July 31, 2003
The Norinchukin Bank

The Third Consultative Paper for Commercial Banks Released by The Basel Committee on Banking Supervision (Comment)

First, we would like to express our gratitude to the Committee for the continuous efforts which have been made to formulate fair and appropriate contents of the requirements for new regulations through deliberations with industry. Also, we would like to thank the committee for providing us with this opportunity to voice our opinions.

1. Overview

In the new regulatory plans, detailed and in-depth requirements have been established in the overall plan. Therefore, it is envisioned that some irregularities will emerge in actual implementation. In addition, the results from QIS3 indicate that the calculation results of minimum capital requirements contain certain deviations, some of which may need revision in the future. This is unavoidable because, in order to calculate the required capital that better corresponds to risks, compared to current regulations, a more in-depth framework has been designed. However, we request that further flexible measures be carried out continuously to enable "fine-tuning".

2. The First Pillar

(1) The Internal Rating-Based Approach for credit risks

Since internal ratings serve as a basis for the management of credit risk portfolios as well as a starting point for the framework for risk-sensitive capital regulations, it is understandable that stricter operations are required when allocating ratings. However, to some extent, it appears that this has been excessively carried out. These requirements should simply be developed as items and a flexible scheme that can be used to evaluate actual measures in the operation of bank methodologies is necessary.

First, multiple stress tests are required not only in allocating internal ratings but also in the second pillar. Besides, the objectives and purposes for each test are not clearly described therein. Stress testing may be one effective tool to deal with pro-cyclicality. However, we feel that this requirement can be adequately met in the second pillar. Second, the expression for calculating risk-weights, which uses default probabilities that are a basis to classify the grades for internal ratings, is based on considerably conservative assumptions. This indicates that an establishment of rigorous stress tests tends to be more superfluous. Third, doubts remain as to whether credit risk portfolio-management by internal rating systems derived from such excessively strict criteria will be practical. From this viewpoint, it cannot be denied that there is a possibility that double standards in actual management and the calculation of regulatory capital will be imposed.

(2) **Securitisation**

There is an aim to switch to a more risk-sensitive system to improve areas where securitisation risks are not properly covered in the current regulations. We believe this approach is adequate from the viewpoint of securing sound bank business. However, this still lacks consistency when compared with other asset classes. Specifically, from actual transactional aspects, the following points should be improved.

- In The Rating-Based Approach, the risk weight needs to be reduced because the risk weight criteria that are allocated in the non-investment grade (BB+ or below) greatly differ from those for corporate business credits.

- In The Rating-Based Approach, private ratings are treated as ineligible. In Japan, however, there still remains an environment to prevent the external disclosure of securitisation activities and, hence, a considerable number of securitisation transaction with private ratings exist. If private ratings remain ineligible, the development of markets, which is beginning to serve as a core function of "indirect financing" at a financial system in Japan, may be hindered. Those private ratings where formal evidence has been given by eligible External Credit Assessment Institutions should also be made eligible.

- With regard to capital assessment to liquidity facilities, parameters are established based on credit risks for the security pool, regardless of the fact that the risk contents originally incurred are not credit related. We think this treatment is excessive and review based on the location of risks is needed.

3. The Second Pillar

In the supervisory review process, the adequacy of capital, including risks that are not fully covered by the first pillar, will be evaluated in accordance with risk profiles of each bank. Evaluation results will be utilized for internal management, the direction bank risk management should be moving in.

To realize the above, it is important that each bank performs risk assessment based on the contents of their portfolios and ALM structure, and develops individual management methods that comply with both management and operational strategies. It is also important for regulations by the supervisory authorities to be compatible with such internal management methods. The double standard of the capital adequacy regulations, where the second pillar becomes a mere compliance requirement whose criteria are different from the first pillar, must be avoided. <u>This is an important task that needs to be addressed continuously over time for more sophisticated development</u> through unremitting inventive and original approaches.

Furthermore, bank risks vary in each country or region depending on financial practices, business characteristics in financial institutions, and roles in financial systems. After taking the above factors into account, even if basic financial techniques are the same, it is inevitable that differences will arise due to the individual evaluation and management methods each bank uses for assessing the adequacy of capital. Even today, the promotion of sophisticated management methods in each country using so-called economic capital in internal management has been examined. When compared globally, however, these methodologies and their utilization methods differ significantly.

Taking the above into account, it is desirable that supervisory authorities implement the second pillar after due consideration of the above individual aspects and situations in each country. In addition, it is desirable that the second pillar be implemented over time with a consensus of all parties. Also, if necessary, a trial period longer than that of the first pillar should be considered.

In addition, the transparency of the supervisory review by financial authorities is required in the second pillar. However, in order to avoid possible misunderstandings and/or confusion that may cause "market failures" when disclosing evaluation and management methods the authority used for markets, it is important to set aside more time to promote an appropriate understanding within relevant market.

4. The Third Pillar

With regard to disclosure information outlined as a requirement, in comparison with the second consultative paper, we respect that this has been considerably narrowed down from a standpoint of bolstering appropriate market discipline. However, over-detailed areas still remain. This needs to be further simplified while taking into account the consistency with international accounting standards.

In addition, the following points need to be addressed:

- With regard to confidentiality, limited exemption measures are stipulated for exceptional cases. However, in the "proprietary and confidential information" targeted therein, types of information that encompass proprietary values will be likely to change in accordance with various situations, including the trends of financial markets. For this reason, more flexible measures are required in actual operations.