



FINANCIAL STABILITY INSTITUTE

BANK FOR INTERNATIONAL SETTLEMENTS

Regional Seminar on Global Financial Turmoil and the Changing Face of Financial Sector Supervision

Update from Basel

Jointly organised by the
Financial Stability Institute (FSI) &
Financial Services Volunteer Corps (FSVC) &
MENA Financial Regulators' Initiative

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Stefan Hohl, FSI/BIS, Senior Financial Sector Specialist



Most Recent Developments

- G20 meeting
- Press releases (March 2009)
 - More BCBS and FSF members!
- Strengthen the level of capital in the banking system
 - Combination of measures such as introducing standards to promote the build up of capital buffers that can be drawn down in periods of stress, strengthening the quality of bank capital, improving the risk coverage of the capital framework and introducing a non-risk based supplementary measure.
 - Not now! But, the regulatory minimum level of capital will be reviewed in 2010



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Basel II consultative package (www.bis.org)

- Released on 16 January
- *Revisions to the Basel II market risk framework*
- *Guidelines for computing capital for incremental risk in the trading book*
 - For comment until 13 March 2009
- *Proposed enhancements to the Basel II framework*
 - For comment by 17 April 2009



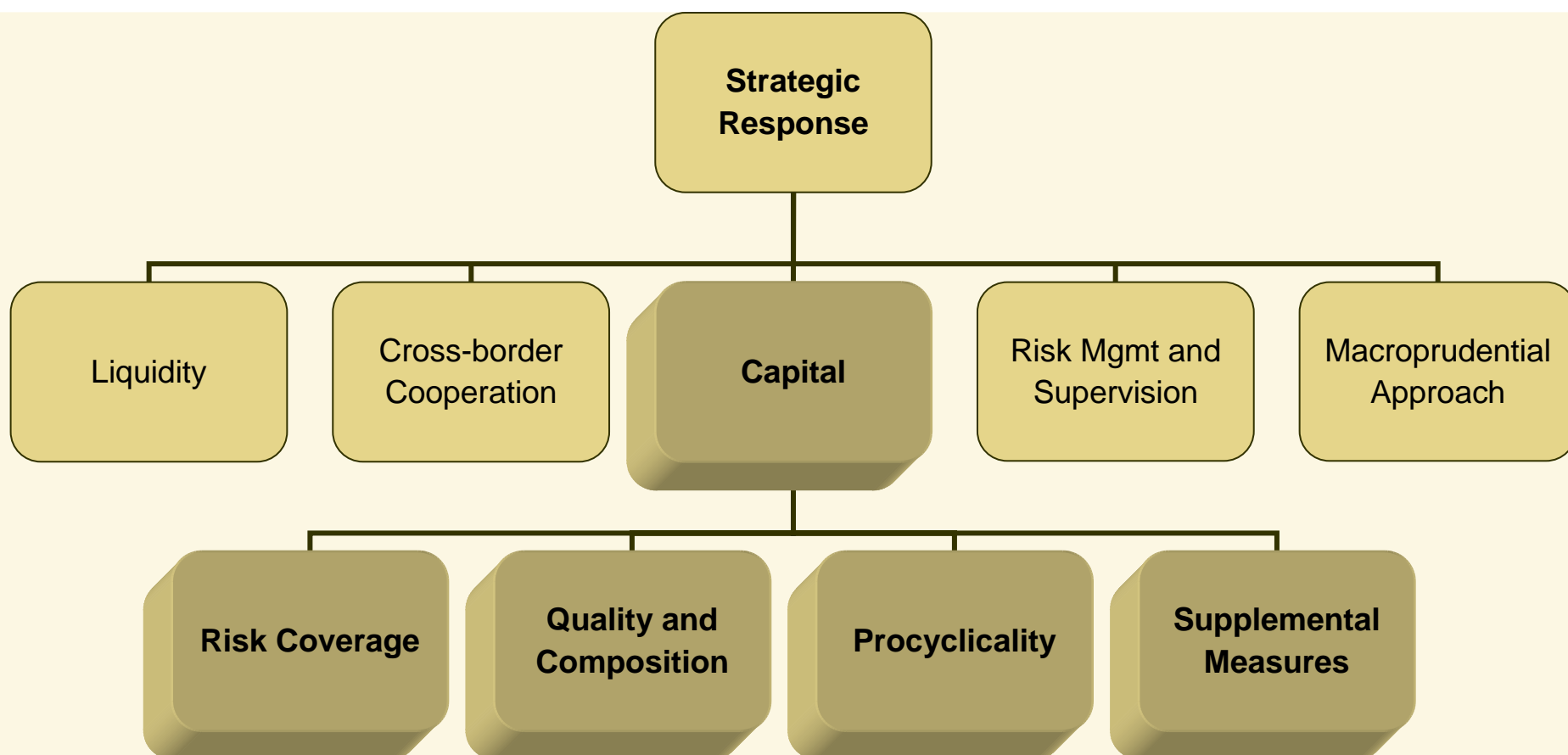
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**Risk Management and
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Risk Management and Supervision

