

Basel II target institutions (whether Basel II was initially for the largest banks in developed countries.

Basel I was aimed for at international active banks in developed countries¹. The Basel Committee focused on facilitating and enhancing information sharing and cooperation among bank regulators in major countries and developing principles for the supervision of internationally active large banks.²(Kaufman, G.G., 2003). Both Basel's were designed by regulators from developed economies to meet the main perceived regulatory challenges and their largest banks faced³. The main criticisms have been in its applications and impacts on developing countries. This seems intrinsically linked to the fact that developing countries are not at all represented in the Basel Committee for Bank Supervision (BCBS). The new framework has been designed primarily for adoption by the G-10, and the Basel Committee originally expected this group of countries to be ready to implement the framework by the beginning of 2007. Current G-10 members are Belgium, Netherlands, Canada, Sweden, France, Switzerland, Germany, UK, Italy, US and Japan. At the same time, the Basel Committee recognizes that many non G-10 countries worldwide may wish to adapt the new framework to their own national realities and circumstances, and to have their own timetable for adopting the new rules. Countries from the European Union (EU) are set to comply with the new Basel rules from January 2007. The same deadline applies to advanced countries in Asia. However, banking regulators in the US decided to delay adoption at least until January 2008. At the same time they are proposing adoption of different approaches for the US banks. In September 2006, the four regulators proposed that the IRB (internal ratings-based) approach should apply to the largest and internationally active banks only (26) in total. For the remaining banks, the US regulators are proposing a revised version of the existing capital rules known as Basel IA. Basel II covers all OECD (Organisation for Economic Co-operation and Development), the advanced economies. Within this group the largest anomaly is in the US, where only the largest banks will be required to adopt the accord, it is being optional for others.(Griffith-Jones, S., 2007).⁴ Indeed, US banks regulators have effectively rejected Basel II as a requirement for all but the largest 10 or so internationally active banks, which would be required to use the advanced IRB approach.⁵ All other banks may compute their RBC on the basis of the current Basel I, although they can adopt the advanced IRB approach if they wish and their supervisors concur. The major features of Basel II have been incorporated by the EU in a proposed revision of its Capital Adequacy Directive (CAD) for financial institutions. (Kaufman, G.G., 2003).

¹ info.worldbank.org/etools/docs/library/154927/financeforum2002/pdf/laurin_baselii.ppt -

² Kaufman, G.G., 2003., *Basel II, the roar that moused*

³ Griffith-Jones, S., 2007, *Implications of Basel II for stability and Growth in Developing Countries, Proposals for future research and action*

⁴ <http://www.cml.org.uk/cml/policy/issues/721>

⁵ Kaufman, G.G., 2003., *Basel II, the roar that moused*

Basel II present expanded scope (whether Basel II is applied to every type of bank).

The new framework will apply to all ‘credit institutions’ (principally banks but also other institutions such as credit cooperatives which receive deposits and other repayable funds from the public and make loans for their own account) and investment firms⁶. Special adaptations of Basel II rules in the European Commission’s new framework provide for greater flexibility regarding the selection of more sophisticated approaches and options, simpler rules for the capital changes for the operational risks for low/medium investment firms. A large share of banking assets in most regions will be subject to the rules of Basel II by the end of this current decade. For foreign banks however, there could be a problem if the supervisor of an international bank in its parent country and that of a subsidiary or branch in a host country apply different rules. In this circumstance, it might be unwilling to allow the foreign entity to use this approach (Basel II). (Cornford, A., 2005). In Australia, the APRA believes that the Australian banking system will be made safer and more efficient by all ADIs adopting Basel II, even if only in its standardized guises. Safer, because ADIs, their supervisors and market participants will have available capital measures that better reflect their risk profile and therefore true financial condition. And more efficient because bank business decisions will be more closely based on the underlying economics of transactions rather than the regulatory distortions created by the existing rules⁷. (Egan, B., 2003). Consistent with the move away from the ‘one size fits all’ approach, Basel II is designed to be flexible and to be able to reflect the complexity of the business undertaken by specific banks. In a small bank, for example, lending decisions may be made largely on the judgement of the lending officer. Banks can decide where on the complexity scale they wish to operate. A small ADI, such as a credit union, can happily exist with a small number of simple products. Operating in its own market it can be competitive and innovative, while maintaining a simple risk profile that can be adequately protected against with simple risk management strategies and practices. At the other extreme, a sophisticated global bank providing a broad suite of products will require complex risk measurement practices and strategies. Basel II makes available a capital solution for the small banks offering a small number of uncomplicated products, a solution for the most complex banks and a solution for those banks in between. (Egan, B., 2003). A bank unnecessarily applying a complex capital regime will pay the substantial cost of implementing and operating that regime but will receive a poor return on that investment in terms of capital reduction and cost of funding. On the other hand, a sophisticated global bank not investing in the systems appropriate to its business will pay the cost of holding more capital, and in all probability face the risk of suffering more losses, than its competitors.

