

July 31, 2003

Rating and Investment Information Inc.
3-8-1 Nihonbashi-Ningyocho
Tokyo 103-0013 (JAPAN)

Comment on the Third Consultative Paper (CP3) of the New Basel Capital Accord (Basel 2)

Rating and Investment Information, Inc. (R&I) appreciates the opportunity to make a comment on CP3 of Basel 2 issued by the Basel Committee on Banking Supervision (the Basel Committee) in April 2003.

1. Exemption from use of assessments by external credit assessment institutions (ECAIs) in determining the risk weights for corporate claims in the Standardized Approach (Para 42)

(1) R&I supports the Basel Committee's principle of adopting the market best practices as a base for the regulatory capital adequacy framework and increasing the Basel 2's risk sensitivity compared to the current Capital Accord in order to encourage ongoing improvements of the banks' risk management capabilities.

(2) However, Paragraph 42 permits banks to risk weight all corporate claims at 100% without regard to external ratings in the standardized approach, while the banks should obtain supervisory approval. R&I believes that this treatment is not consistent with the basic principle of CP3, "risk sensitive minimum capital requirements" and widens a gap with the Foundation Internal Ratings-Based (IRB) Approach.

(3) While R&I believes that the provisions of this paragraph will not be applied to seek "cherry-picking" nor regulatory arbitrage, we recommend that the Basel Committee writes a guideline for the use of external ratings that, if conditions permitted in each country, national supervisory authority should require banks to use external ratings.

2. Mapping process of ECAI rating in standardized approach (Para 62 to 65 and Annex 2)

(1) When national supervisors compare the default rate by the ECAI rating in mapping process with the Reference cumulative default rate (CDR) and Benchmark CDR, we demand that the Basel Committee provides guidance for supervisors to stipulate more clearly the considerations for the size of samples used in calculation of default rate for each rating, and the differences in the definitions of default.

(2) Meanwhile, R&I publishes annually the broad-definition default ratio (*1) as an indicator of de facto insolvency of debts rated by R&I. The broad-definition default ratio is calculated based on the time series data for the 25-year period from fiscal 1978 to fiscal 2002, and the number of Japanese companies covered with this survey stands at 1,250. In June 2003, R&I also disclosed the transitional rating matrix of three-year periods for asset-backed securities, as the securitization market has been substantially developing since 1996.

3. Interpretation for "Restructuring" (Paragraph 162, footnotes 47)

(1) In response to the inclusion of the "restructuring" as the credit events in the requirements for mitigating credit risks, R&I demanded, in its previous "Comment on Second Working Paper on Securitization" (dated December 16, 2002), that the issue be reexamined in consideration of the views of market players and accepted market practices.

(2) R&I views the interpretation for restructuring prescribed in CP3 as appropriate, since the provision has been developed in consideration of market views and improved from the interpretation mentioned in the Working Paper above.

(3) Meanwhile, R&I believes that with regard to the data on the incidence of restructuring versus default in the footnote 47 demanded by the Basel Committee, the broad-definition default ratio (*1) published by R&I could serve as reference data for the purpose.

4. Definition of loans to small businesses classified as retail exposures in the IRB Approach (Paragraph 199-200)

(1) R&I considers that the definition of loans to small businesses classified as retail exposure in the IRB Approach are still unclear.

(2) We understand that the small business markets largely differ from each other country and it is difficult for the Basel Committee to present common criteria.

(3) It is our understanding that the descriptions of the paragraphs in CP3 have been based on practices of U.S. small business loan market. R&I believes that the direct application of the provisions to other countries which may have different financial market practices is impractical.

(4) Consequently, R&I recommends that the Basel Committee encourages national supervisory authorities to publish guidelines consistent with their countries' small business markets as early as practical.

5. Non-acceptance of non-published rating (Paragraph 525 (b))

(1) R&I basically considers it desirable to publish all the ratings issued by R&I. However, in fact there are many unpublished ratings in the Japanese securitization market. Historically, Japanese financial market has been developed along with bilateral bank loans, therefore few individual financial transactions have inherently been published. Taking into consideration the prevailing conventions in the Japanese financial market, one idea is to leave a scope for treating non-published and published ratings equally at national discretion until the market accepts the published ratings as a natural course of business. As a preliminary matter, R&I never differentiates published ratings from non-published rating in the rating decision process, in its results nor its follow up monitoring. Publishing or non-publishing is dependent on the intention of the issuer or arranger (hereinafter referred to as the "applicant for rating").

(2) Additionally, the supervisory authorities may confirm non-published ratings. In fact, R&I has delivered the "Rating Certificate" upon the request of the applicant for rating, and the supervisors are easy to obtain the rating at the time of examination through the applicant.

(*1) The events for broad-definition default included the failure to repay the corporate bonds or statutory bankruptcy, as well as restructuring events such as forgiveness of debts. The review of the particulars may be considered a reference data. Please see the Report on Published Ratings (ver. June 2003) for the latest data.

<http://www.r-i.co.jp/jpn/release/200306/j03-a-028.pdf> (Japanese)

<http://www.r-i.co.jp/eng/release/200306/e03-a-028.pdf> (English)