical conditions, i.e. an entity in one country with a special risk profile should be treated in the same way as other entities with the same profile in other countries.

1.2. Pillar 2 must not weaken the intention of Pillar 1 : it is a complement to and not a substitute for Pillar 1.

It will be a challenge for the regulators to strike a suitable balance between i) flexibility, ii) consistency all through the implementation and iii) complexity, as the rules are applicable to all international entities; when there is no international standard however, the situation becomes very complex (e.g. it is not sure whether regulators will apply a multiplier [1]).

Therefore, **it is important to foster collaboration between the banks, the regulators and the trade-bodies, as well as between home and host country supervisors in order to protect the level playing field, and to ensure that a) home/host issues are resolved, b) the New Basel Accord will be applied on a cross-border level and c) there will be consistency across countries.**

1.3. Two-tier markets could appear : fragmentation of the market in such a way that "Advanced" banks serve specific customer groups, while riskier counterparties become the preserve of less sophisticated players.

1.4. Consolidation issues will crop up frequently : increased pressure on home and host country regulators to define their roles with respect to overall assessment of capital adequacy at group level and subsidiary level.

E.g. as for the operational risk, a balance must be struck between enabling each supervisor to fully satisfy its obligation to ensure the safety and soundness of the banks operating in its jurisdiction, and enabling a bank to implement its AMA across multiple jurisdictions. **The host country supervisors should be encouraged to cooperate with, and rely on, the home country supervisors for the verification of the conceptual soundness of the AMA methodology and the operational risk data used by the bank [2].**

2. Transparency and accountability : will supervisors publish in advance the criteria to be used for reviewing the banks' internal capital assessments, or will banks make their own judgment beforehand and be subject to reassessment by the supervisors afterwards ?

2.1. Pillar 2 clearly states that "If a supervisor chooses to set target or trigger ratios or to set categories of capital in excess of the regulatory minimum, factors that may be considered in doing so should be publicly available". There is an absolute need for transparency as for

the criteria on the basis of which the supervisors decide to make capital requirements more stringent. E.g. credit risk securitisation [3] and significance of risk transfer [4], weight of the reputation and strategy risks.

In order to make sure that identical objective and well-known rules will

[1] As for the operational risk, the application of such a multiplier would not be acceptable after the validation of an AMA model by the supervisors.

[2] Furthermore, the role of the host country supervisor should be limited to reviewing the integrity of AMA implementation in its jurisdiction instead of determining the conceptual soundness of the AMA itself.

[3] Pillar 2 clearly states that "where supervisors consider that a bank's approach is not adequate, they will take appropriate action". Again, what are the objective criteria for determining whether an approach is adequate or not ?

[4] Pillar 2 also states that "Regulators may have concerns about the degree of risk transferred, such as retaining or repurchasing significant amounts of risk or "cherry picking" the exposures to be transferred via a securitisation". How will the regulators determine the criteria ?

be applied to every entity, the ABB-BVB insists on the need for regulators to apply prudential practices and it fully supports the intention expresses by the Accord Implementation Group to publish more information about the capital requirements laid down by the regulators depending on the risk profile.

2.2. Pillar 2 does not imply a structural increase in comparison with Pillar 1 ; the Pillar 2 add-ons apply to individual risks only.

3. Adequacy of the supervisor's resources for taking on increased responsibility on a timely basis.

FINAL DRAFT BASEL ACCORD (CP3) : OBSERVATIONS OF THE ABB-BVB

ANNEX VI : DETAILED OBSERVATIONS ON PILLAR 3

The Belgian Bankers' Association (Association belge des Banques – Belgische Vereniging van Banken, in short ABB-BVB) puts forward the following detailed observations concerning Pillar 3 in the "CP3" draft document.

EVOLUTION

CP 3 meets some important concerns of the banking industry, since the disclosure requirements have been positively amended :

- The Committee recognizes the need for the disclosure framework to be aligned with international accounting standards. We understand this means that mandatory disclosures expressed by IAS will supersede the same requirements under Pillar 3 (cf. table 4 - p. 160).
- Pillar 3 applies only to the top consolidated level of the banking group. Disclosures for individual banks within the group would not be required in general (except for disclosures of Total and Tier 1 ratio) (cf. § 771 - p. 157).
- The disclosure requirements :
  - have been reduced, especially as for securitisation disclosures (table 9 - p. 166) ;
  - take into account the confidentiality (sensibility, proprietary information) of the disclosure. The disclosure of the bank's strategy for assessing the capital adequacy for example is no longer required (cf. table 3 - p. 159).

