COUNCIL *of* MORTGAGE LENDERS

Basel Committee on Banking Supervision

Response by the Council of Mortgage Lenders

To the New Basel Capital Accord Third Consultative Document

31 July 2003

Introduction

1. The Council of Mortgage Lenders welcomes this opportunity to comment on the third consultative document. The United Kingdom's mortgage industry has a well-deserved reputation for being both innovative and highly competitive. It is important that the New Accord does nothing to damage that. To put this in perspective, the UK has the second largest mortgage market in Europe and the third largest market in the world.

2. The Council of Mortgage Lenders is the representative trade body for the residential mortgage lending industry in the UK. Its 144 members currently hold over 98% of the assets of the UK mortgage market. CML members lend for owner-occupation, to the private rented sector and for new-build, repair and improvement to social housing.

3. The CML welcomes the changes introduced in the Third Consultative Document. Overall, the industry has welcomed the broad structure and direction of the New Accord. The move to a 35% weight for the revised standardised approach was seen by smaller UK lenders as being particularly helpful with respect to the competitive position with IRB based lenders.

4. The CML has already contributed to the European Mortgage Federation's response on the New Accord and which we endorse.

The Response

5. In this brief response our aim is to highlight key **concerns** from the UK mortgage lending industry perspective.

6. The New Accord as drafted remains complex and onerous to apply at the IRB level. This will act to deter some lenders from migrating from the revised standardised approach to IRB. The most obvious example of this relates to segmentation of the retail loan book. Crudely, the more segments required the bigger the loan book must be to achieve statistical significance for each pool. The guidance given in paragraphs 363 – 371 would suggest a large number of pools and indeed a single pool containing a large concentration of the book is specifically prohibited. There has to be a sensible trade off between setting up a more risk sensitive framework and encouraging lenders to migrate to IRB status. The requirements for retail lending as set down will be too onerous for some UK lenders. It is suggested that national regulators should have the discretion to accept a smaller number of segments than the minimum implied, where this can be clearly justified.

7. These concerns are compounded by the detailed requirements set down in the paper, for example, on the assessment horizon for ratings of borrowers. Lenders are instructed to use a longer and conservative time horizon that the one year used in PD estimation. Although credit scoring at the time of application is widespread in the UK, behavioural modelling over the life of a loan is less well developed. It would be helpful to have more detailed guidance on how this requirement might be implemented.

8. Notwithstanding these concerns, it is important that the New Accord as drafted continues to offer sufficient discretion to national regulators to allow for sensible adjustments across a very diverse range of markets, products and circumstances. The Basel Committee has a difficult task here because equally UK lenders expect the New Accord to be applied with a reasonable degree of 'high level' rigour to ensure a level playing field globally. The tenor of current debates in the USA would, for example, suggest this might not be achieved everywhere.

9. The Basel Committee have sensibly recognised that there should be flexibility in the application of IRB across asset classes. Phased roll out is to be allowed within the same business unit or in the case of retail sub class. It is noted that once a lender has adopted an IRB approach it is expected to maintain that except in 'extraordinary' circumstances. This further re-inforces the points made in (1) and the need to give more help to lenders migrating between approaches, and in particular to lenders primarily concerned with retail lending (for whom there is only an advanced approach).

10. Members have expressed concern that the guidance on operational risk is far from clear. They have highlighted paragraphs 615, 621 and 624 as requiring clarification and amplification. These include the ways regulators might impose the alternative standardised approach, how and why an initial period of monitoring will be applied in practice for the standardised approach, the extent of national regulator discretion and again how and why incentivisation techniques might be applied.

11. It would be helpful if the same standards regarding the definition of residential/retail loans were applied across the New Accord in both approaches (also with regard to days due in default). Differing definitions will confuse and complicate movement between approaches.

12. There remain concerns that lending to 'social housing' ie, low cost rental housing in the UK that is part grant aided by government in terms of construction costs and where the state meets the rental charges of tenants unable to pay may be disadvantaged by the New Accord. As corporate lending, the capital charges under the foundation approach may well be higher than those under the revised standardised approach. This may have the effect that lenders will need to increase the price of their lending to the non profit, government regulated bodies that supply and manage this housing. This would be unhelpful and is clearly an unintended consequence of the New Accord that requires attention. National regulators do not have the discretion to deal with this and there is a case for giving them clear additional powers to deal with lending to non-profit housing entities that are state subsidised and regulated to provide low cost homes.

13. Finally, the CML has been actively engaged with the development and promotion of Islamic compliant mortgages in the UK. It is important that the treatment of such mortgages in the New Accord does not disadvantage these structures relative to mainstream UK mortgage products. Murabaha structures already attract a 50% weighting under Basel 1 and will presumably move forward to lower weightings under the New Accord. The current position of Ijara loans is less favourable at 100% and it is important this is considered, ideally with them receiving the same residential/retail treatment as Murabaha.

Contact

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