

ICBS 2004
PANEL ON BASEL II IMPLEMENTATION

**KEY ISSUES FOR THE TRANSITION
TO BASEL II IN NON G-10 COUNTRIES**

MADRID, SEPTEMBER 2004

INTRODUCTION (1)

- Basel II is an initiative that promises key advances in risk management and banking supervision around the world.
- The challenge for non G-10 countries is to take the new framework not as a threat but as an opportunity to improve risk management and banking supervision.
- The vast majority of non G-10 countries will adopt this new framework.
- The non G-10 countries form a very heterogeneous group.

INTRODUCTION (2)

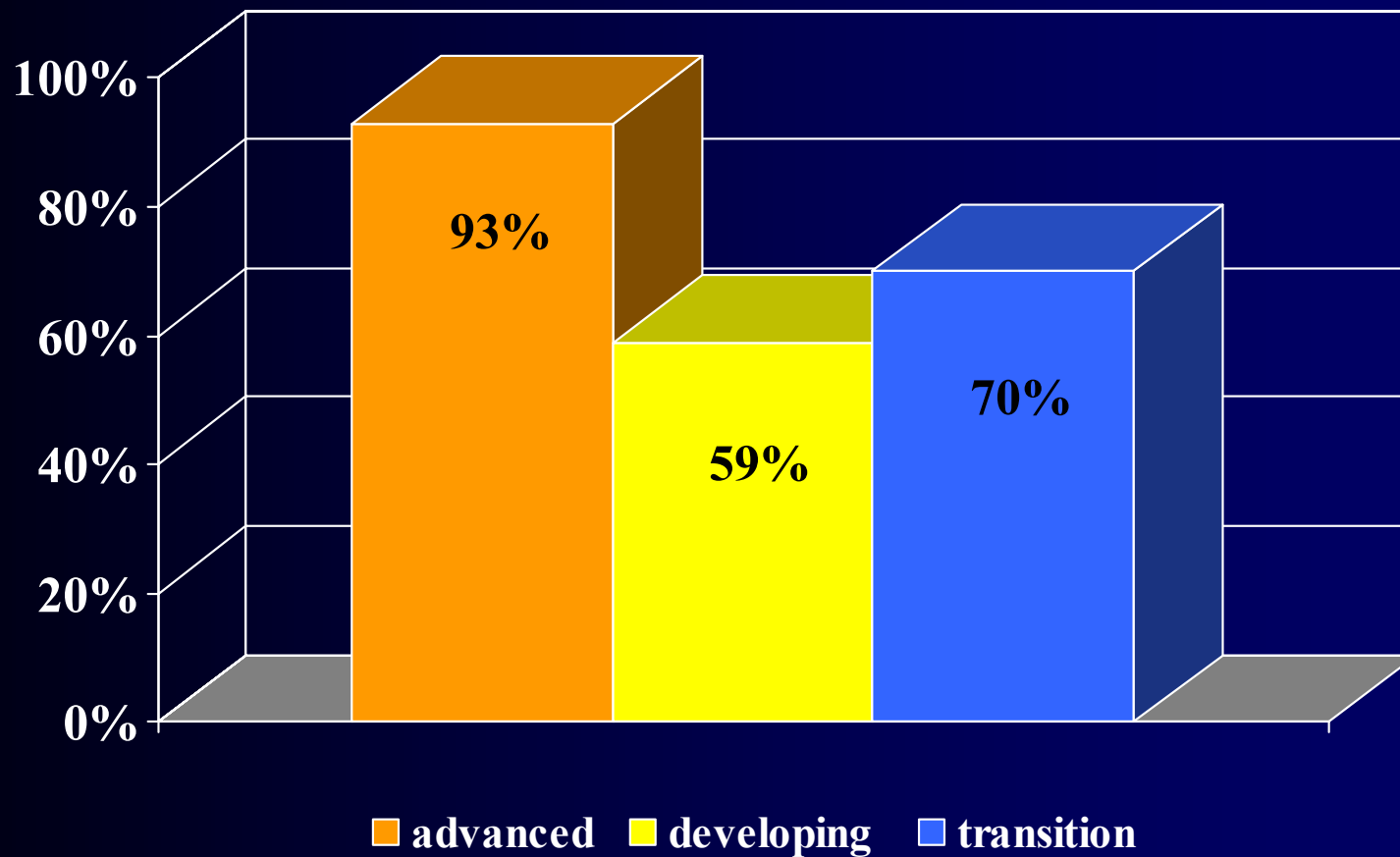
- Bank lending is the major source of finance in developing countries. This explains why Basel II has become such a sensitive issue and its implementation has raised so many legitimate concerns.
- It is clear that the transition in developing countries will be complex and lengthy.
- Flexibility is key for successful implementation.
- For all these reasons, the transition process will not follow a uniform pattern and timeline across different jurisdictions.

