

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

The various Basel-based committees and the Financial Stability Forum (FSF) took a number of initiatives during the second quarter of 2005. In the case of the Basel Committee on Banking Supervision, the activities reflected further progress towards the implementation of Basel II. The FSF held its first African regional meeting as well as a roundtable meeting on the implementation of international standards and codes. Table 1 provides a selective overview of these and other recent initiatives.

Basel Committee on Banking Supervision

BCBS meets with wider group of supervisors ...

... and releases documents related to Basel II ...

... and corporate governance

Updated rules for trading-related exposures and double default

In July, the BCBS met in session with the Core Principles Liaison Group (CPLG), the Committee's working group that includes banking supervisors from 16 non-Committee member countries, the IMF and the World Bank. As part of the dialogue with the wider supervisory community, views were exchanged on the ongoing efforts to update the Core Principles for Effective Banking Supervision, the implementation of Basel II and corporate governance, as well as accounting and auditing issues. At the time of the meeting, the Committee, together with the International Organization of Securities Commissions (IOSCO), released capital recommendations for trading-related exposures and double default effects. In addition, it published guidance on the estimation of loss-given-default (LGD) during economic downturns. Furthermore, consultative materials were issued on the fifth Quantitative Impact Study (QIS 5) and on supervisory guidance for the use by banking organisations of the fair value option amendment issued by the International Accounting Standards Board (IASB). Finally, later in July, the Committee issued for public comment revised guidance to help promote the adoption of sound corporate governance practices by banking organisations.

Concerning *trading-related exposures and double default effects*, a paper setting out capital rules was jointly issued with IOSCO, based on a consultative document published in April 2005 which elicited comments from around 40 banks, investment firms, industry associations, supervisory authorities and other organisations. The rules released in July supplement some aspects of Basel II and of the 1996 Market Risk Amendment by dealing with counterparty credit risk, double default effects, short-term maturity adjustments and failed

Main initiatives by Basel-based committees and other bodies			
Press releases and publications over the period under review			
Body	Initiative	Thematic focus	Release date
BCBS	Basel Committee meets with wider group of supervisors, releases documents related to Basel II	<ul style="list-style-type: none"> Capital requirements for banks' exposures to trading-related activities, including counterparty credit risk, and for the treatment of double default Guidance on the estimation of loss-given-default Release of consultative materials on QIS 5 Consultative paper on supervisory guidance for use by banking organisations of the IASB's fair value option amendment 	July 2005
	<i>Enhancing corporate governance for banking organisations</i>	<ul style="list-style-type: none"> Consultative document updating 1999 guidelines 	
CGFS	<i>Foreign direct investment in the financial sector – experiences in Asia, central and eastern Europe and Latin America</i>	<ul style="list-style-type: none"> Summary of follow-up workshops to the March 2004 CGFS report Discussion of national experiences with FSFDI and issues for private sector operators and authorities in charge of financial stability and public policy 	June 2005
CPSS ¹	<i>New developments in large-value payment systems</i>	<ul style="list-style-type: none"> Examines new developments in LVPSs since 1997 report 	May 2005
	<i>Central bank oversight of payment and settlement systems</i>	<ul style="list-style-type: none"> Sets out publicly what has been learned about effective oversight 	
	<i>General guidance for payment system development</i>	<ul style="list-style-type: none"> Sets out 14 guidelines 	
FSF	Roundtable meeting on implementation of international standards and codes	<ul style="list-style-type: none"> Stocktaking of achievements since 2000 and way forward 	April 2005
	<i>First African Regional Meeting</i>	<ul style="list-style-type: none"> Strengths and vulnerabilities in global and regional financial systems, efforts to strengthen financial systems at the regional level 	May 2005

¹ Timothy F Geithner, President and Chief Executive Officer of the Federal Reserve Bank of New York, was appointed CPSS Chairman by the Governors of the central banks of the G10 countries with effect from June 2005.

Source: Relevant bodies' websites (www.bis.org and www.fsforum.org).

Table 1

transactions. In addition, the guidelines improve on the current trading book regime, in particular with regard to the treatment of specific risks.

Regarding the *estimation of LGD*, the BCBS published a number of principles that banks are expected to adhere to in order to become eligible to use own estimates of LGDs within the internal ratings-based approach of

Eligibility criteria and flexibility for loss-given-default

Basel II. The Committee recognised that potentially higher than average realised losses during times of high default rates might prove a material source of unexpected credit losses for some exposures. The BCBS considered that a principles-based approach, which provides a significant degree of flexibility, was most appropriate at this time.

QIS 5 exercise gets under way

The Committee also released three consultative documents, one on QIS 5, another on banks' use of the fair value option and a third on enhancing corporate governance. Consistent with the schedule set out in March 2005 for QIS 5, the BCBS issued a draft of the QIS 5 workbook and accompanying instructions for comment by participating banks by 5 August 2005. The Committee intends to publish the final version of the QIS 5 package in September 2005, in time for the data collection exercise to take place between October and December 2005.

Clarification on the fair value option

The consultative document containing supervisory guidance on banks' use of the IAS 39 *fair value option* addressed two key points: first, it defined a set of sound risk management and control processes around use of the option; and, second, it analysed the possible effects of a bank's use of the option on supervisory assessments of its risk management systems and regulatory capital. In addition, the guidance suggested additional information that supervisors might collect to better understand the use of the fair value option by banks and its potential impact on the supervisory assessment of institutions' financial strength. The paper is open for comment until 31 October 2005.

