THE NEW BASEL CAPITAL ACCORD – CONSULATATIVE DOCUMENT (CP3)

COMMENTS FROM TANZANIA

The following are some of the concerns raised on the document: -

Company Turnover Threshold

There is great concern on the turnover definition of Small and Medium Enterprises (SME). The argument is that the definition takes no consideration of the differences in the level of economic development in different countries. The threshold has been set at levels much higher than a majority of the companies operating in the Tanzanian market and markets of similar size. It is suggested that the supervisor locally define the threshold.

Reference to Rating Agencies' Scores

There are currently no rating agencies in Tanzania and most likely many other countries of similar level of development. Even in the event that such an agency is formed, it is unlikely that such an agency will within reasonable period of time, gain the necessary international recognition for its ratings. The implication of this is that all the companies would consequently receive a more stringent risk weighting of UNRATED. This will definitely not be reflective of the true risk position of the market. Due consideration should be given to developing economies on the possibility of relaxing risk weights for un-rated companies which may [in the local supervisor's opinion] be considered to deserve a lower rating.

Frequency of Valuations of Collateral

The proposal of annual assessment of collateral is considered too high a frequency, which may unnecessarily increase borrowing costs. A frequency of 3-4 years would be considered ideal.

Options on the choice of the model to use

The Accord is considered prejudicial to smaller banks, which will be forced to conform to the Standardized models that have much more stringent requirements. The question of increased compliance costs is also of much concern to such banks. The Committee should precisely state whether there would be any option out of adoption of the New Accord for such banks.

Cross boarder implementation

We understand that the Committee is working on cross border issue of the implementation of the Accord. However, the following concerns could be usefully taken into account in the process of policy formulation.

Firstly, is the issue of increased compliance cost resulting from adoption of different approaches by different entities of the same banking group. This would arise from a need to run parallel systems in order to satisfy the differing needs of lead and local supervisors.

Secondly, it carries a corollary that banking groups' total capital would be the sum of the higher of home and host supervisory requirements throughout their geographical spread rather than an objective assessment of their capital needs on a consistent basis. These could lead to a conclusion that businesses in smaller, emerging economies were not worthwhile, discouraging competition and the spread of best practice to such regions.

Fluctuations around thresholds

CP3 specifies a number of monetary thresholds that demarcates different classifications or treatments. No provision has however been made to cater for inflation or exchange rate movements that may force a company to fluctuate above and below the threshold. Similar considerations apply to portfolios where the overwhelming majority of the constituents fall on one side of a threshold but a small proportion fall on the other. For example a bank would normally treat a small borrower under a retail credit process whereas it may not have access to accounts of other companies in the same group, which would otherwise lead to a different classification.

Allowing a small level of exceptions such as percentage variance could substantially alleviate the problems. For example portfolios may be regarded as qualifying for a particular treatment provided at least 95% of their constituent parts meet the criteria.

Maturities

Problems similar to the ones identified in the preceding paragraph in defining cut-offs. It is suggested that maturity cut-offs relating to for example a period of 'three months' should always be expressed as being inclusive of exposures of exactly that maturity and not end one day short of it. eg paragraph 291'... original maturity of less than three months' could better be defined by '....original maturity of three months or less'

Conservatism

The Committee has not been willing to recognise bank's own credit risk models though the calibration of the IRB approaches in the New Accord has been based on the application of a simplified form of credit model. Apparently, this model, like most statistical models of risk, uses estimates of mean and variance to produce the required level of capital to cover tail risk. It is of concern that some aspects of the minimum requirements will result in banks being forced to bias their inputs away from the true mean and towards a 'stressed' estimate. Whilst there may be a place for stress testing within a bank's overall risk management, using stressed inputs to a model calibrated on a non-stressed basis will result in vastly over-stated capital requirements. The inputs should represent a bank's best estimate of normal circumstances.

An example of this is found in para 430. Whereas the use of default-weighted average LGD is agreeable, no relevance exists for the use of the additional requirement that 'the bank must use LGD estimates that are appropriate for an economic downturn'. As most defaults occur in periods of economic downturn, a bank's average recovery experience will automatically be weighted towards such periods and to require a yet more extreme 'worst case' calculation makes the calculation unreasonably conservative. The same applies to the requirement of EAD to be appropriate for an economic downturn, contained under paragraph 437.

Recognition of Credit Risk Mitigation

The New Basel Capital Accord allows for recognition of financial collateral. The majority of exposures in the Tanzanian economy are secured by non-financial collateral. It is suggested that there should be a national discretion to lower the A- boundary for recognition of credit mitigation if there is to be any effects in the lending book.