SUPERVISORY ASSESSMENT

- Basel II requires sufficiently strong regulatory and supervisory foundations.
- Prior to implementation, it will be necessary to establish an accurate diagnosis of the state of regulation, supervision, and bank management.
- A number of aspects must be examined: the legal and regulatory framework; the supervisory system; financial infrastructure; corporate governance and management systems; financial disclosure and market discipline.
- Most of these issues are referred to in the Basel Core Principles (BCP).

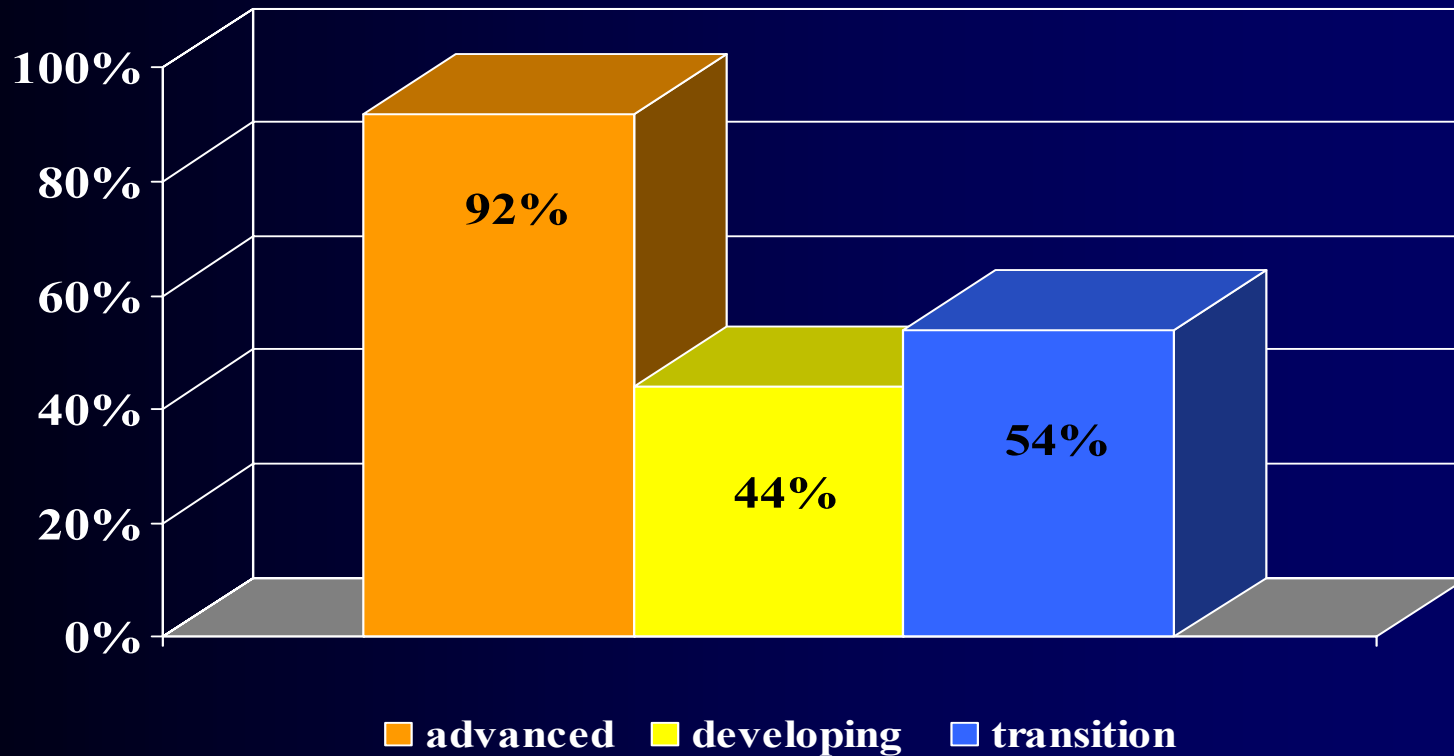
WHAT DO WE KNOW ABOUT GENERAL BCP COMPLIANCE IN DEVELOPING COUNTRIES? WE KNOW THAT IT IS RELATIVELY LOW

