THE BASEL INDEX AND CAPITAL ADEQUACY IN THE NEW CAPITAL FRAMEWORK

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Key Principles of Supervisory Review Process

- **Principle 1**: Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.

- **Principle 2:** Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.

- **Principle 3:** Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.

- **Principle 4**: Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained and restored.

SOME BASEL INDEX CAPITAL FORMULAS

$$BIm = Cm / RWA = 8\% \qquad (1)$$

$$Cm = 8\% * RWA = 8\% * CRWA + MR + OR \qquad (2)$$

$$Cm' = 10\% * RWA = 10\% * CRWA + MR + OR \qquad (3)$$

From (1):

$$\%\Delta BIm = \%\Delta Cm \qquad (4)$$

From (2) and (3):

$$\Delta Cm = (10\% - 8\%) * RWA = 2\% * CRWA \qquad (5)$$

where:

BIm	=	Minimum Basel Index
Cm	=	Minimum Capital Requirement
RWA	=	Risk weighted assets
CRWA	=	Credit risk weighted assets
MR	=	Market risk capital charge
OR	=	Operational risk capital charge

Table N° 1
Capital effects of increasing the minimum Basel Index above 8%

BIm (%)	ΔBIm	%ΔBIm=%ΔCm	ΔCm (Amount)
8	0	0.0	0.0
9	1	12.5	0.01*CRWA
10	2	25.0	0.02*CRWA
11	3	37.5	0.03*CRWA
12	4	50.0	0.04*CRWA
13	5	62.5	0.05*CRWA
14	6	75.0	0.06*CRWA
15	7	87.5	0.07*CRWA
16	8	100.0	0.08*CRWA

Table N° 2
Solvency rating of banks

Factors	Evaluation criteria	Rating		
		A	B	C
Provisions on credit risk	- Trustworthy measurement of expected losses in loan portfolios - Full provisioning of expected losses in loan portfolios			
Pillar I	- Capital allocation to credit risk, market risk and operational risk - Capital stock and capital allocated to different risks - Capital and Basel Index in relation to their minimums			
Pillar II	- Capital sufficiency in stress-tests - Policy to maintain capital in adverse economic and financial conditions.			
Risks not considered in Pillar I	- Measurement and control of: - Liquidity risk - Interest risk in banking book - Concentration risk in loan portfolios - Other significant risks			