

Implications of the revised approach to finalising the new Basel Accord

The Basel Committee on Banking Supervision (Basel) has said that the next consultative paper on the new capital adequacy framework (CP 3) will not be issued in early 2002 as previously announced. This is to allow for additional review, quality assurance and a further quantitative impact study (QIS). This delay is to allow Basel to make CP 3 the almost final version of the Accord.

For the present, Basel is neither indicating a date for the publication of CP 3, nor announcing any delay to its overall implementation date of 2005. This suggests that the consultation on CP 3 will be short and also suggests that Basel will have little appetite for fundamental revision to CP 3. This means that firms need to ensure that their lobbying is done now and should not count too much on the response period for CP 3 as a further opportunity to influence the debate on the major issues.

The implications of this delay for the EU Directive that will implement the new Basel standards for EU credit institutions and investment firms are potentially serious. The 2004 elections to the European Parliament are now very likely to interrupt the legislative process, making it difficult to complete the process by 2005.

Following significant representations from the industry, Basel will undertake an additional review of the draft Accord over the next few months to assess the overall impact on banks and the banking system before releasing CP 3. The Basel Committee wants CP 3 to be an almost final version of the complete new Capital Accord. The review will focus on four issues:

- The balance between risk-sensitivity and its attendant complexity on the one hand, with the need for clarity, simplicity and effectiveness on the other;
- The treatment of small- and medium-sized enterprises, which has become a major political issue in a number of G10 countries;
- The delivery of a complete text of the draft Accord, including areas, such as securitisation and specialised lending, which are still under discussion; and
- The calibration of minimum capital requirements to set a level of capital that, on average over the industry, is approximately equal to the requirements of the present Accord, while providing incentives to firms to use more risk-sensitive approaches.

Once a draft of the full Accord has been completed, Basel will undertake a comprehensive impact assessment. Basel had planned to do this simultaneously with the next consultation period, but will now do this before releasing CP 3. CP 3 will be issued for consultation after the results of the QIS have been reflected in the text.

Basel had previously announced its intention to finalise the new Accord in 2002 for implementation in 2005. Although it is not yet announcing a revised schedule for completion or implementation of the new Accord and has not set a date for issuing CP 3, Basel states that it does not believe that the review process will be lengthy.

This suggests that the consultation on CP 3 will be short and that Basel will have little appetite for fundamental revision to CP 3. The compromises that will be needed to reach agreement on the draft CP 3 are in any case likely to make change difficult. This means that firms need to ensure that their lobbying is done now and in interacting with regulators on the QIS. They should not count too much on CP 3 as a further opportunity to influence the debate on the major issues.

Initiative to support implementation of the new Accord

Basel has set up an Implementation Group, to be chaired by Nicholas Le Pan, Superintendent of Financial Institutions, Canada. The Group will allow supervisors to share information and approaches related to the implementation of the new Accord. Basel sees this as recognition that supervisors need to begin planning for implementation and as a way of promoting consistency between countries.

Implications for firms

Firms need to continue their implementation preparations – just as supervisors are clearly continuing theirs. Basel thinks that it has the measure of the problems to be resolved to finalise the Accord, and firms should not count on continuing delay. This is very much a short respite and is more likely to affect the detailed parameters that firms are required to apply rather than the data that they will need to produce. There is no indication that this delay will be the cue for a fundamental revision of the proposals. Many leading firms are not delaying their implementation plans, and our experience with many of these suggests that any delay to the supervisory timetable makes the challenge of implementation only marginally less formidable.

The wide experience that we have already obtained from PricewaterhouseCoopers Basel projects at a number of leading institutions across Europe has identified some

common themes. In particular, we are finding that firms are tending to focus on the many tactical issues on a piecemeal basis. Relatively few firms have developed a strategic vision of how they will put the Basel II proposals into practice and bring together all of their credit risk, operational risk, capital modeling and reporting capabilities to best effect.

There are also a number of common problem areas in respect of credit and operational risk:

- Addressing data availability issues, particularly in respect of operational and credit loss data;
- Setting risk appetite;
- Determining the appropriate organisational structure for risk management;
- Establishing an adequate risk management framework (including policies & procedures, governance, roles & responsibilities);
- Refining existing credit risk grading systems to meet the new requirements;
- Ensuring the adequacy of supporting processes, systems and models; and
- Ensuring that the information for disclosure requirements is appropriately supported with adequate audit trails.

Likewise, with regard to the overall Basel implementation, there are fundamental program issues to be resolved in most firms that will be critical to success. These include:

- Providing effective program management and certainty of delivery;
- Defining the scope and ambition of development with regard to deriving strategic and operational benefits, as well as compliance;
- Ensuring there is clarity of development approach;
- Ensuring completeness and accuracy of the process to translate regulatory requirements into systems and data requirements;
- Ensuring appropriate prioritisation of systems development; and
- Allocating ownership of development and development costs.

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