LEVEL OF COMPLIANCE BY COUNTRY GROUPING



**WE ALSO KNOW THAT COMPLIANCE WITH THE
BASEL CORE PRINCIPLES RELEVANT FOR BASEL II IS
EVEN LOWER THAN GENERAL COMPLIANCE**

LEVEL OF COMPLIANCE BY COUNTRY GROUPING



WHAT ARE THE PRACTICAL IMPLICATIONS OF THIS SITUATION FOR BASEL II IMPLEMENTATION?

- The answer depends on the view taken of the relationship between BCP and Basel II.
- If BCP compliance is seen as an essential prerequisite for Basel II, implementation ought to be postponed until satisfactory compliance is achieved.
- If Basel II is seen as an extension and deepening of BCPs, then the transition to the new framework becomes part of BCP implementation itself.

OPTIONS AND DECISION-MAKING

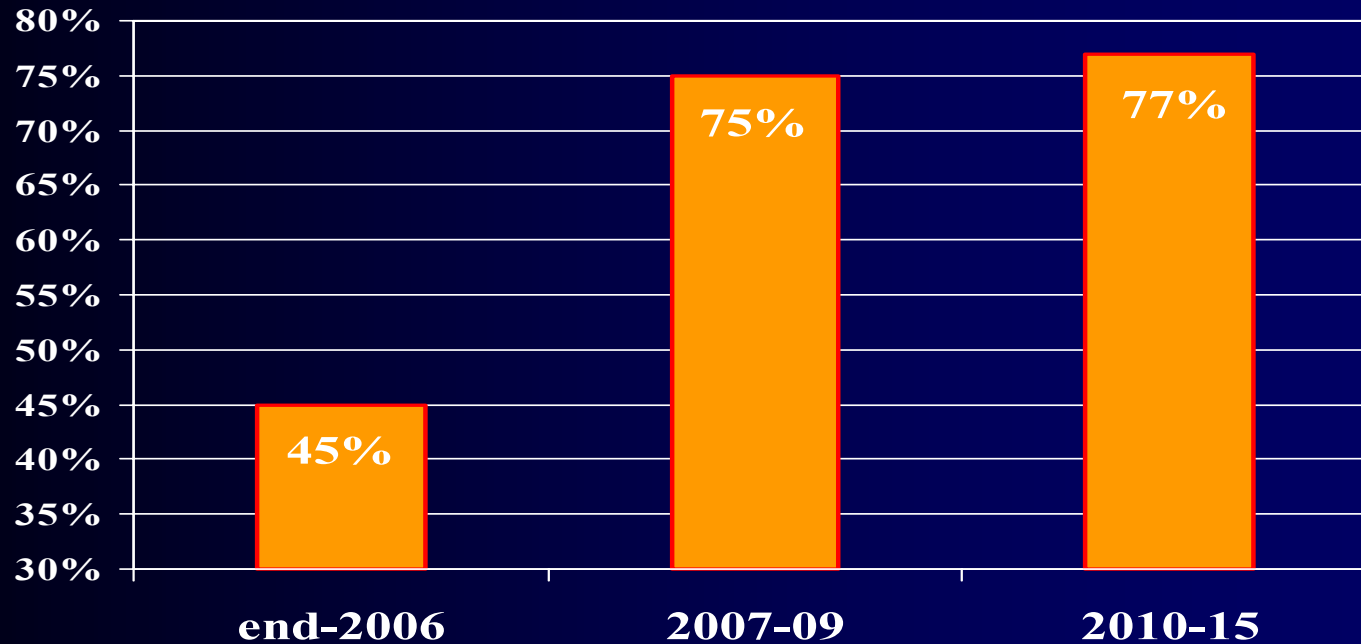
- The new framework provides enough flexibility as regards the scope of application and timing.
- The more advanced countries are prepared to move immediately to Basel II within the timeframe set by the Committee.
- However, stepwise or gradual implementation seems best suited to the needs of most non G-10 countries.
- A recent survey conducted by the FSI provides some insights as to the plans of non G-10 countries.

