Lecture

INSTITUTE OF ACTUARIAL & QUANTITATIVE STUDIES

Class: TY BSc

Subject : Basel

Subject Code:

Chapter: Unit 1 Chapter 2

Chapter Name: Basel regulation: Overview

Today's Agenda

1. Basel committee
    1. History
    2. Laying the foundation

2. What are Basel Accords?

3. Basel summary
    1. Comparison

1 The Basel Committee

The Basel Committee on Banking Supervision (BCBS) is the primary global standard setter for the prudential regulation of banks and provides a forum for regular cooperation on banking supervisory matters. Its 45 members comprise central banks and bank supervisors from 28 jurisdictions.

1.1 History

- The Basel Committee – initially named the Committee on Banking Regulations and Supervisory Practices – was established by the central bank Governors of the Group of Ten countries at the end of 1974 in the aftermath of serious disturbances in international currency and banking markets (notably the failure of Bankhaus Herstatt in West Germany).

- The Committee, headquartered at the Bank for International Settlements in Basel, was established to enhance financial stability by improving the quality of banking supervision worldwide, and to serve as a forum for regular cooperation between its member countries on banking supervisory matters. The Committee's first meeting took place in February 1975, and meetings have been held regularly three or four times a year since.

- The BCBS describes its original aim as the enhancement of "financial stability by improving supervisory knowhow and the quality of banking supervision worldwide." Later, the BCBS turned its attention to monitoring and ensuring the capital adequacy of banks and the banking system.

1.1 History

- The meetings are named "Basel Accords" since the BCBS is headquartered in the offices of the Bank for International Settlements (BIS) located in Basel, Switzerland.

- Since its inception, the Basel Committee has expanded its membership from the G10 to 45 institutions from 28 jurisdictions.

- Member countries include Australia, Argentina, Belgium, Canada, Brazil, China, France, Hong Kong, Italy, Germany, Indonesia, India, Korea, the United States, the United Kingdom, Luxembourg, Japan, Mexico, Russia, Saudi Arabia, Switzerland, Sweden, the Netherlands, Singapore, South Africa, Turkey, and Spain.

1.2 Laying the foundation

- At the outset, one important aim of the Committee's work was to close gaps in international supervisory coverage so that

i. no banking establishment would escape supervision; and
ii. supervision would be adequate and consistent across member jurisdictions.

A first step in this direction was the paper issued in 1975 that came to be known as the "Concordat".

- The Concordat set out principles for sharing supervisory responsibility for banks' foreign branches, subsidiaries and joint ventures between host and parent (or home) supervisory authorities.
- In May 1983, the Concordat was revised and re-issued as Principles for the supervision of banks' foreign establishments.

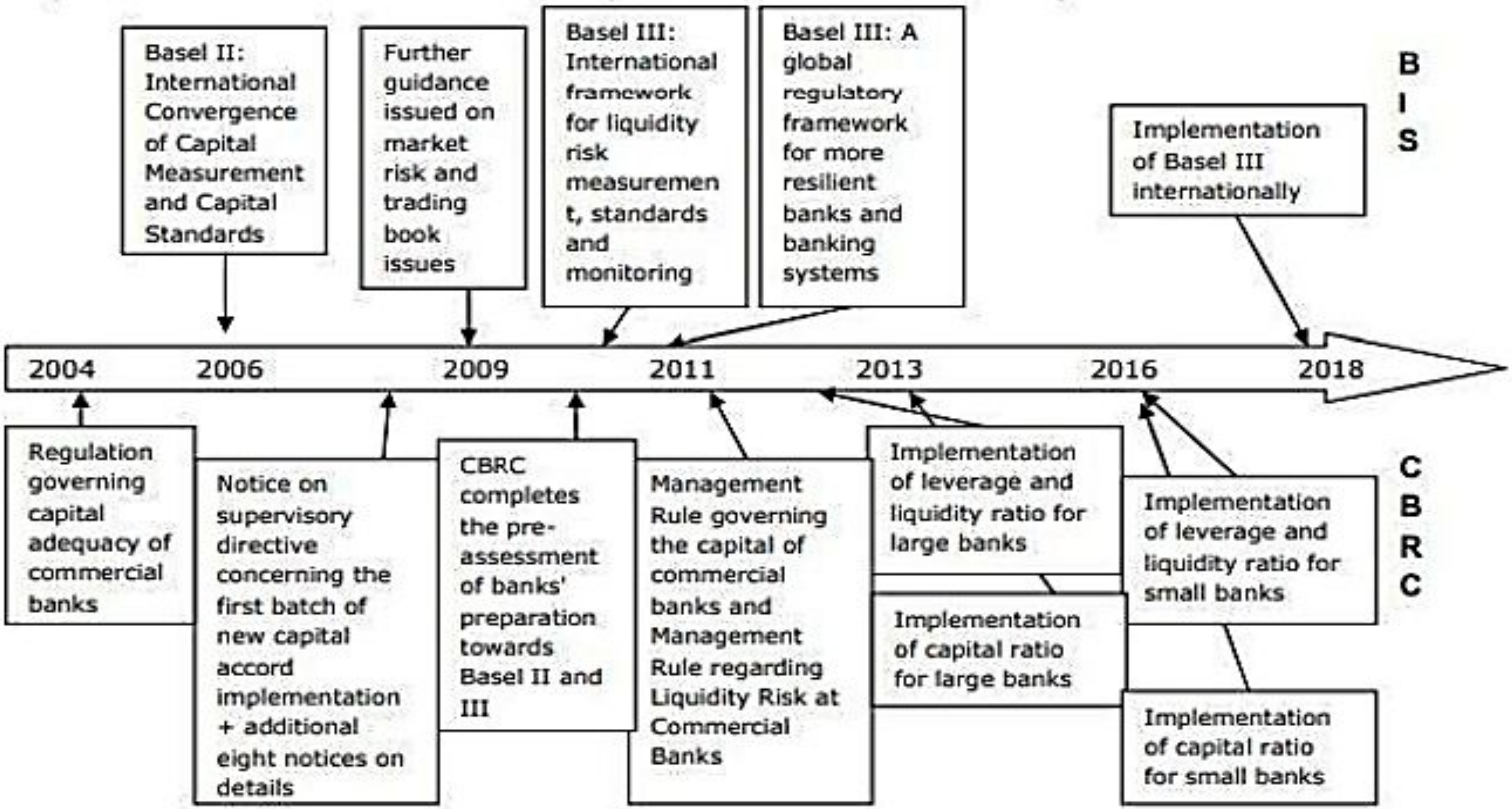
2 What are Basel Accords?

