Appendix I

Overview of Technical Issues Resolved

Parallel running and capital floors

Parallel running for banks adopting the foundation internal ratings-based (IRB) approach to credit risk will apply for one year during 2006.

Banks moving directly from the existing framework to the advanced approaches to credit and operational risk will have two years of parallel running/impact studies during 2006 and 2007.

The floors on both foundation and advanced approaches in 2008 and 2009 would be 90% and 80%, respectively. Foundation IRB banks will apply a floor of 95% in 2007.

Treatment of revolving retail exposures

At its May meeting, the Basel Committee on Banking Supervision specified its treatment for consumer credit cards and other revolving retail exposures. The mechanics of the treatment, which will be incorporated into the Committee's mid-year 2004 text, are outlined below.

- The required capital charges for qualifying revolving retail exposures (QRRE) will be aligned to the results of recent empirical studies. The asset correlation for QRRE will be fixed at 4%, rather than requiring that correlation varies with the probability of default, as specified in the third consultative paper issued in April 2003.

- With regard to securitised portfolios of QRRE, the capital framework will reflect more closely the economics of such transactions. Undrawn credit lines related to securitised exposures are allocated between the seller's and investor's interests. The seller's share of undrawn lines related to securitisation exposures will be included in the internal ratings-based (IRB) approach to credit risk, while the investors' share of undrawn lines related to such exposures will be addressed through a revised set of credit conversion factors (CCF) under both the IRB and standardised securitisation treatments of early amortisation provisions. The revised CCFs for non-controlled early amortisation provisions are provided below. Modest changes are similarly being made to the CCFs for controlled early amortisation provisions.

Non-controlled early amortisation features for uncommitted retail exposures

Excess spread	**Credit Conversion Factor (CCF)**
133.33% of trapping point or more	0% CCF
less than 133.33% to 100% of trapping point	5% CCF
less than 100% to 75% of trapping point	15% CCF
less than 75% to 50% of trapping point	50% CCF
less than 50% of trapping point	100% CCF

Required measures for loss-given-default

Another agreement reached today addresses the potential for loss rates to be higher than average when borrowers default during an economic downturn. This issue was described in the Committee's third consultative paper published in April 2003, which requested banks adopting the AIRB approach to take this potential risk into account in assigning LGDs, particularly for exposures where it would make a material difference. Subsequent discussions with industry participants have indicated both that the importance of this issue varies across exposure types and that individual banks do not have highly-developed approaches to assess this risk.

The Committee believes that its framework should retain the concept of a single assigned LGD that should reflect "economic downturn" conditions where necessary to capture the relevant risk. The Committee considers that one possibility would be for banks' internal LGD processes to focus on assessing an expected LGD, while seeking to develop a broad consensus on how to achieve appropriate "economic downturn" LGDs for the various exposure categories. In this regard, it will be highly desirable to obtain additional industry input and dialogue on the approaches that can be used to ensure appropriate "economic downturn" LGDs are applied where necessary.

The calibration of Basel II

The Committee believes it is important to reiterate its objectives regarding the overall level of minimum capital requirements. These are to broadly maintain the aggregate level of such requirements, while also providing incentives to adopt the more advanced risk-sensitive approaches of the new framework. The Committee has confirmed the need to further review the calibration of the new framework prior to its implementation. Should the information available at the time of such review reveal that the Committee's objectives on overall capital would not be achieved, the Committee is prepared to take actions necessary to address the situation. In particular, and consistent with the principle that such actions should be separated from the design of the framework itself, this would entail the application of a single scaling factor - which could be either greater than or less than one - to the results of the new framework. The current best estimate of the scaling factor using QIS 3 data adjusted for the EL-UL decisions is 1.06. The final determination of any scaling factor will be based on the parallel running results, which will reflect all of the elements of the framework to be implemented.