82% OF SURVEYED NON G-10 COUNTRIES INTEND TO ADOPT BASEL II

Region	Number of respondents	Respondents intending to adopt Basel II	%
Asia	18	15	83.3
Africa	22	16	72.7
Latin America	15	11	73.3
Caribbean	7	5	71.4
Middle East	8	7	87.5
Non-BCBS Europe	37	34	91.9
Total	107	88	82.2

A SIGNIFICANT PERCENTAGE OF JURISDICTIONS, BANKS AND BANKING ASSETS ARE EXPECTED TO BE SUBJECT TO BASEL II IN 2007-09 *

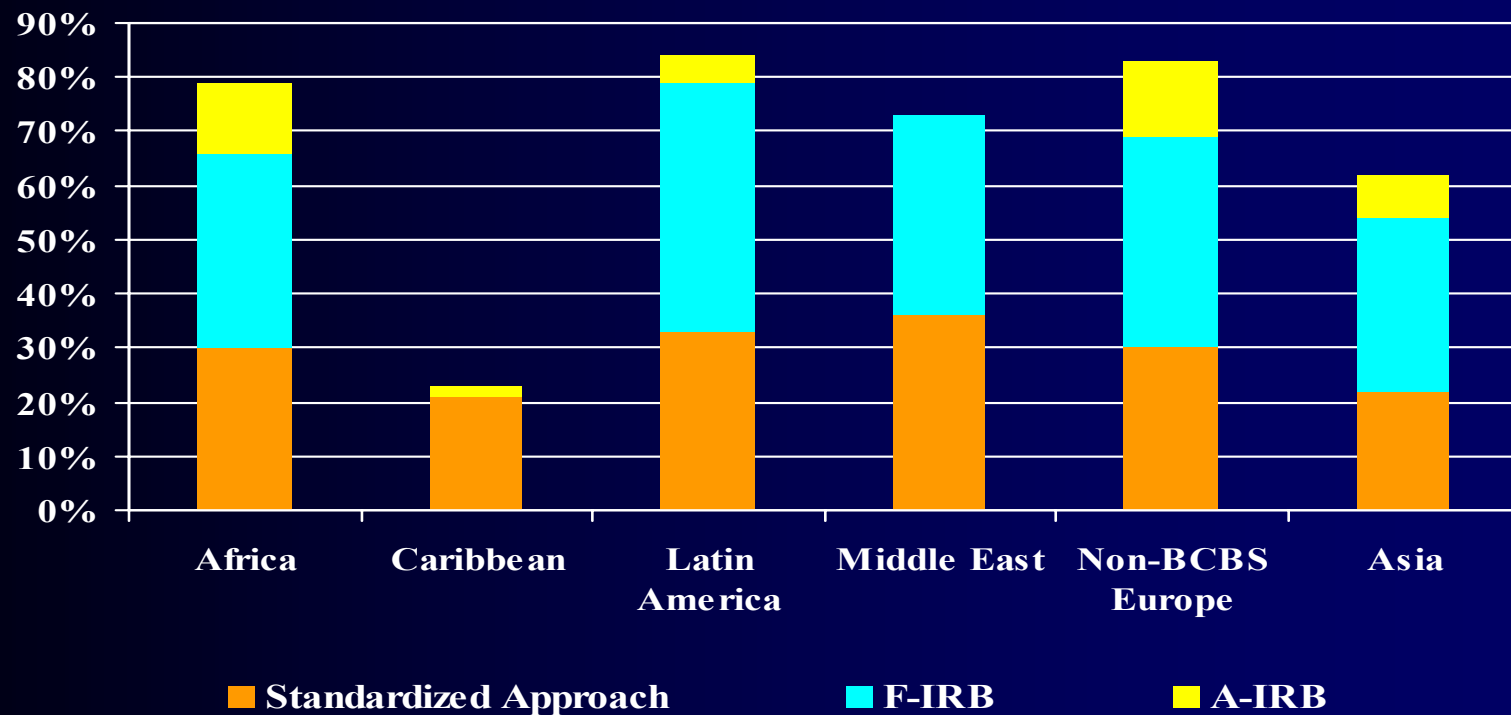
PERCENTAGE OF BANKING ASSETS EXPECTED TO BE SUBJECT TO BASEL II IN 2007-09 (WEIGHTED AVERAGE)



