



Basel Committee Secretariat
Basel Committee on Banking Supervision
Bank of International Settlements
CH-4002 Basel
Switzerland.

By email to BCBS.Capital@bis.org

30 July, 2003

Dear Sir

Response to the third consultative paper (CP3) on the New Basel Capital Accord (Basel II).

In May 2001, the IVSC responded to the previous consultation on Basel II. Before commenting on the third consultative paper, we would like to take the opportunity to briefly update the Committee on the development of the International Valuation Standards.

Development of International Valuation Standards

In June of this year, the 6th edition of the International Valuation Standards (2003) was published. The new edition can be freely viewed on the IVSC web page (www.ivsc.org) in accordance with the IVSC commitment to ensure that all valuers, particularly from emerging and developing economies, have access to the standards.

With the publication of the 6th edition (the most comprehensive to date) the outright adoption or convergence with the IVS is rapidly gathering pace. For example

- The South African Institute of Valuers is to reproduce IVS 2003 in its 2003 Members' Handbook as national standards
- The Slovenia Institute of Auditors is to translate and reproduce IVS 2003 again as national standards
- Russia, Poland, Latvia are just some of the countries who have sought permission to translate IVS 2003 to assist in convergence
- The Royal Institution of Chartered Surveyors has adopted the key standards and applications from IVS 2003 in the new (2003) edition of the Appraisal and Valuation Manual
- Australia and New Zealand are to adopt and reproduce key standards and applications from IVS 2003 as national standards in the 2003 Professional Practice Manual

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In early July, representatives from the IVSC member institute representing the USA – the Appraisal Institute – were able to introduce the 2003 edition of the International Valuation Standards to participants at a seminar on the Valuation of Real Estate held in Basel by the Financial Stability Institute.

IVSC Comments on the Third Consultative Paper (CP 3)

The IVSC raised a number of issues in our previous letter and we welcome the fact that many have been addressed. Principally these have been a clarification in the term and usage of Commercial Real Estate, a clearer recognition of Income Producing Real Estate, and a refinement of the Exceptional Treatment.

However, in that letter we called on the Basel Committee to adopt the definition of Market Value together with the supporting material promoted by the IVSC. We are disappointed to note on page 91, paragraph 472, use of the term “objective market value of collateral” alongside its own definition.

The IVSC definition is widely accepted throughout the real estate valuation world and is reproduced in many national standards.

Paragraph 472 requires a “qualified professional” to value property when information indicates that the value of the collateral may have declined materially...” In most countries, a “qualified” professional valuer will be a member of a national valuation institute that is a member of the IVSC and that has adopted the IVSC definition of Market Value. In a world that is striving for greater commonality and understanding of definitions, it seems extraordinary for the Basel Committee to introduce a new term and definition in preference to one that has wide global understanding and acceptance.

Although the Basel II requirements relate to capital adequacy, they should not conflict with the broader accounting disclosure standards. Indeed at para 762 page 155, there is a commitment “to maintain an ongoing relationship with the accounting authorities and monitor developments in this area *to promote consistency between disclosure frameworks.*” The IVSC would contend that the introduction of the term ‘objective market value’ militates against such consistency.

The IVS are gaining increasing recognition as necessary to the consistent and rigorous application of the International Financial Reporting Standards (previously International Accounting Standards). International Accounting Standard, IAS16, *Property, Plant and Equipment* states “*The fair value of land and buildings is usually its market value. This value is determined by appraisal normally undertaken by professionally qualified valuers.*” The IVSC was represented on the steering committee that developed the more recent IAS 40, *Investment Property*. This Standard gives more detailed guidance on determining

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'Fair Value'. In the Basis for Conclusions published with IAS 40, it was acknowledged that the IASB's concept of Fair Value is similar to the IVSC concept of Market Value and that the Board believes that the guidance on Fair Value in IAS 40 is, "*in substance, and largely in wording as well, identical with the guidance in IVS 1*".

The IVSC would therefore urge the BCBS to reconsider the use of "*Objective Market Value*" and the accompanying wording in Basel II, in favour of the international definition of Market Value in International Valuation Standards.

Conclusion

In our previous letter we drew attention to the IMF Staff Comments on the Proposals of the Basel Committee for a New Capital Adequacy Framework (24 February 2000) in which it was stated that "*without proper rules on asset valuation any capital adequacy assessment is bound to be misleading*" and the paper called for rapid progress to provide guidance or standards for asset valuation."

A similar sentiment was expressed in a more recent paper (Sept 23 2002) prepared by staff of World Bank and IMF. The paper reviewed Fund/Bank experience in conducting Basel Core Principles (BCP) assessments but also taking into account the pending revision of the Capital Accord.

One of the key reform themes emerging from the review was that "*Guidance on good practices in loan classification and provisioning is urgently needed.... Without more accurate asset valuation and provisioning, profitability, capital and capital adequacy figures are seriously flawed.*" The paper called for the development of more precise guidelines on collateral valuation.

Recognition by the Basel Committee of the International Valuation Standards would not only strengthen the provisions of the Capital Accord but would also strengthen the ability of valuation standard setters to develop and further improve their standards and gain wider global recognition and adherence.

Yours sincerely,



John Edge
Chairman, International Valuation Standards Committee