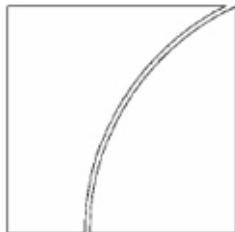


Basel Committee  
on Banking Supervision



International Convergence  
of Capital Measurement  
and Capital Standards

A Revised Framework

June 2004



BANK FOR INTERNATIONAL SETTLEMENTS

# BASEL II in the German Banking Industry

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## **BASEL II – What is BASEL II?**

- **The Basel Committee on Banking Supervision is a committee of Banking Supervisory authorities that was established by the central bank governors of the group of Ten Countries in 1975.**
- **These countries are:**
  - Europe: Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom,
  - North America: Canada, the United States of America,
  - Asia: Japan
- **The Committee usually meets at the Bank of International Settlement in Basel, where the permanent Secretariat is located.**

## **BASEL II – What is BASEL I?**

- **In 1988 the first “Basel Accord” was endorsed.**
- **This Accord described the goals of increasing the capital of banks to reduce the instability in critical times.**
- **The simple method of measuring the counterparty credit risk has some negative / unwished impacts:**
  - **Credits for companies are “expensive” compared i.e. with credit to “OECD”-countries.**
  - **Daimler-Chrysler or Lufthansa are treated in the same way as a small company like FI.NET.**
  - **...**

## **BASEL II – The idea of BASEL II**

- **The Basel Committee on Banking Supervision’s (the “Committee”) work over years (since 1999)**
  - to secure international convergence
  - on capital adequacy
  - on revisions to supervisory regulations
  - governing the capital adequacy
  - of internationally active banks.
- **The result is called “the framework” or “the BASEL II accord”.**
- **In June 2004 the “revised Framework” has been published by the committee after various circulations of the draft and additional proposals according to “quantitative impacts studies” (QIS) among the participating countries.**

## **BASEL II – the Pillars of BASEL II**

- **BASEL II accord consists of three pillars**
  - **Pillar 1: Minimum capital requirements**
    - credit risk
    - operational risk
    - trading book issues
  - **Pillar 2:**
    - Supervisory Review Process
  - **Pillar 3:**
    - Market Discipline.
  
- **The implementation efforts in Europe (Germany, Austria, Switzerland, France) concentrate on the first pillar, especially on credit risk.**

