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

Basel Committee on Banking Supervision

The BCBS issues a third consultative paper on the New Basel Capital Accord ...

In April, the Basel Committee on Banking Supervision (BCBS) issued to banks and all other interested parties a third consultative paper on the New Basel Capital Accord. Comments received will help the BCBS make final modifications to its proposal for a new capital adequacy framework. The goal of the Committee continues to be completion of the New Accord by the fourth quarter of 2003, with implementation to take effect in participating countries by end-2006. With that in mind, work has already begun in a number of countries on draft rules that would integrate Basel capital standards with national capital regimes. An overview paper, which accompanies the third consultative document, provides a summary of the new capital adequacy framework.[1] It also outlines changes to the proposal since the release in October 2002 of the third Quantitative Impact Study (QIS 3), which banks from 43 countries used to assess the impact of the New Accord on their portfolios.

... releases the results of the third Quantitative Impact Study ...

In May, the BCBS released an overview of the global results of QIS 3.[2] QIS 3 aimed at allowing the Committee to gauge the impact of the proposals for a New Basel Capital Accord before finalisation of the third consultative paper (CP 3). Overall, the results were in line with BCBS objectives; minimum capital requirements would be broadly unchanged for large internationally active banks, taking into account the fact that they are likely to use the internal ratings-based (IRB) approaches. The proposals would offer an incentive for internationally active banks to adopt the more sophisticated IRB approaches. For smaller, more domestically oriented G10 and EU banks capital requirements could be substantially lower than currently under the IRB approaches, largely reflecting the importance of retail lending for these banks. In other countries there would be significant variations depending on the conditions in the different markets and the focus of activity of the banks.

1 See *Overview of the New Basel Capital Accord*, April 2003, at www.bis.org.

2 See *Quantitative Impact Study 3 – overview of the global results*, May 2003, at www.bis.org.

However, all the results are thought to be somewhat overstated, in part because of difficulties in identifying new forms of collateral.

The BCBS also noted that changes made to the second consultative paper (CP 2) proposals had generally delivered the desired results. For example, capital requirements for loans to small and medium-sized enterprises will generally be no higher than currently. The Committee has decided to make a few targeted reductions to the standardised approach proposals, in particular a lower risk weight of 35% for residential mortgages, and recognition that "past due" loans with significant levels of provisioning warrant a lower risk weight than 150% on the net amount remaining. An alternative standardised treatment for operational risk will be offered at supervisory discretion, available for use with any of the three credit risk approaches. Finally, elements of the IRB proposals have been fine-tuned. In late May, the BCBS published a further supplementary document providing more detail on some areas of QIS 3.[3]

... and publishes the 2001 disclosure survey results

Also in May, the BCBS published the results of the 2001 disclosure survey, which provides an overview of the disclosure practices of a sample of internationally active banks.[4] The publication of the results forms part of a sustained effort by the Committee to promote transparency and effective market discipline in the banking and capital markets, especially in the light of the coming implementation of the New Basel Capital Accord. The survey focuses on the annual reports of 54 banks. It includes 104 questions covering quantitative and qualitative disclosures in a number of categories: capital structure, capital adequacy, market risk modelling, internal and external ratings, credit risk modelling, securitisation activities, asset quality, credit derivatives and other credit enhancements, other derivatives, geographic and business line diversification, accounting and presentation policies, and other risks.

The survey reveals improvements in disclosure ...

The survey reveals that many banks have continued to expand the extent of their disclosures. Overall, in 2001 banks disclosed 63% of the items included in the survey, up from 59% in 2000 and 57% in 1999. The main other findings are: (i) the most prevalent disclosures in 2001 were those on accounting and presentation policies, other risks and capital structure, while those on credit enhancements (including credit risk modelling and credit derivatives) were least widespread. Disclosure of information on internal risk models was also much more common for market risk than for credit risk; (ii) disclosures of information on securitisation activities, internal and external ratings and credit enhancements has considerably expanded since 1999. The most noteworthy improvement is the increase in the disclosure of information on other risks (operational and legal risks, liquidity risk and interest rate risk in the banking book), with the result that this became one of the most commonly provided

... particularly for operational, legal and banking book risks

3 See *Supplementary information on QIS 3*, May 2003, at www.bis.org.

4 See *Public disclosures by banks: results of the 2001 disclosure survey*, Basel Committee Publications No 97, May 2003, at www.bis.org.

disclosures in 2001; and (iii) regarding individual disclosure items, the most common were on the structure of capital, accounting and presentation policies, market risk modelling or capital adequacy.

The BCBS encourages further transparency in credit risk mitigation

In view of these results, the BCBS encourages banks to further enhance transparency in their use of credit risk mitigation techniques, asset securitisation and internal ratings, given that disclosure in these areas will be qualifying criteria for the recognition or use of these techniques under the New Basel Capital Accord. Furthermore, the few banks that do not provide the most common disclosures are urged to improve their practices, as such disclosures will, for the most part, be required under the New Accord.

Committee on Payment and Settlement Systems

The CPSS issues a new reference paper on payment arrangements

In April, the Committee on Payment and Settlement Systems (CPSS) issued a new edition of its reference work on payment arrangements in various countries, widely known as the "Red Book". This new edition of the Red Book, *Payment and settlement systems in selected countries*, is a further step towards understanding the way payment systems, including securities settlement systems, work in the countries represented in the CPSS. The latest edition of the Red Book significantly revises and enhances the previous edition, published in 1993. The coverage of different segments and developments in payment systems and securities settlement systems has been broadened. In addition to individual country chapters, this edition also contains a chapter on international payment arrangements and a more comprehensive glossary.

Other initiatives

Market supervisors publish a note on money laundering and terrorism financing

In June, the BCBS, the International Association of Insurance Supervisors and the International Organization of Securities Commissions published a joint note providing a record of the initiatives taken by each sector to combat money laundering and the financing of terrorism. The note was first prepared for the March 2003 Joint Forum meeting in Hong Kong SAR, and thereafter submitted for the information of the Coordination Group at its March 2003 meeting in Berlin. To the extent that institutions in each sector are offering the same services, measures and standards concerning anti-money laundering (AML) and combating the financing of terrorism (CFT) need to be reasonably consistent, otherwise there could be a tendency for criminal funds to flow to institutions in those sectors operating under less stringent standards. However, variations in patterns of relationships between institutions and customers in each sector require AML/CFT measures to be tailored to the circumstances of the relationship. Hence, AML/CFT standards may reasonably differ in the detail and intensity of their application.