

**Discussion of the article by  
R. Repullo and J. Suarez  
“LOAN PRICING UNDER BASEL  
CAPITAL REQUIREMENTS”**

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## OBJECTIVE OF THE PAPER:

- Analyze the implications of Basel 2 on the pricing of corporate loans by banks.
- More precisely, does the Internal Ratings Based (IRB) approach lead to a correction of the distortions introduced by the flat 8 % capital charge of Basel 1?

## WHAT THEY DO:

- Use the single risk factor model of Gordy (2000) to compute distribution of credit losses.
- Compute competitive loan rates for two types of banks:
  - those who adopt IRB approach
  - those who stick to standardized approach.

## WHAT THEY FIND (1):

- Banks who choose IRB approach will specialize on low risk loans and charge **lower** rates than under Basel I.
- Banks who choose standardized approach will specialize on high risk loans and charge **same** rates as under Basel I.

## WHAT THEY FIND (2):

- Calibration exercise: adopting IRB imply a reduction in loan rates of 50 bp for low risks (PD = 0,01 %) but an increase of 80 to 200 bp for high risks (PD = 10 %).
  - Suggest that interest income should be deduced from capital charges.
- ⇒ reduce loan rates for high risks.

## GENERAL OPINION:

- This is a very neat paper, simple yet rigorous.
- It leads to a simple recommendation deduce interest income from capital charges (otherwise loan rates will be too high for risky firm).