REMAINING ISSUES

- CP 3 still includes too much qualitative and quantitative disclosures on credit risks for portfolios subject to IRB approaches (cf. table 6 - p. 162).
  In our opinion :
  - technical information about PD, LGD, EAD should be made available only to the supervisory authorities ;
  - it is premature to disclose this kind of information from the outset. If required by the market, this information could be provided progressively after some time (cf. implementation date of Basel 2 + 3 years).

- The treatment of insurance subsidiaries is inconsistent :
  - deduction according to Pillar 1 (p. 2 - point D) ;
  - Pillar 3 requires identification of insurance subsidiaries which are not deducted (table 1- p. 158).

- "back" testing results of the credit risk model should be made available only to the regulators (under Pillar 2) (cf. table 6 f-) - p. 162)."

CP 3 – PILLAR 3 : LINE BY LINE COMMENTS

QL = qualitative disclosures; QT = quantitative disclosures

1.1 Scope of application

CP 3 – BASEL II (Table 1 – p157)	OUR STANDPOINT
QL : a. The name of the top corporate entity in the group to which the Basel Accord applies	Agreed
QL : b. An outline of differences in the basis of consolidation for accounting and regulatory purposes with a brief description of the entities within the group (a) that are fully consolidated ; (b) that are pro-rata consolidated ; (c) that are given a deduction treatment ; and (d) from which surplus capital is recognised plus (e) that are neither consolidated nor deducted (e.g. where the investment is risk weighted)	The scope of consolidation should be the same for regulatory reporting as for accounting purposes. Otherwise, it increases administrative costs and causes discrepancies in the disclosed "own funds".
QL : c. Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group	Agreed
QT : d. The aggregate amount of surplus capital of insurance subsidiaries (whether deducted or subjected to an alternative method) included in the capital of the consolidated group.	The treatment of insurance subsidiaries remain inconsistent: according to Pillar 1, these subsidiaries are to be deducted. On the other hand, Pillar 3 asks to identify the insurance rules which are not deducted.
QT : e. The aggregate amount of capital deficiencies in all subsidiaries not included in the consolidation.	Only <u>material</u> subsidiaries should be mentioned. Moreover we think it is the responsability of the supervisors to ascertain the undercapitalisation of financial institutions and it is not the bank's task to disclose such information.
QT : f. The aggregate amount (e.g. current book value) of the firm's total interest in insurance entities, which are risk weighted rather than deducted from capital or subjected to an alternative group-wide method, … . In addition, indicate the quantitative impact on regulatory capital of using this method versus deduction or alternate group-wide method.	Same remark as in d).

(*) If there is no remark, it means that disclosures is agreed.

1.2. *Capital structure*

CP 3 – BASEL II (Table 2 – p158)	OUR STANDPOINT
QL : a. Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments	Agreed
QT : b. The amount of tier 1 capital, with separate disclosure of: - paid-up share capital/common stock - reserves - minority interests in the equity of subsidiaries - innovative instruments - other capital instruments - surplus capital from insurance companies - goodwill and other amounts deducted from tier 1	Some of these informations are already disclosed in the financial statements.
QT : c. The total amount of tier 2 and 3 capital	Agreed
QT : d. Deductions from tier 1 and tier 2 capital	Agreed
QT : e. Total eligible capital	Agreed

1.3. Capital adequacy

CP 3 – BASEL II (Table 3 – p159)	OUR STANDPOINT
QL : a. A summary discussion of the bank's approach to assessing the adequacy of its capital to support current and future activities	This remains a sensitive information that banks are not willing to disclose.

