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ABSTRACT

This research proposes to set in three-step procedure markup-based credit-risk weights for short-term loan commitments. The first step option-prices under the “true” Martingale restriction the credit risk of short commitments and determines their duration-dependent funding proportion. By combining these factors, the second one computes the ‘fair’ capital charge corresponding to the commitment ‘true’ credit risk; a charge that is then compared to the accounting-based ones computed with the Basel-1 and Basel-2 credit-conversion and principal-risk factors. The fair-value procedure has the advantage that: (i) no-arbitrage commitment put values impose some quasi-market discipline, and (ii) aligned regulatory and economic capital requirements are likely to prevent any regulatory arbitrage. The last step finally proposes a new two-dimensional risk-weighting system, which accounts for the borrower’s rating ranges of public credit agencies.