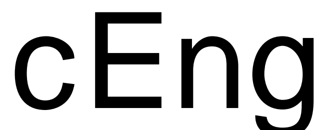
BASEL COMMITTEE ON BANKING SUPERVISION



Press release

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Ref no:

16 January 2001

The New Basel Capital Accord

The Basel Committee on Banking Supervision today issued a proposal for a New Basel Capital Accord that, once finalised, will replace the current 1988 Accord. William J McDonough, Chairman of the Basel Committee and President and Chief Executive Officer of the Federal Reserve Bank of New York, introduced the proposal, noting, “the new framework is intended to align regulatory capital requirements more closely with underlying risks, and to provide banks and their supervisors with several options for the assessment of capital adequacy”. Mr McDonough added that, in putting forward these proposals for a New Basel Capital Accord, the Committee believes it has laid the groundwork for a flexible capital adequacy framework that has the capacity to adapt to changes in the financial system and will enhance safety and soundness.

The proposal is based on three mutually reinforcing pillars that allow banks and supervisors to evaluate properly the various risks that banks face. The New Basel Capital Accord focuses on: **minimum capital requirements**, which seek to refine the measurement framework set out in the 1988 Accord; **supervisory review** of an institution’s capital adequacy and internal assessment process; and **market discipline,** through effective disclosure to encourage safe and sound banking practices.

The focus of the 1988 Accord was initially on internationally active banks, but it since has been adopted by more than 100 countries. “The Committee has consulted with supervisors worldwide in developing the new framework, and expects the New Basel Capital Accord to be adhered to by all significant banks around the globe after a certain period of time,” said Claes Norgren, Director General at Finansinspektionen, Sweden, and Chairman of the Basel Committee’s Task Force on the Future of Capital Regulation, the group leading the review of the Accord.

Structure of package

The comments received on the proposals set out in the Committee’s first consultative paper, issued in June 1999, and ongoing dialogue with the industry and supervisors worldwide, have greatly assisted the Committee in developing the proposals set out in the package released today. This package comprises three parts:

- The first is the *Overview of the New Basel Capital Accord*, which discusses the rationale for the key components of the new framework. It provides an explanation of the structure of the proposals and identifies particular areas where the Committee is seeking input and feedback.
- The second part, *The New Basel Capital Accord*, sets forth the detailed proposals. This document, once finalised, will be the definitive basis for the rules that member countries would be expected to adopt to replace the 1988 Accord. The new framework is expected to be implemented in 2004.
- The third component comprises a set of supporting documents that provide background information and technical details regarding the underlying analysis for the proposals.

The Committee recognises that the New Basel Capital Accord is more extensive and complex than the 1988 Accord. "The complexity of the new framework is a natural reflection of the advancement and innovations in the financial marketplace and the need for a more risk-sensitive framework," said Danièle Nouy, Secretary General of the Basel Committee. The key aspects of the proposals set out in these documents are briefly highlighted below. Readers are encouraged to refer to the accompanying document released by the Basel Committee Secretariat, titled "*The New Basel Capital Accord: an explanatory note,*" for a general description of the contents of the consultative package.

Pillar 1

In the proposals for Pillar 1 - minimum capital requirements - the Committee intends to replace the one-size-fits-all framework set out in the 1988 Accord with a variety of options. The New Basel Capital Accord sets out those options from which banks, with the authorisation of their supervisor, can choose depending on the complexity of their business, as well as the quality of their risk management. "This framework will motivate banks to improve continuously their risk management capabilities so as to make use of the more risk-sensitive options and, thus, produce more accurate capital requirements," said Mr McDonough. He noted that the Committee also is placing greater emphasis on banks' own assessment of the risks to which they are exposed in the calculation of regulatory capital charges.

For credit risk, a *standardised approach* building upon the 1988 Accord and introducing the use of external credit assessments will be available for less complex banks. Banks with more advanced risk management capabilities, which can meet rigorous supervisory standards, can make use of an *internal ratings-based approach*. Under this approach, some of the key elements of credit risk, such as the probability of default of the borrower, will be estimated internally by a bank. The Committee is also proposing an explicit capital charge for operational risk. A number of possible options for this calculation are elaborated on in the consultative package.

With respect to the overall level of capital, the Committee's primary goal is to deliver a more risk-sensitive methodology that on average neither raises nor lowers regulatory capital for banks, after including the new operational risk capital charge. Naturally, capital requirements may increase or decrease for an individual bank depending on its risk profile.

Pillar 2

The Committee's ongoing work has also affirmed the importance of the supervisory review process as a critical complement to the minimum capital requirements. The New Basel Capital Accord therefore proposes procedures through which supervisors ensure that each bank has sound internal processes in place to assess the adequacy of its capital and set

targets for capital that are commensurate with the bank's specific risk profile and control environment. This internal process would then be subject to supervisory review and intervention where appropriate.

Pillar 3

The Committee believes that the disclosure requirements and recommendations set out in the package will allow market participants to assess critical information describing the risk profile and capital adequacy of banks. The proposals provide more detailed guidance on the disclosure of capital structure, risk exposures and capital adequacy.

Next steps

Comments on the New Basel Capital Accord should be submitted by 31 May 2001 to relevant national supervisory authorities and central banks. In addition, they may be sent to the Basel Committee on Banking Supervision at the Bank for International Settlements, CH-4002 Basel, Switzerland. Comments are also invited via e-mail: BCBS.Capital@bis.org or by fax: +41 61 280 9100 and should be directed to the attention of the Basel Committee Secretariat. To increase transparency, the Committee intends to publish on its website comments received during the second consultative period. Comments that are clearly marked as confidential will not be published.

The Committee intends to finalise the New Basel Capital Accord by the end of 2001. It is envisioned that the New Accord will be implemented in member jurisdictions in 2004. This timetable will accommodate national rulemaking procedures and allow adaptation of banks' internal systems, supervisory processes and regulatory reporting.

The Committee recognises that implementation of these proposals will in many cases require supervisors to augment their resources. It nonetheless believes that a capital adequacy framework that is more sensitive to risk and promotes strong risk management practices will contribute to financial stability globally, thereby justifying any required additional resources. The Committee and the BIS's Financial Stability Institute stand ready to provide assistance and together will serve as a forum for information, dissemination and exchange among supervisors.

The documents referred to in this note can be obtained from the BIS website at www.bis.org.