QT : b. Capital requirements for credit risk :
- portfolios subject to STA or simplified standardised approaches
- portfolios subject to IRB approaches:
  - corporate, interbank, and sovereign
  - residential mortgages
  - qualifying revolving retail
  - other retail
- securitisation exposures
	Agreed

QT : c. Capital requirements for equity risk in the IRB approach :
- Equity portfolio subject to the market-based approaches;
  - Equity portfolio subject to simple risk weight method; and
  - Equities in the banking book under the internal models approach (for banks using IMA for banking book equity exposures)
- Equity portfolios subject to PD/LGD approaches
	Agreed

QT : d. Capital requirements for market risk : - STA - Internal models approach - Trading book	Agreed
QT : e. Capital requirements for operational risk: Basic indicator approach Standardised approach Advanced measurement approach	The Bank which has adopted AMA, should not be required to give the capital requirements for the BA or the STA
QT : f. Total and Tier 1 capital ratio: F or the top consolidated group F or significant bank subsidiaries (stand alone or sub-consolidated depending on how the Capital Accord is applied)	Agreed

1.4. General qualitative disclosures

CP 3 – BASEL II § 773 – p 160	OUR STANDPOINT
QL : a. for each risk area banks must describe their risk management objectives and policies including : - strategies and processes ; - structure and organisation of the relevant risk management function ; - scope and nature of risk reporting and/or measurement systems ; - policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges / mitigants	Agreed

1.5. Credit risk :general disclosures for all banks

CP 3 – BASEL II (Table 4 – p 160)	OUR STANDPOINT
QL : a. The general qualitative disclosures requirement (cf 1.4) with respect to credit risk, including: - Definition of past due and impaired (for accounting purposes) ; - Definition of approaches followed for specific and general allowances and statistical methods ; - Discussion of the bank's credit risk management policy ;	Agreed. But we insist on consistency between accounting and regulatory definitions, although this consistency is not yet reached, IAS rules being not yet finalized.
QT : b. Total gross credit risk exposures, plus average gross exposure over the period broken down by major types of credit exposure	We understand that mandatory disclosures expressed by IAS supersede the same requirements under Pillar 3. Otherwise, some general disclosures, such as geographic/industry/ counterparty distribution of exposures broken down by different types of credit exposures could cause an operational issue as some type of counterpart are specific to Basle 2 (e.g. SME identification based on the turnover).
QT : c. Geographic distribution of exposures, broken down in significant areas by major types of credit exposure	
QT : d. Industry / counterparty type distribution of exposures, broken down by major types of credit exposure	
QT : e. Residual contractual maturity breakdown of the whole portfolio, broken down by major types of credit exposure	
QT : f. By major industry or counterparty type: - Amount of past due/impaired loans; - Specific and general allowances; and - Charges for specific allowances and charge-offs during the period.	
QT : g. Amount of impaired loans and past due loans broken down by significant geographic areas including, if practical, the related amounts of specific and general allowances.	
QT : h. Reconciliation of changes in the allowances for loan impairment.	

1.6. Credit risk : disclosures for portfolios subject to the standardised and supervisory risk weights in the IRB approaches

CP 3 – BASEL II (Table 5 – p 161)	OUR STANDPOINT
QL : a. For portfolios under STA : - Names ECAI and ECA used, plus reasons for any changes ; - Types of exposures for which each agency is used ; - a description of the process used to transfer public issue ratings onto comparable assets in the banking book ; - the alignment of the alphanumerical scale of each agency used with risk buckets	Agreed
QT : b. - For exposures subject to the standardised approach, amount of a bank's outstandings (rated and unrated) in each risk bucket as well as those that are deducted; and - For exposures subject to the supervisory risk weights in IRB (HVCRE, any SL products subject to supervisory slotting criteria and equities under the simple risk weight method) amount of a bank's outstandings in each risk bucket.	Agreed

1.7. Credit risk : disclosures for portfolios subject to IRB approaches

<table>
<tr><th>CP 3 – BASEL II (Table 6 – p 162)</th><th>OUR STANDPOINT</th></tr>
<tr><td>QL : a. Supervisor’s acceptance of approach / supervisory approved transition</td><td>Agreed</td></tr>
<tr><td>QL : b. explanation and review of the :
- structure of internal rating system and relation between internal and external ratings
- use of internal estimates other than for IRB capital purposes
- process for managing and recognising Credit Risk Mitigation
- Control mechanisms for the rating system including discussion of independence, accountability and rating systems review.</td><td rowspan="3">A general comment is that Basel continues to ask the disclosure of too excessive and too detailed quantitative and qualitative information focused on credit risks.

In our view, the capacity of the market to understand these detailed prudential figures is clearly overestimated. There is a considerable risk of misinterpretation of data due to the increasing complexity of the disclosures required.

Therefore to publish complex information of a technical nature, such as Loss Given Default(LGD), Exposure at Default (EAD) of Probability of Default (PD) grades is excessive.