* ASSETS OF JUST OVER 5,000 BANKS IN 73 JURISDICTIONS.

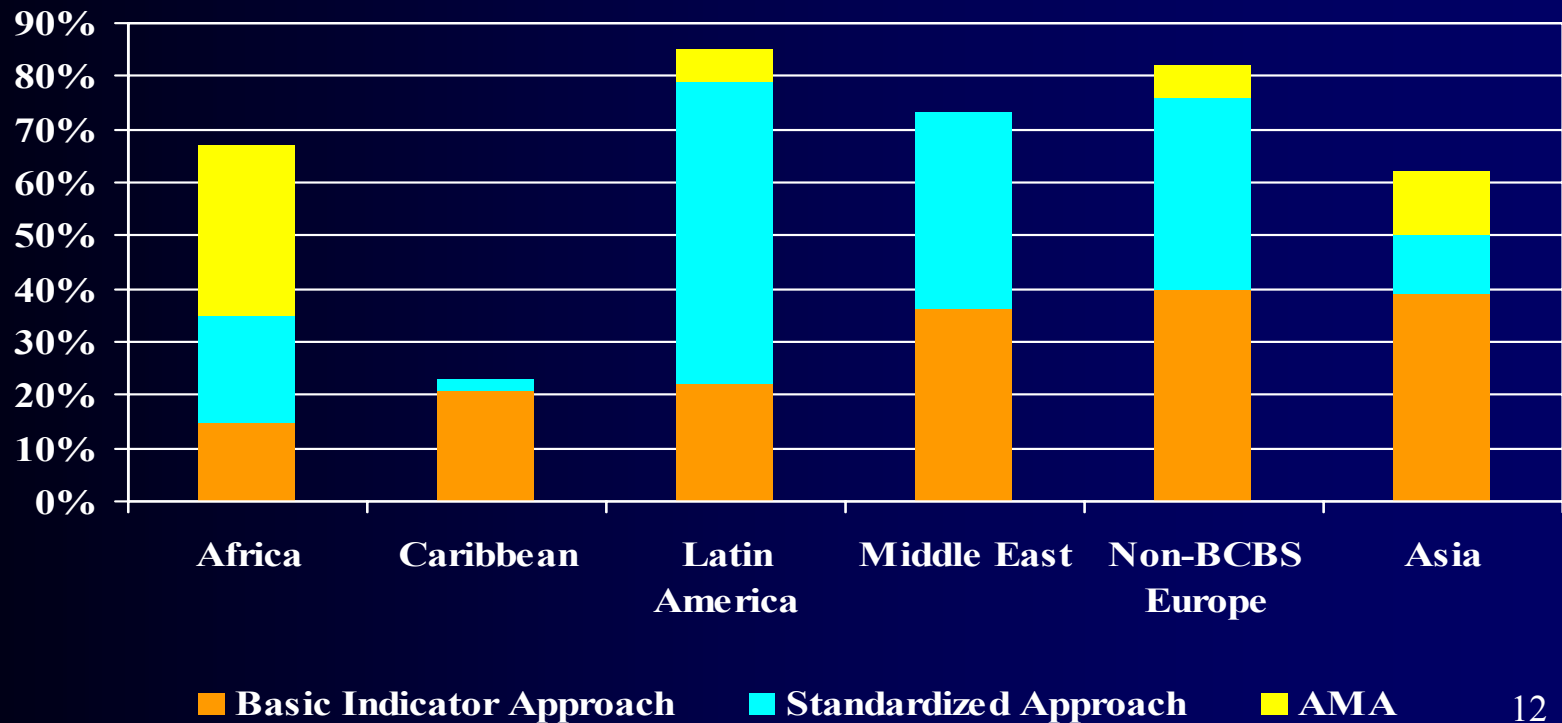
THE STANDARDIZED AND FOUNDATION IRB APPROACHES ARE THE TWO PREFERRED OPTIONS FOR CREDIT RISK AMONG NON G-10 COUNTRIES