The BCBS has developed a series of highly influential policy recommendations known as the Basel Accords. These are not binding and must be adopted by national policymakers in order to be enforced, but they have generally formed the basis of banks' capital requirements in countries represented by the committee and beyond

The Basel Accords refers to a set of banking supervision regulations set by the Basel Committee on Banking Supervision (BCBS).

Their key function is:

1. To ensure that banks hold enough cash reserves to meet their financial obligations and survive in financial and economic distress.
2. To strengthen corporate governance, risk management, and transparency.
3. The regulations are considered to be the most comprehensive set of regulations governing the international banking system.


Basel II: International Convergence of Capital Measurement and Capital Standards
Further guidance issued on market risk and trading book issues
Basel III: International framework for liquidity risk measuremen t, standards and monitoring
Basel III: A global regulatory framework for more resilient banks and banking systems
Implementation of Basel III internationally
B I S
2004
2006
2009
2011
2013
2016
2018
Regulation governing capital adequacy of commercial banks
Notice on supervisory directive concerning the first batch of new capital accord implementation + additional eight notices on details
CBRC completes the pre-assessment of banks' preparation towards Basel II and III
Management Rule governing the capital of commercial banks and Management Rule regarding Liquidity Risk at Commercial Banks
Implementation of leverage and liquidity ratio for large banks
Implementation of capital ratio for large banks
Implementation of leverage and liquidity ratio for small banks
Implementation of capital ratio for small banks
C B R C

3 Basel Summary

Basel I summary

The Basel Committee was formed in response to the liquidation of a Europe-based bank in 1974 This incident prompted the G-10 nations to set up the Basel Committee on Banking Supervision (BCBS), under the direction and supervision of the Bank of International Settlements, which is in Basel, Switzerland. As a result of the liquidation of the bank, this committee instigated the Basel 1 Accord in 1988 and focused on the capital adequacy of financial institutions.

Basel II summary

The Basel II Accord was introduced following substantial losses in the international markets since 1992, which were attributed to poor risk management practices. The Basel II Accord makes it mandatory for financial institutions to use standardized measurements for credit, market risk, and operational risk. However, different levels of compliance allow financial institutions to pursue advanced risk management approaches to free up capital for investment.

Basel II.5 summary

It is a complex and tedious set of capital-based regulations that overlook critical issues such as leverage, liquidity, the separation of investment and commercial banking, and the problem of TBTF. Basel 2.5 maintains the procedure whereby regulatory capital is calculated on the basis of risk-weighted assets, where weights are determined primarily by the credit rating agencies

3 Basel Summary

Basel III summary
Basel III is an extension of the existing Basel II Framework, and introduces new capital and liquidity standards to strengthen the regulation, supervision, and risk management of the whole of the banking and finance sector.

Basel IV summary
Basel IV is a regulatory capital standard for banks that are active internationally. It was developed by the Basel Committee on Banking Supervision and was finalized in December 2017. The goal of Basel IV is to improve financial stability by strengthening the regulation and supervision of banks worldwide. Basel IV BCBS finalises reforms on Risk Weighted Assets (RWA)

3.1 Comparison

Basel 1	Basel 1 was formed with the main objective of enumerating a minimum capital requirement for banks.
Basel 2	Basel 2 was established to introduce supervisory responsibilities and to further strengthen the minimum capital requirement.
Basel 3	Focus of Basel 3 was to specify an additional buffer of equity to be maintained by banks.

3.1 Comparison

	Risk Focus
Basel 1	Basel 1 has the minimal risk focus out of the 3 accords.
Basel 2	Basel 2 introduced a 3 pillar approach to risk management.
Basel 3	Assessment of liquidity risk in addition to the risks set out in Basel 2 was introduced by Basel 3.

3.1 Comparison

	Risks Considered
Basel 1	Only credit risk is considered in Basel 1.
Basel 2	Basel 2 includes a wide range of risks including operational, strategic and reputational risks.
Basel 3	Basel 3 includes liquidity risks in addition to the risks introduced by Basel 2.

3.1 Comparison

	Predictability of Future Risks
Basel 1	Basel 1 is backward-looking as it only considered the assets in the current portfolio of banks.
Basel 2	Basel 2 is forward-looking compared to Basel 1 since the capital calculation is risk-sensitive.
Basel 3	Basel 3 is forward looking as macroeconomic environmental factors are considered in addition to the individual bank criteria.