

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

Basel Committee on Banking Supervision

The BCBS issues a paper on compliance in banks

In October, the Basel Committee on Banking Supervision (BCBS) issued a consultative document entitled *The compliance function in banks*. The purpose of such a function is to assist a bank in managing its compliance risk – the risk of legal or regulatory sanctions, or financial or reputational loss that a bank may suffer as a result of its failure to comply with all applicable laws, rules and standards. Compliance risk management has become more formalised within the past few years and has emerged as a distinct risk management discipline. The document provides basic guidance for banks and sets out banking supervisors' views on compliance in banking organisations.

Committee on Payment and Settlement Systems

The CPSS publishes statistics on payment systems

In November, the Committee on Payment and Settlement Systems (CPSS) published a new document providing statistical data on payments and payment systems in the 13 CPSS member countries. This most recent version of *Statistics on payment and settlement systems in selected countries* (otherwise known as the "Red Book") contains data for 2002 and earlier years. The data are presented in detailed tables for each individual country as well as a number of comparative tables.

Financial Stability Forum

The FSF holds its third Latin American meeting

In November, the Financial Stability Forum (FSF) held its third Latin American Regional Meeting, hosted on this occasion by the Central Bank of Chile. Senior representatives from finance ministries, central banks, and supervisory and regulatory authorities from four FSF member countries and 10 regional non-member countries attended the meeting. Senior officials from international institutions represented on the FSF also took part.

Participants exchanged views on strengths and vulnerabilities in international and regional financial systems. They shared the opinion that the

The latest on the New Basel Capital Accord

On 14–15 January, the members of the BCBS met in Basel to discuss responses to public comments received on the New Basel Capital Accord and review progress since the agenda was established in Madrid in October 2003. The BCBS reaffirmed its commitment to finalising the New Accord by mid-2004 and took decisions on a number of key issues.

Public comments supported the BCBS's proposal on credit-related losses

The BCBS received 52 letters of comment from institutions and industry associations on its October 2003 proposal to revise the capital treatment for expected and unexpected credit losses. Respondents generally welcomed the Committee's solution and agreed that it would align regulatory capital more closely with the concepts underpinning leading banks' economic capital modelling processes. The Committee believes that these comments will be instrumental in strengthening the quality of the New Accord. Moreover, it agrees with industry comments that the cap on the recognition of excess provisions should not be based on Tier 2 capital components. Instead, it has decided to convert the cap to a percentage (to be determined) of credit risk-weighted assets. A technical note outlining the concrete modifications necessary to implement this decision was published on 30 January (see *Modifications to the capital treatment for expected and unexpected credit losses*).

Significant progress achieved on the treatment of securitisation exposures

In response to public comments on the third consultative paper (CP 3) on the New Accord, the Committee agreed to simplify the treatment of securitisation-related exposures and align it more closely with industry practice. Under the new treatment, banks will be allowed to derive the risk weights on unrated exposures to asset-backed commercial paper conduits (mainly liquidity facilities) by mapping their internal risk assessments to external credit ratings; a less complex "supervisory formula" will be available for determining capital for unrated securitisation exposures; and both originating and investing banks will be able to make equivalent use of the "ratings-based approach" (RBA) for rated securitisation exposures. Finally, the Committee reviewed the calibration of the securitisation RBA risk weights to ensure a closer alignment with the level of risk inherent in the positions.

The main points are set out in Attachment A of the press release of 15 January entitled "Continued progress toward Basel II" and in a more detailed technical note specifying the revisions to the securitisation proposals published on 30 January (see *Changes to the securitisation framework*).

Advances on credit risk mitigation techniques and related issues

In response to industry comments, the BCBS agreed to refine the rules for recognising credit risk mitigation techniques. It likewise recognises that the existing treatment of credit risk mitigation must continue to evolve in order to reflect industry practices, particularly as they relate to double default effects. The Committee believes that recognition of these effects is necessary, though it is essential to consider all of the implications, especially those related to measurement, before deciding on a solution. It will continue to work on this topic with the intention of finding a prudentially sound solution as promptly as possible prior to implementation of the New Accord.

