

Recent initiatives by Basel-based committees and the Financial Stability Forum

Basel Committee on Banking Supervision

The BCBS issues two papers on electronic banking ...

In July, the Basel Committee on Banking Supervision (BCBS) issued final versions of *Risk management principles for electronic banking* and *Management and supervision of cross-border electronic banking activities*.¹ The purpose of these papers is to provide supervisory guidance on safety and soundness in electronic banking activities. The first paper identifies 14 risk management principles for electronic banking to help banking institutions expand their existing risk oversight policies and processes to cover their electronic banking activities. The second paper identifies additional risk management principles specific to cross-border electronic banking activities.

... welcomes FATF documentation on money laundering ...

Also in July, the BCBS welcomed the Financial Action Task Force's (FATF) revised documentation on combating money laundering. The Committee noted that its publication *Customer due diligence for banks*, released in October 2001, had been reflected in the FATF's recommendations concerning customer due diligence. Whereas its own paper specifically addresses risk management by banks, the BCBS recognises that the FATF's recommendations apply to anti-money laundering procedures for all financial and non-financial institutions.

... publishes a report on implementing the New Accord ...

In August, the BCBS published a report entitled *High-level principles for the cross-border implementation of the New Accord*. As the Committee moves towards the completion of Basel II, this interim publication highlights the work of the Accord Implementation Group (AIG) in developing a set of principles to facilitate closer, practical cooperation and information exchange among supervisors.² The report points out that the existing cross-border responsibilities of home and host country supervisors, as established in the Basel Concordat and the original Accord, will continue to apply when the New

¹ The papers were initially released for consultation in May 2001 and October 2002 respectively. They are available at www.bis.org.

² The AIG was set up by the BCBS to serve as a means for supervisors to share information on and approaches to the implementation of the New Accord.

Accord is finalised. The New Accord calls for enhanced levels of cooperation between supervisors.

In the same month, the BCBS issued a consultative paper providing banks with practical guidance on managing their “know-your-customer” (KYC) risks on a consolidated basis. The publication, entitled *Consolidated KYC risk management*, is a supplement to the Committee’s *Customer due diligence for banks*. It examines the critical elements for effective management of KYC policies and procedures in banks’ foreign branches and subsidiaries, namely customer acceptance policies, customer identification, ongoing monitoring of higher-risk accounts and risk management.

... and issues a paper on customer due diligence

In September, the BCBS published a revised version of *Principles for the management and supervision of interest rate risk*. The paper was originally released as a supporting document to the second consultative paper on the New Accord in January 2001. The new version was issued for comment.

Next steps for the New Basel Capital Accord

On 10–11 October 2003, the members of the BCBS met to discuss responses to public comments received on the New Basel Capital Accord.

The BCBS received over 200 comments on its third consultative paper (“CP 3”).^① The responses indicated that there was continued broad support for the structure of the New Accord and agreement on the need to adopt a more risk-sensitive capital framework.

All members of the Committee agreed on the importance of finalising the New Accord expeditiously and in a manner that was technically and prudentially sound. The New Accord should offer considerable benefits over the existing system. Moreover, it was important in the near term to provide banks with as much certainty as possible while they planned and prepared for the adoption of the new rules. BCBS members committed to work promptly to resolve the outstanding issues by no later than mid-2004.

The Committee also acknowledged the importance of national rule-making processes under way in several jurisdictions and that it would need to consider the outcome of these processes within this time frame.

The BCBS welcomed the efforts of banks in preparing for implementation and encouraged them to continue. The ongoing further discussions by the Committee as outlined in this box were not expected to alter the need for banks to continue improving databases and risk management systems in preparation for the New Accord.

Areas of focus

The principal areas in which the BCBS identified opportunities to improve the framework were: changing the overall treatment of expected versus unexpected credit losses; simplifying the treatment of asset securitisation, including eliminating the “supervisory formula” and replacing it with a less complex approach; revisiting the treatment of credit card commitments and related issues; and reviewing the treatment of certain credit risk mitigation techniques. The BCBS and its working groups have developed a plan for addressing these issues.

Treatment of expected and unexpected losses

With respect to the internal ratings-based (IRB) treatment of credit losses, the existing proposals call for banks to hold enough capital to absorb expected and unexpected credit losses. BCBS members recognised that this approach represented a practical compromise to address differences

^① The comments are available at www.bis.org.

in national accounting practices and supervisory rules regarding provisioning. However, in the light of the public comments received on CP 3 and subsequent research undertaken by its working groups, the Committee decided to revisit the issue and to adopt an approach based on unexpected losses subject to an adjustment to the definition of eligible capital for IRB banks.

The broad direction of the approach that the BCBS asked its working groups to develop further was described in an attachment to the press release published on the BIS website on 11 October. The BCBS invited interested parties to comment on this proposal by end-2003. Although the Committee did not believe that the proposal would substantially change the mechanics of the New Accord, it considered it sufficiently important to merit additional public consideration.