Strengthening risk coverage

- Trading book
 - Incremental risk charge (IRC)
 - “Stressed” VaR requirement
- Banking book
 - CDOs of ABS (resecuritisations)
 - ABCP liquidity lines
 - Greater due diligence for rated products



Revisions to the Market Risk Framework

- Part of Committee's work program in response to crisis
- Addressed in April 2008 FSF recommendations and November 2008 G20 Declaration
- But initiated prior to crisis
 - July 2005 Trading book paper
 - Twice consulted on Incremental Risk Charge (IRC)
 - On IDRC in October 2007 (default only)
 - On (comprehensive) IRC in July 2008 (to capture default, migration, credit spread and equity price risk)



Revisions to Market Risk

- January 2009 Committee two documents are result of comments received on July 2008 proposal
 - Revisions to the Basel II market risk framework
 - Guidelines for computing capital for incremental risk in the trading book
- Banks are not yet able to model IRC in comprehensive way (i.e. in particular not for securitised products and credit spread risk/equity price risk)
- Revised proposals include



Consultative Documents – Guiding Principles

- More capital is needed
 - Including the objective to reduce the incentive for regulatory arbitrage between the banking and trading books
- VaR models failed during crisis
- Therefore, Value-at-Risk (VaR) adjusted to also capture stress periods
- Revised methodology
 - VaR based on current parameters times 3 or 4 (based on backtesting) for both general market risk and specific risk
 - Based on 99 % confidence level, 10 day holding period
 - Plus a stressed VaR times 3



Consultative Documents – Guiding Principles

- For specific risk there are additional capital requirements
- Taking into account different liquidity horizons
- IRC for unsecuritised products
 - Should capture default and migration risk
 - 99.9% confidence interval, 1 year capital horizon, minimum 3 month liquidity horizon
- For securitised products
 - Capital charges in (revised) securitisation framework apply (under both models and standardised approach)
- Will increase capital for Trading Book significantly



Other significant issues

- Extension of prudent valuation guideline for all positions that are accounted for at fair value
 - Especially important for positions without actual market prices, as well as less liquid positions
- Committee consults on banking book treatment for all (or illiquid) trading book positions
- For equities, uniform 8% specific risk charge without exceptions for liquid and well diversified portfolios
- TBG is undertaking impact study
 - Data collection
 - Results by fall 2009
- Implementation of new regime by 31 December 2010



Pillar 1 Changes - Summary

- Resecuritisation Risk Weights
 - Higher RW for resecuritisation exposures in both, the standardized approach (SA) and the internal ratings based approach (IRB)
- Resecuritisation Risk Weights (higher RW)
- No use of Ratings Subject to Self-guarantee
- Improved due diligence for the use of external ratings, i.e. higher operational requirements for credit analysis
- Liquidity facilities (LF) in the SA and IRB
 - RW of 50%, regardless of maturity
- Elimination of the favourable capital treatment for general market disruption LFs in SA and IRB



Revisions to Pillar 3 - Summary

- Proposed enhancements to Pillar 3 in line with FSF, but sometimes wider than Pillar 1 requirements
 - Securitisation exposures in the trading book;
 - Sponsorship of off-balance sheet vehicles;
 - Internal Assessment Approach (IAA) and other ABCP liquidity facilities;
 - Resecuritisation exposures;
 - Valuation with regard to securitisation exposures;
 - Pipeline and warehousing risks with regard to securitisation exposures



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Quality and composition

- Definition and composition of capital
- Importance of Tier 1 capital
- Relevance of Tier 2 capital



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Procyclicality

- Monitoring of Basel II
- Capital buffers
- Provisions
- Pillar 2 assessments
- Stress testing standards
- Through-the-cycle vs. Point-in-time
- Supplementary measures



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Supplemental measures

- Leverage ratio
- Revenue-based ratio
- Systemic assessments
- ...



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**Strategic
Response**

Liquidity

Cross-border
Cooperation

Capital

**Risk Mgmt and
Supervision**

Macroprudential
Approach

**Supplementary
Pillar 2 guidance**

**Guidance and
Consultations**

**Counterparty
Credit Risk**



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Supplemental Pillar 2 guidance

- Firm-wide governance and risk management, crisis highlighted
 - lack of banks fully understanding their own risks
 - Importance of effective capital planning and longer-term capital maintenance
- Specific risk management topics:
 - Risk concentrations;
 - Off-balance sheet exposures with a focus on securitisation;
 - Reputational risk and implicit support;
 - Valuation and liquidity risks; and
 - Sound stress testing practices.



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Guidance and consultations

- *Principles for Sound Liquidity Risk Management and Supervision* (September 2008)
- *Supervisory guidance for assessing banks' financial instrument fair value practices* (comment period ended 6 February 2009)
- *Principles for sound stress testing practices and supervision* (comment period ended 13 March 2009)