Banks using the more sophisticated approaches to calculate regulatory capital for credit and operational risk will also be expected to hold capital for interest rate risk in the banking book and will have to take into account the full range of risks, including business/strategic, credit concentration and business cycle effects, in their own capital allocation models. In saying this APRA acknowledges the difficulty in measuring some of these risks, such as

⁶ Cornford, A., 2005, *The global implementation of Basel II: Prospects and outstanding problems*

⁷ Egan, B., 2003, *Monitoring risk in the financial system*, Australian Prudential Regulation Authority

business/strategic, and will be working closely with the banks to ensure sensible outcomes.
(Egan, B., 2003)

References

1. Lecture slides downloaded from internet,
info.worldbank.org/etools/docs/library/154927/financeforum2002/pdf/laurin_baselii.ppt -
2. Kaufman, G.G., 2003., *Basel II, the roar that moused*, Federal reserve bank of Chicago
3. Griffith-Jones, S., 2007, *Implications of Basel II for stability and Growth in Developing Countries, Proposals for future research and action*, Ibase Rio Meeting on Financial Liberalisation and Global Governance: The Role of International Entities
4. Internet source, <http://www.cml.org.uk/cml/policy/issues/721>
5. Cornford, A., 2005, *The global implementation of Basel II: Prospects and outstanding problems*
6. Egan, B., 2003, *Monitoring risk in the financial system*, Australian Prudential Regulation Authority

Banking Committee on Banking supervision, 2003., *Overview of the New Basel Capital Accord*, Bank for international settlements (Refer below)

Implementation of the New Accord Transition to the New Accord

56. The Committee believes the proposals contained in CP3 are suitable for a wide range of banks in different countries. Within the G10, Committee members have agreed to a common implementation date for the New Accord of year-end 2006. In these countries, the implementation of the new Accord is intended to encompass internationally active banks, and

other significant banks as national supervisors deem appropriate. In a number of G10 countries, the Basel II framework will be applied to the entire banking system. National supervisors in the G10 will ensure that banks not implementing Basel II will be subject to prudent capital adequacy regulation.

57. While the New Accord has been designed to provide options for banks and banking systems worldwide, the Committee acknowledges that outside the G10 moving to the new framework in full in the near future may not be the first priority for all supervisors in terms of what they need to do to strengthen their supervision. Where this is the case, each national supervisor should consider carefully the benefits of the new framework in the context of its domestic banking system when developing a timetable and approach to implementation.

58. Given resource constraints and other priorities, it should be neither surprising nor inappropriate for these timetables, particularly in non-G10 countries, to extend beyond 2006. That said, supervisors should consider implementing key elements of the supervisory review and market discipline components of the New Accord even if the Basel II minimum capital requirements will be implemented after year-end 2006.

59. Many national supervisors have already begun to plan for the transition to Basel II. To assist in this process, the Committee has asked a group of supervisors from around the world, with IMF and World Bank participation, to develop a framework for assisting non-G10 supervisors and banks in the transition to both the standardised and foundation IRB approaches of the New Accord. The Committee believes that continued co-operation along these lines is essential to ensuring a successful transition to the New Accord.