

Joseph Yam: Basel II - back to the future

Opening remarks by Mr Joseph Yam, Chief Executive of the Hong Kong Monetary Authority, at the HKMA Seventh Distinguished Lecture: "Basel II: Back to the Future", Hong Kong, 4 February 2005.

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Let me first extend a warm welcome to all of you to this seventh HKMA Distinguished Lecture. It is a great pleasure for me to introduce our speaker, Governor Jaime Caruana, and our discussant, Mr David Eldon.

Basel II, or the New Capital Accord, or whatever we might call it, has been on the minds of bankers and regulators for around five years now. This new framework of capital adequacy standards for banks, issued by the Basel Committee on Banking Supervision, is an important step forward in the field of regulation. By making capital requirements more risk-sensitive, Basel II will bring banking regulation more into line with the way that banks themselves manage risk. It will also give banks the incentive to improve their own risk management. Basel II will help make banks stronger, and it will improve the safety, stability and efficiency of financial systems.

The title of Governor Caruana's lecture today, "Back to the Future", might for a moment give the impression that Basel II is the stuff of science fantasy. There is no doubt that it is a highly complex matter, and that it has – literally – required the recruitment of physicists and rocket scientists by the regulators and banks tasked with its implementation. There were, I think, times when the pessimists among us wondered whether there would be the resources, and the will, for this initiative to get off the ground. But, thanks to the enormous effort and co-operation among those involved, implementation, over the course of the next few years, appears now to be very much a certainty. Over the past few months, regulators around the world, including those in this region, have been setting out the approaches they intend to adopt in implementing Basel II, and banks have been preparing themselves energetically for implementation.

Approaches vary from one jurisdiction to another: one of the key features of Basel II is its flexibility. In Hong Kong, our aim is to switch over to Basel II at the start of 2007, in line with the approach being adopted in other major international financial centres, and of the Basel Committee members themselves. We see value in being among the first in adopting Basel II, not only because of the intrinsic merits of the New Accord, but also because this city has one of the highest concentrations of banking institutions in the world, with a strong presence of international banking groups.

Many people all over the world have been involved in Basel II. But there is no-one more qualified to speak on the subject than our guest today. Governor Caruana is the current Chairman of the Basel Committee on Banking Supervision. He is also Governor of the Banco de Espana, and a Member of the Governing Council of the European Central Bank. Governor Caruana has extensive experience in both the private and public sector in Spain, and is the author of several publications on the Spanish financial system. We are greatly honoured that he has accepted our invitation to speak on Basel II today.

The Basel II project was already several years old when Governor Caruana took over its leadership, as Chairman of the Basel Committee, in May 2003. But he has put his own stamp on this project, and has made three special personal contributions. First, he has brought the formulation process to a successful conclusion with the publication last June of the definitive document on the revised framework. Producing this necessary road-map was no easy achievement given the differing views that had to be taken into account, and the considerable degree of scepticism in the industry. Secondly, he has, through persuasion and advocacy, managed to convert scepticism towards Basel II into a positive and constructive attitude. He has done this in particular by stressing that, when you look beneath the surface, Basel II is not so much about how capital adequacy ratios are calculated, as about how banks can improve their risk management and, thereby, how the efficiency of the banking system can be improved. He has also placed emphasis on the point that Basel II applies not just to advanced banking systems but to banking systems in all stages of development – an observation of particular relevance to this region.

Thirdly, and of no less importance to us in Hong Kong, Governor Caruana has personally supported greater involvement by non-G10 members in the Basel II process. Within this region, central bankers have been increasingly active in recent years in trying to ensure that our voice is heard in the process of policy formulation and standard-setting in Basel. Governor Caruana has on a number of occasions

spoken out on the need to ensure that our voices are indeed heard, and that our views are actually taken into account. And there are signs that this practice is turning into a tradition: it has been extended to other areas, such as the review of the Basel Committee Core Principles for Effective Supervision, in which Hong Kong is heavily involved.

Successful implementation of Basel II depends not just on the standard-setters and the regulators, but also on the banks themselves. The enthusiasm with which the Hong Kong banking community has taken to Basel II has been impressive. As a senior member of this community, our discussant today is particularly well equipped to provide the perspective from the banks. We are fortunate in having secured David Eldon's presence today. After more than 40 years in banking, many of them in Hong Kong, he is about to retire from the field. He is thus currently much in demand among his many friends within the financial community, who wish to fete him on his retirement. He is also receiving bookings in his new, risk-taking career as popular singer and entertainer – a field in which we wish him every success. I take this opportunity to pay tribute to David for his outstanding contributions to Hong Kong during difficult and challenging times, not just in the financial sphere, but also in the many community and charitable activities in which he is involved.

Ladies and gentlemen, it is an honour to welcome Governor Jaime Caruana as speaker, and Mr David Eldon as discussant. I now have much pleasure in inviting Governor Caruana to deliver the seventh HKMA Distinguished Lecture.