At its meeting in January 2004, the BCBS will evaluate the outcome of the consultation on the expected/unexpected loss issue, assess further related work on the calibration of the IRB approach and review the progress made in resolving the other technical issues mentioned above. It will also assess the work on the calibration of the IRB approach in the light of the Committee's objectives on overall capital. At that time, the Committee will provide a further update on the status of its discussions. The BCBS does not foresee the need for changes to the standardised approach.

Calibration of the New Accord

The BCBS also discussed the importance of ensuring that the calibration of the New Accord achieves the Committee's objectives. Accordingly, the Committee agreed that prior to implementation a further review of calibration would be conducted on the basis of additional information. If necessary, the Committee will propose additional adjustments to calibration based on this review. These adjustments are not expected to alter the fundamental structure of the New Accord.

Financial Stability Forum

The FSF discusses vulnerabilities in financial systems ...

In September, the Financial Stability Forum (FSF) met to discuss three broad topics: vulnerabilities in the international financial system; market foundations and corporate governance; and offshore financial centres.

Concerning the first topic, the Forum noted the general improvement in financial conditions and the increasing, if uneven, signs of a global recovery. Members felt that downside risks seemed more muted than when the FSF last met in March 2003. Nevertheless, they also noted that domestic and international imbalances persisted and could pose risks.

... encourages work on credit risk transfer and reinsurance ...

The FSF also discussed efforts under way to identify and close information gaps in the area of credit risk transfer (CRT). In particular, members encouraged the Joint Forum to pursue its plan to take stock of institutional participation in the CRT market and to assess the need for related supervisory information, with a focus on addressing financial stability concerns.³ Members also welcomed the ongoing work in this area by the Committee on the Global Financial System, which requested that the G10 central banks begin collecting separate data on credit default swaps in the context of the semiannual survey of over-the-counter (OTC) derivatives markets by the end of 2004. In addition, the FSF urged insurance supervisors and insurance firms to continue moving forward together to resolve a number

³ The Joint Forum was established in 1996 under the aegis of the BCBS, the International Organization of Securities Commissions and the International Association of Insurance Supervisors.

of complex issues concerning the reinsurance industry and to ensure that plans for new information on this market segment, including data on global reinsurance markets, were relevant to strengthening market discipline.

With regard to market foundations and corporate governance, the Forum reviewed progress and international coherence in a number of areas, including auditor oversight and audit practice standards, accounting standards, the relationship between credit agencies and financial analysts, and the OECD's work on corporate governance.

Lastly, the FSF reviewed the Offshore Financial Centres (OFCs) initiative it launched in May 2000, based on a report prepared by IMF staff on their OFC assessment programme. The Forum welcomed the improvements that had taken place in supervisory and regulatory arrangements in many OFCs, as well as in cooperation on such matters. It supported making the monitoring of OFCs an integral part of the IMF's financial sector surveillance work. The FSF attached particular importance to the publication of the IMF assessments as a means of enhancing transparency and enabling the position of individual OFCs to be evaluated by all parties concerned.

... and reviews initiatives on offshore centres

Other initiatives

In July, the G10 central banks announced that they would carry out their triennial survey of global activity in foreign exchange and derivatives markets in April and June 2004. The reporting exercise will comprise the collection of market data on the dollar value of turnover in spot foreign exchange transactions and OTC foreign exchange and interest rate derivatives transactions. In addition, it will cover notional amounts outstanding and gross market values of foreign exchange, interest rate, equity, commodity, credit and other OTC derivative instruments. The format of the survey will be broadly similar to the one conducted in April and June 2001, incorporating only a limited number of refinements and clarifications. The objective of the reporting exercise is to obtain reasonably comprehensive and internationally consistent information on the size and structure of foreign exchange and OTC derivatives markets, with a view to helping authorities and market participants better monitor global patterns of activity and improve market transparency.

The G10 central banks announce the 2004 triennial survey

In August, the Joint Forum released two reports dealing with a number of issues common to the banking, securities and insurance sectors. The first report, *Trends in risk integration and aggregation*, is based on a survey of 31 financial institutions. It highlights the emphasis being placed on the management of risks on a firm-wide basis and related efforts to develop quantitative measures of aggregate risk, for example via economic capital models. The second report, *Operational risk transfer across sectors*, is based on interviews carried out with 23 financial institutions. It focuses on risk management and supervisory issues arising when operational risk is transferred from protection buyers to protection sellers.

The Joint Forum releases reports on risk integration and operational risk

In September, the G10 finance ministers and central bank governors discussed the general climate and key challenges facing the G10 economies. They also welcomed the increasingly widespread use of collective action

The G10 finance ministers welcome the use of CACs

clauses in international sovereign bond issues and noted that they looked forward to the inclusion of such clauses as a standard feature of bond issues in all major legal jurisdictions as an important element of the debt resolution framework.