Moreover it is doubtful whether the market would make sufficient use of such information. There is of course no objection to provide this information to supervisors (under Pillar 2). However it would be premature to disclose this information from the outset. This information should be provided only after some time (i.e. implementation date of Basel 2 + 3 years).</td></tr>
<tr><td>QL : c. Description of the internal ratings process, provided separately for five distinct portolios:
- Corporate (including SMEs, specialised lending and purchased corporate receivables), sovereign and bank;
- Equities;
- Residential mortgage;
- Qualifying revolving retail, and
- Other retail.

The description should include, for each portfolio:
- The types of exposure included in the portfolio;
- The definitions, methods and data for estimation and validation of PD, and for portfolios subject to the IRBA, the LGD and/or EAD, including assumptions employed in the derivation of these variables; and
- Description of deviations as permitted under paragraph 418 and footnote 84 from the reference definition of default where determined to be material, including the broad segments of the portfolios affected by such deviations.</td></tr>
<tr><td>QT : d. Percentage of total credit exposures (drawn plus EAD on the undrawn) to which IRB approach disclosures relate.</td></tr>
</table>

QT : e. For each portfolio (as defined above) except retail: - Presentation of exposures (outstanding loans and EAD on undrawn commitments, outstanding equities) across a suficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk; - For banks on the IRB advanced approach, default-weighted average LGD (percentage) for each PD grade (as defined above); and - For banks on the IRB advanced approach, amount of undrawn commitments and default-weighted average EAD; For retail portfolios (as defined above), either: - Disclosures outlined above on a pool basis (i.e. same as for non-retail portfolios); or - Analysis of exposures on a pool basis (outstanding loans and EAD on commitments) against a sufficient number of EL grades to allow for a meaningful differentiation of credit risk.	Same remark
QT : f. Actual losses (e.g. charge-offs and specific provisions) in the preceding period for each portfolio (as defined above) and how this differs from past experience. A discussion of the factors that impacted on the loss experience in the preceding period – for example, has the bank experienced higher than average default rates, or higher than average LGDs and EADs.	Such information should be handled in Pillar 2. Approval from supervisor reflects the quality of the model and the back testing results.
QT : g. Banks' estimates against actual outcomes over a longer period. At a minimum, this should include information on estimates of losses against actual losses in each portfolio (as defined above) over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each portfolio. Where appropriate, banks should further decompose this to provide analysis of PD and, for banks on the advanced IRB approach, LGD and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.	Same remark

1.8 Equities : disclosures for banking book positions

CP 3 – BASEL II (Table 7 – p 165)	OUR STANDPOINT
QL : a. The general qualitative disclosure requirement (above) with respect to equity risk including : - Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons ; - Discussion of important policies covering the valuation and accounting of equity holdings in the banking book. The includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.	Agreed
QT : b. Value disclosed in the balance sheet and fair value of investments and, for quoted securities, comparisons to publicly quoted share values (where the share price is materially different from fair value)	Agreed
QT : c. The types and nature of investments, including the amount that can be classified as : - Publicly traded - Privately held	Agreed
QT : d. The cumulative realised gains (losses) arising from sales and liquidations in the reporting period.	Agreed
QT : e. Unrealised or latent revaluation gains (losses) included in Tier1 and/or Tier 2 capital.	Agreed
QT : f. Capital requirements broken down by appropriate equity groupings consistent with the bank's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition or grandfathering provisions regarding regulatory capital requirements.	Agreed

1.9 *Credit risk mitigation techniques: disclosures for standardised and IRB approaches*

CP 3 – BASEL II (Table 8 – p 166)	OUR STANDPOINT
QL : a. The general qualitative disclosure requirement (above) with respect to credit risk mitigation - policies and processes for, and an indication of the extent to which the bank makes use of, on- and off-balance sheet netting; - policies and processes for collateral valuation and management; - a description of the main types of collateral taken by the bank; - the main types of guarantor/credit derivative counterparty and their creditworthiness; and - information about (market or credit) risk concentrations within the mitigation taken.	Agreed
QT : b. For each separately disclosed credit risk portfolio under the standardised and/or foundation IRB approach, the total exposure (after netting) that is covered by: - eligible financial collateral; and - other eligible IRB collateral; before the application of haircuts.	Agreed
QT : c. For each separately disclosed portfolio under the standardised and/or IRB approach, the total exposure (after netting) that is covered by guarantees/credit derivatives.	Agreed