## BASEL II – Legal aspects / Time Schedule

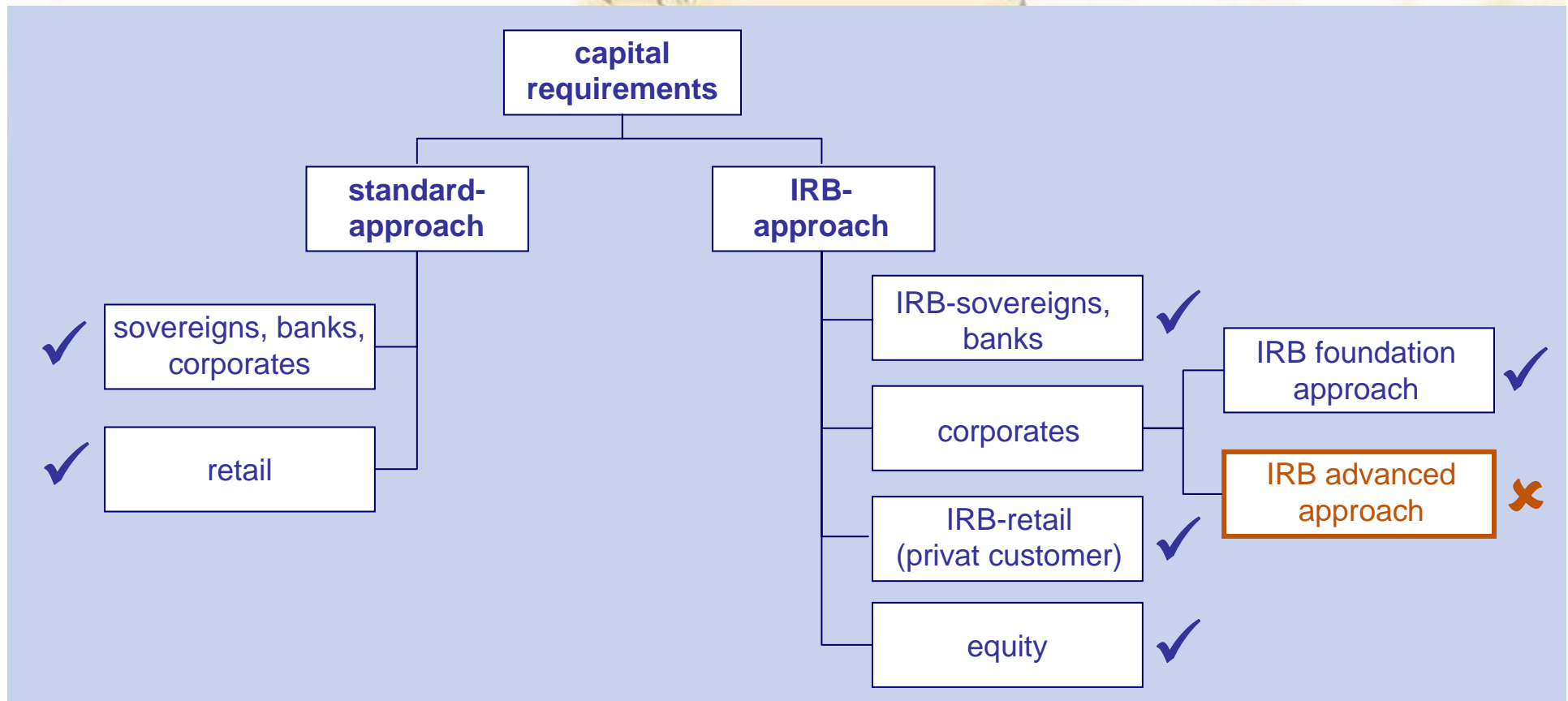
- Final version of **BASEL II** accord is published by the committee.
- Transformation into European law is still under development, but **almost** finished (Brussels).
- National implementation rules and the detailed laws are **not** completed – the final version is taking more time than estimated. In Germany we expect the final version at the earliest in June / July 2006.
- The requirements resulting from the national law are not yet finally specified by the national umbrella organizations (like “DSGV” – the German Savings Bank Organization).

## BASEL II - Time schedule

- The original schedule for introduction in German Banking Industry is **no longer realistic.**
- “First report to government” Milestone will probably need to be postponed from beginning 2007 to **2008.**

# BASEL II – Credit Risk – different approaches

Different approaches are developed for the minimum capital requirements (credit risk) - example for implementation in german banking industry



## BASEL II – time schedule for German savings banks

2005	2006	2007	2008-2009	2010
1 <sup>st</sup> year of data history	2 <sup>nd</sup> year of data history	Basel II start-option	transition period	
<ul style="list-style-type: none"> <li>• rating / scoring of the credit portfolio</li> <li>• collection data about losses</li> </ul>		<ul style="list-style-type: none"> <li>• <b>past start date:</b> Basel II-measurement rules, binding Basel II-reporting</li> <li>• In parallel: continued “traditional” reporting till end of 2009 for floor calculation required</li> </ul>		
<b>Till 2010 or 2011 collection PD-history for 5 years (IRB-Foundation-Approach)</b>				
For banks and sovereigns the using of partial use is planned, as the requirements are not defined finally.				
<b>Till 2010 or 2011 additionally LGD / EAD-History for IRB Retail</b>				
				data history must be available
				process of collection data (i.e. by IT-centers)
				data collection is often operated by the umbrella organization

\* Based on the European proposal (Brussels) banks do have the right to choose the start date for participating in BASELII (2007 or 2008). The timeframe for collecting data moves in parallel.

## BASEL II – Figures

- Risk classification of **customers** (rating note, PD probability at default)
- Risk classification of **products, contracts**
- **Definition** of “in case of default”, e.g. 90 days of overdraft, reserve for bad debt, ..
- Analyzing loans and securities, realization, ...
- Risk adjusted pricing
- Estimated loss, quotes ... (EAD, EL, LGD, PD, ...)

## BASEL II – Situation of IT Development

- There are three main banking ‘clusters’ in Germany :
  - ❖ The **private** banks (Deutsche Bank, Dresdner Bank, ...) of which only a few are global players involved in international banking (approx. **20%** of German banking market).
  - ❖ The Savings Bank Organization (**50%**).
  - ❖ People’s Bank Organization (Volksbanken) (**25%**).