Consultation on corporate governance

Lastly, the Committee issued revised guidance to help promote the adoption of sound corporate governance practices by banking organisations. The paper, entitled *Enhancing corporate governance for banking organisations*, is an update of the BCBS's earlier guidance published on this topic in 1999. It is open for comment until 31 October 2005. The new paper emphasises the importance of the role of auditors (and other control functions), boards of directors, senior management and supervisors in contributing to sound corporate governance. The need for effective management of conflicts of interest is also stressed, together with transparency in governing. Particular attention is paid to activities conducted through structures that may lack transparency, or which function in jurisdictions that pose impediments to information flows.

Committee on the Global Financial System

In June 2005, the CGFS published a *summary of the follow-up workshops* held with central banks from emerging Asia, central and eastern Europe and Latin America, based on its earlier report entitled *Foreign direct investment in the financial sectors of emerging market economies*. Recognising the relevance of regional factors in the assessment of financial sector foreign direct investment (FSFDI), the Committee organised the workshops with a view to exploring issues raised in the original report with a broader range of central banks in the regions concerned. The original report, published in March 2004, pointed out the benefits brought about by foreign direct investment in terms of financial stability and efficiency for the recipient regions, but also highlighted the need to

focus on the management of country risk and the assessment of conditions in host country financial systems. During the subsequent workshops held in 2004, the discussion of national experiences with FSFDI underscored the beneficial effects emanating from intensified competition, greater availability of banking services, technology transfer and easier access to financing in host countries. Improved financial market liquidity and better risk management were manifestations of these benefits. When it was countercyclical, foreign bank lending was seen as reinforcing financial stability. However, foreign bank entry could in some instances also distort credit allocation or amplify asset price cycles. Workshop participants identified several areas warranting the attention of policymakers wishing to maximise the benefits of FSFDI. These included strengthening the legal and accounting framework in the host countries, enhancing local market discipline, and harmonising the views of home and host country authorities in charge of financial stability.

CGFS publishes summary of workshops on financial sector FDI

Committee on Payment and Settlement Systems

In May, the CPSS released three new reports prepared by working groups acting under its aegis. The first paper examines *new developments in large-value payment systems (LVPSs)*. This report takes stock of developments in LVPSs since the Committee's 1997 report on real-time gross settlement systems. The main conclusions of the report are that interbank payments today settle faster, require a lower amount of liquidity (mainly central bank money), and have lower costs. The demand for cross-border payments has increased over time and while the trade-offs between risks and costs can be complex, today's LVPSs offer more flexibility in addressing them. The second paper deals with *central bank oversight of payment and settlement systems*. This report sets out publicly what has been learnt about this function, which became a formal function of central banks only relatively recently, sometimes in conjunction with one or more other authorities. The report examines the need for oversight, its scope and the activities involved, together with the source of central banks' oversight responsibilities. Ten principles for effective oversight are provided. The third publication provides *general guidance for payment system development* in the form of 14 guidelines. The report notes that, while the central bank is always a driving force in the development of the national payment system, it requires a cooperative effort from various stakeholders such as banks and regulatory agencies.

CPSS issues reports on large-value payment systems ...

... and central bank oversight of payment systems ...

...as well as general guidance for payment system development

Financial Stability Forum

On 17 April, the FSF Secretariat, in cooperation with the IMF and World Bank, convened a roundtable meeting on the international implementation of financial sector standards and codes among various interested parties, including representatives of the FSF members. This was in response to a decision at the FSF meeting in March to initiate a review of progress in the implementation of the standards and codes highlighted by the FSF in 2000. Participants took stock of the achievements to date and discussed ways to further promote

FSF meeting on international standards and codes in the financial sector

progress. The FSF plans to discuss this review at its forthcoming meeting in September 2005.

First FSF African
Regional Meeting

On 29–30 May, the FSF held its *First African Regional Meeting* in Pretoria, South Africa. Participants discussed the strengths and vulnerabilities of international and regional financial systems, global imbalances and the effects of strengthening commodity prices on national economies. The positive impact of progress in domestic structural reform and of international developments on African economies (in terms of growth and price stability) was acknowledged. Regional policymakers are faced with challenges emanating from globalisation, the ongoing evolution of the global economy, and volatile growth and export earnings. Against this background, participants reviewed initiatives to maintain and strengthen national financial systems, including measures to pursue macroeconomic stability and to create a robust legal and financial infrastructure. The meeting also noted progress in regional cooperation.

BIS Conference: “Past and Future of Central Bank Cooperation”

On 27–29 June 2005, the Fourth BIS Annual Conference, the timing of which coincided with the 75th anniversary of the Bank, was held on the theme of the “*Past and Future of Central Bank Cooperation*”. The conference provided an overview of the history of central bank cooperation, from the interwar period to the present day, also assessing the contributions that the BIS has made in this domain. While central bank cooperation in the area of monetary stability was of primary importance during the Bretton Woods era, the balance of activities shifted towards coordinated efforts to promote financial stability in the years that followed. The challenges facing the future of central bank cooperation were discussed in a policy panel session at the end of the conference. The conference presentations are available at www.bis.org/events/conf050628.htm.