Alongside this work, the Committee plans to undertake a review of counterparty credit risk and trading book issues in coordination with the International Organization of Securities Commissions.

Pillar 2 implementation clarified

In response to recent discussions with banking organisations, the Committee agreed on clarifications for implementing the supervisory review of capital, or Pillar 2 of the New Accord. These clarifications are appended as Attachment B to the press release of 15 January entitled "Continued progress toward Basel II".

Cooperation between home and host supervisors

Building on the principles published in August 2003 (*High-level principles for the cross-border implementation of the New Accord*), the Accord Implementation Group (AIG) of the Committee has been evaluating several actual case studies. This exercise is contributing significantly to member authorities' understanding of practical aspects of cross-border implementation.

The Committee has agreed on principles for the cross-border implementation of the advanced measurement approaches (AMAs) for operational risk requirements. These principles balance the need for the adequate capitalisation and sound risk management of significant internationally active entities in cross-border banking groups with the need for the practical application of the AMAs within these groups. The details of the proposal and related principles were published on 30 January (see *Principles for the home-host recognition of AMA operational risk capital*).

Schedule

Working groups will make recommendations on the outstanding issues at the next meeting of the BCBS in May 2004, where the Committee will additionally address the calibration of capital requirements. Both efforts will allow the Committee to achieve its mid-2004 goal and to ensure that the text will provide a solid basis for national implementation processes and allow the industry's preparations to proceed. In accordance with the decisions announced in October 2003, the Committee will again evaluate the New Accord's calibration prior to implementation.

The BCBS has reaffirmed its objective to maintain broadly the aggregate level of regulatory capital in the banking system. It intends the simpler approaches to produce overall capital requirements that are by and large equivalent to those of the existing rules, while establishing incentives to adopt the more advanced approaches. The Committee will, moreover, continue to work to ensure that the Accord remains up to date with the best practices in risk measurement and management.

economies in the Latin American region were generally showing signs of recovery, reflecting policy improvements among other factors, but that the region continues to face vulnerabilities.

Participants
exchange views on
debt
management ...

Participants discussed the sustainability of current and expected levels of public debt, pointing to the need to manage debt in such a way as to reduce the impact of market shocks. In that regard, it was noted that some countries in the region have taken advantage of the favourable external financing environment to consolidate their debt position. A continuation of favourable financial and economic conditions should be used to improve fiscal positions. Participants also pointed to the reforms already implemented and those still needed to enhance domestic securities markets, in order to facilitate public sector debt management and to provide alternative sources of funding and risk management for the private sector. They discussed the risks posed by currency mismatches and partial dollarisation and considered ways to reduce those risks, including the maintenance of good macroeconomic policies, a floating exchange rate regime and an adequate prudential framework. They also noted the value of foreign direct investment in the financial sector and agreed that a sound and predictable regulatory and legal environment is needed to address the concerns of both parent institutions and host authorities.

... crisis
prevention ...

Participants exchanged views on international crisis prevention and resolution, pointing in particular to the successful incorporation of collective action clauses in recent bond issues by countries in the region.

They also shared views on the New Basel Capital Accord, the framework of which is expected to be completed by mid-2004 (see the box on page 112). They agreed that national supervisors will need to review carefully whether the preconditions for implementation of the New Accord are satisfied and, if not, what steps they should be taking to enhance their regulatory, supervisory and risk management capacity.

... and the New
Basel Accord ...

Participants reviewed initiatives currently under way to strengthen corporate governance. A number of measures have been taken and laws enacted, but enforcement of the rules is a key problem. In that regard, enhancement of judicial and legal systems is warranted. Participants pointed to the implementation of a number of national and international auditor oversight mechanisms, as well as efforts to reach an international consensus on accounting standards, to strengthen financial reporting frameworks. They also considered the issues of conflicts of interest affecting financial analysts and the integrity of the credit rating process. In all of these areas, participants stressed that further progress is desirable – in Latin America as in other regions – to improve efficiency, transparency and investor confidence.

... and review
initiatives on
corporate
governance