PERCENTAGE OF BANKING ASSETS EXPECTED TO BE SUBJECT TO CREDIT RISK APPROACHES IN 2007-09, BY REGION (WEIGHTED AVERAGE)



THE BASIC INDICATOR AND STANDARDIZED APPROACHES ARE THE TWO PREFERRED OPTIONS FOR OPERATIONAL RISK AMONG NON G-10 COUNTRIES

PERCENTAGE OF BANKING ASSETS EXPECTED TO BE SUBJECT TO OPERATIONAL RISK APPROACHES IN 2007-09, BY REGION (WEIGHTED AVERAGE)



POLICY IMPLICATION ISSUES (1)

- Reinforcing provisioning standards.
- Introducing macro-prudential considerations.
- Assessing the competitive implications of different policy options (level playing field).
- Making a decision on small banks.
- The appropriate balance between supervisory and market discipline.
- Home/host cooperation and communication.

POLICY IMPLICATION ISSUES (2)

- Assessing implementation risks.
- Development of a reliable and independent credit rating industry at the national level.
- Simultaneous implementation of new accounting and corporate governance standards.
- Decision-making subject to national discretion on Pillar I.
- Effective implementation of Pillar II.
- Implementation of Pillar III.

PRACTICAL ISSUES

- Involvement of banks and bankers.
- Developing credit registries/bureaus
- Communication and dialogue with the industry.
- Quantitative impact studies.
- Implementation plan.
- Preparing legal changes
- Building supervisory capacities.

FINAL REMARKS

- Basel II is already a concrete proposal and will become a global standard in the near future.
- Non G-10 countries must take it as an opportunity.
- The majority of non G-10 countries will move to Basel II.
- Supervisory assessment is key for successful implementation.
- The implementation process poses a number of supervisory challenges, of which the home/host issue will be one of the most important for effective implementation.
- Building supervisory resources will be essential for non G-10 countries. To this end, technical assistance and the transfer of expertise from G-10 countries and international organizations will be required.