1.10 Securitisation : disclosure for standardised and IRB approaches

CP 3 – BASEL II (Table 9 – p 166)	OUR STANDPOINT
QL : a. The general qualitative disclosure requirement (above) with respect to securitisation, (including synthetics), including a discussion of : - the institution's objective in relation to securitisation. - The roles played by the bank in the securitisation process (e.g. originator, investor, servicer, provider of credit enhancement, sponsor of asset backed commercial paper facility, liquidity provider, swap provider, etc…) and an indication of the extent of the bank's involvement in each of them.	Agreed
QL : b. Summarise the bank's accounting policies for securitisation activities, including : - Whether the transactions are treated as sales or as financings; - Recognition of gain on sale; - Key assumptions for valuing retained interests; - Treatment of synthetic securitisations if this is not covered by other accounting policies (e.g. on derivatives)	These disclosures should be in conformity with IAS which should prevale on Basel 2 requirements.
QT : c. Names of ECAIS used for securitisations and the types of securitisation exposure for which each agency is used.	Agreed
QT : d. The total outstanding exposures securitised by the bank and subject to the securitisation framework (broken down into traditional/synthetic), by exposure type.	
QT : e. For exposures securitised by the bank and subject to the securitisation framework: - Amount of impaired/past due assets securitised; and - Losses recognised by the bank during the current period Broken down by exposure type.	
QT : f. Aggregate amount of securitisation exposures retained or purchased broken down by exposure type.	These breakdown should not be required, as the prospectus and investment reports normally contain them already.
QT : g. Aggregate amount of securitisation exposures retained or purchased broken down into a meaningful number of risk weight bands. Exposures that have been deducted should be disclosed separately.	
QT : h. Aggregate outstanding amount of securitised revolving exposures segregated by originator's interest and investors' interest.	
QT : i. Summary of current year's securitisation activity, including the amount of exposures securitised (by exposure type), and recognised gain or loss on sale by asset type.	

1.11 Market risk
Disclosures for banks using the standardised approach

CP 3 – BASEL II (Table 10 – p 167)	OUR STANDPOINT
QL : a. The general qualitative disclosure requirement (above) for market risk including the portfolios covered by the standardised approach	Agreed
QT : b. The capital requirements for: - interest rate risk - equity position risk - foreign exchange risk - commodity risk	Agreed

1.12 Market risk
Disclosures for banks using the IMA for trading portfolios

CP 3 – BASEL II (Table 11 – p 168)	OUR STANDPOINT
QL : a. The general qualitative disclosure requirement (above) for market risk including the portfolios covered by the IMA	Agreed
QL : b. For each portfolio covered by the IMA: - the characteristics of the models used - a description of stress testing applied to the portfolio - a description of the approach used for backtesting/validating the accuracy and consistency of the internal models and modelling processes	These disclosure should only be relevant for regulators (under Pillar 2) and not to be disclosed
QL : c. The scope of acceptance by the supervisor	
QT : d. For trading portfolios under the IMA: - The aggregate value-at-risk (VaR) - The high, median and low VaR values over the reporting period and period-end - A comparison of VaR estimates with actual outcomes, with analysis of important “outliers” in backtest results	Agreed

1.13 Operational risk

CP 3 – BASEL II (Table 12 – p 168)	OUR STANDPOINT
QL : a. In addition to the general qualitative disclosure requirement (above), the approach(es) for operational risk capital assessment for which the bank qualifies.	Agreed
QL : b. Description of the advanced measurement approach, if used by the bank, including a discussion of relevant internal and external factors considered in the bank's measurement approach. In the case of partial use, the scope and coverage of the different approaches used.	Agreed "Light" version compared to the previous one (instead of "a discussion of important driving factors")
QT : c. For banks using the AMA, the operational risk capital charge before and after any reduction in capital resulting from the use of insurance.	Agreed

1.14 Interest rate risk in the Banking Book (IRRBB)

CP 3 – BASEL II (Table 13 – p 168)	OUR STANDPOINT
QL : a. The general qualitative disclosure requirement (above), including the nature of IRRBB and key assumptions, including assumptions regarding loan prepayments and behaviour of non-maturity deposits, and frequency of IRRBB measurement.	Agreed
QT : b. The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring IRRBB, broken down by currency (as relevant).	This information required under Pillar 2 should be restricted to the regulators (reveal the risk position of the bank).