Bank of Guyana
Comments on
The New Capital Accord

I Scope of Application

1. The New Capital Accord (NCA), commonly referred to as Basel II, is to be applied on a consolidated basis to internationally active banks and at every tier within a banking group. The scope of application of the NCA will be extended to include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group.

   The Capital Accord of 1988 was intended for internationally active banks. However, more than 100 countries adopted it and it has become the standard against which the international financial institutions conduct their reviews.

   In a similar manner one can expect that the NCA will be adopted internationally and become the new benchmark.

   The NCA is scheduled to be issued end-2003 and implementation date is 2006. Basel has recognised that the implementation date may not be realistic for developing countries and is prepared to accommodate a later date.

2. It is apposite to note the US response to the NCA/Basel II.
   - The US Supervisory Authorities have decided that Basel II, in particular, the Advanced-IRB approach for credit risk and the Advanced Measurement Approach for operational risk will have to be applied only by its ten largest banks initially. Another ten large banks may be eligible/allowed to apply Basel II as well.
   - The remaining several thousand banks will remain on Basel I (credit and market risks) and will not have an explicit capital charge for operational risk.
   - In their opinion, Pillar II and Pillar III are already satisfied.

3. Basel II is here to stay. Unlike the US, Guyana and other Caribbean countries as well as other small developing countries will have to implement Basel II since their voices may not be heard.[1] Further, it is likely that future missions/reviews by the international financial institutions will assess the level of compliance with Basel II.

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1. J. Ward makes the point that for various reasons developing countries appear to have no choice! Jonathan Ward – Is Basel II voluntary for developing countries? The Financial Regulator Vol. 7 No. 3, December 2002. pp.51-58.

II Comments

Generally, Caribbean countries are dependent on tourism and or agriculture with the exception of Trinidad where oil and gas is very significant. Guyana is dependent on production of a few primary products, primarily agricultural, which are subject to the vagaries of market forces and climatic conditions. Guyana is a small-open country, very vulnerable to external shocks which can have serious effects on financial stability [and consequently social and political stability].

Guyana does not possess deep financial markets nor the financial infrastructure (rating agency, credit bureau, etc.) to consider many aspects of Basel II. A stock exchange was launched only recently and is still in its nascency. A lot of work will have to be done to comply with the spirit and intent of Basel II.

1. One of the greatest challenges is the paucity of resources, particularly, human resources to cope with the requirements of Basel II. Training of bank supervisors will assume greater importance since Pillar II envisages bank supervisors having the expertise to assess risk management techniques/processes utilised by banks.

2. Since Guyana and many developing countries will have to settle, at least initially, for the less sophisticated options under Pillar I, there is a perception that the large international banks will have a competitive advantage since their application of the sophisticated options under Basel II yields a lower capital charge. This would result in an unlevel playing field in domestic markets where there are locally incorporated banks competing with branches of foreign banks.

3. Another hurdle to cross is to get the banks to buy-in to Basel II since it involves costs and other considerations. For example, banks will have to develop/maintain databases to facilitate statistical/econometric modelling in the future. Banks will incur costs by having to train staff to cope with the requirements of Basel II.

4. In the case of Guyana, sovereign debt now rated at 150% would make access to the international market more difficult and or more expensive.

5. The 15% charge on gross income for operational risk does not provide an incentive for banks to improve/lower their operational risk. In fact, it may penalise banks that have large turnover. Incentives should be built-in to the framework to reward banks that have low operational risk.

   - For example, operational risk could be placed in a scale such as:

Low op risk	5%
Moderate op risk	10%
High op risk	15%

7. Having no rating agencies in Guyana and the Caribbean may subject banks to higher capital charges vis-à-vis those countries that have such agencies.