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COMPTROLLER HAWKE OUTLINES PROMISING APPROACHES TO INTERNATIONAL CAPITAL STANDARDS

WASHINGTON -- Comptroller of the Currency John D. Hawke, Jr. said today that a new approach is needed to the international capital framework and credited the recent consultative paper by the Basel Committee as a first step in the right direction. In a speech to attendees at the International Monetary Conference in Philadelphia, the Comptroller encouraged bankers to comment on the Committee's recently issued consultative paper.

Mr. Hawke outlined significant revisions in the consultative paper, and in particular cited the more forward-looking ideas, use of internal bank ratings and credit risk modeling, as the most promising. "But given the current state of the art of these methodologies," Comptroller Hawke said, "it is questionable whether they will be feasible in the near term."

The internal bank rating approach relies on ratings that banks themselves assign to the risk of credit loss. He said a major challenge to this approach is the lack of consistency among banks in assigning the risk ratings. An example cited by Comptroller Hawke is institutions that define the credit risk attributable to "default" as the probability that a loan will go bad, compared to other institutions that go further and derive a loss figure from a credit that may become a problem.

The other approach, portfolio credit risk modeling, goes a step further than internal modeling by applying sophisticated portfolio modeling techniques to credit risk. The challenges to overcome with this approach are the inability to validate models and the lack of adequate data for building the models. The Comptroller said it will be a number of years before portfolio credit risk models can be used reliably.

Mr. Hawke cited two other important elements that were proposed in the recent Basel consultative paper, market discipline and supervisory review of capital adequacy. Market discipline through improved transparency of bank risk rewards banks that manage risk effectively and penalizes banks with less prudent risk management. Supervisory review enhances the role of bank supervisors in assessing credit risk.

"The OCC has long believed that supervisory review and market discipline are important elements in the review of capital adequacy," said Comptroller Hawke. "However, this is not a view that is held consistently around the world." This underscores the importance of bankers' comments on the Basel consultative paper to revise the capital standards.

Comments are due to the Basel Committee by March 31, 2000.
The paper can be obtained from the Internet site of the Bank for International Settlements at www.bis.org.

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