## **BASEL II – Situation of IT Development**

- **Each cluster belongs to umbrella organizations which are organizing / preparing / dealing with the impacts of the BASEL II accord on the whole group.**
- **The Private Banks developed their own instruments, especially for rating and estimation of figures like PD, LGD, ..**
- **The umbrella organization of the savings banks has developed concepts for different instruments to support BASEL II**
  - ❖ **e.g. Rating Systems, Scorecards, Loss Given Default (LGD), ...**
- **The umbrella organization for the people's bank tries to get a permission not to participate with BASEL II.**

## BASEL II – Status: Implementation of BASEL II

- **Germany:** The major private banks, the internationally focused banks as well as the savings organization in Germany were **early adopters** of BASEL II implementation in Europe / worldwide.
- **France** tries to accelerate the development.
- **Switzerland** is on its way; only UBS and Credit Suisse are international active banks and will participate.
- **Austria** worries about the consequences for the economy, but development is ongoing.
- **USA** don't care about BASEL II.
- **Canada:** work is done?

## BASEL II – Situation of IT Development

### ➤ Germany

- Skepticism about introduction of BASEL II IRB-approach is rising because of high effort and few recognizable **benefits**
- Peoples' Bank will not use these approaches / are asking government for **exceptions**
- Saving Banks are more and more sceptical, confused and **disappointed**

## BASEL II – Situation of IT Development in Germany

- Implementing BASEL II rules has increasingly become a question of **prestige** more than anything else.
- Working with the accord and trying to implement the rules has led to a dramatic **decrease** in the number of banks / decision makers who believe that BASEL II will have a positive impact on their business.
- The costs for BASELII-implementation (only IT-costs, concentration on credit risk) for a bank (like a private bank) or an IT-center are higher than 75 million Can\$ in the last 2-3 years.

## BASEL II – Impact

- The BASEL II accord means much more than controlling the business; the means of “modern” risk management affect virtually **every aspect** of the organization.
- There are impacts on processes from sales organization through to **controlling**.
- The costs of development and IT operations as well as process costs – when supporting all approaches of BASEL II – are **enormous** and **unacceptable** from the economic point of view.

## BASEL II – Impacts (Germany and ??)

- **BASEL II in and of itself does not create value; the improvement on risk measurement and risk reduction in credit business has yet to be proven.**
- **The impact on customers is significant and not accepted by the “market”**
  - ❖ **high information needs, permanent and intensive reporting**
  - ❖ **higher interest rates due to risk components depending on rating notes**
  - ❖ **loans decrease in number and volume due to changed business policy (“risk aversion”) and processes.**

## BASEL II – Impact

- The interest rates for credits will **increase** (only by process costs and depending on the customer's risk rating)
  - ❖ In an already difficult business environment, these impacts tend to place **additional stress** on the overall economy
- The permanent reporting of business data, the storing and analyzing of masses of data is a **challenge** for many parties:
  - ❖ Customers
  - ❖ Banking Industry including umbrella organizations
  - ❖ IT solution providers and operators
  - ❖ Supervisory authorities

## BASEL II – Impact

- **The required systems for risk measurement seem to be too complicated / oversized and need to be rightsized**
  - ❖ **Less is more**
  - ❖ **the figures are “past-oriented”**
  - ❖ **there is not enough concentration on estimation / trend analysis, strategic figures**
- **The ongoing data collection seems to be not systematic due to not finally specified reporting criteria; so “all” data is required without semantic description and / or classification.**

## **BASEL II – news of the last months...**

- **The results of the last Quantity Impact Studies (QIS4) are unexpected (for German banks): obviously there is no / a very small positive affect on minimum capital by using the IRB-approach.**
- **The committee is looking forward to a higher concentration on the internal processes.**
- **The risk resulting from bank's internal systems takes more place in the discussion of the committee.**
- **The European banks and national banks do not longer accept the “ignoring” position of USA and US Banks.**
- **A higher flexibility and more influence by European banks / authorities is required.**

## BASEL II – Recommendations

### ➤ Recommendations:

- ❖ **Step-by-step** introduction of BASEL II to organization
- ❖ Concentration on BASEL II-standard approaches
- ❖ Concentration on goals and strategic planning
- ❖ Clear understanding of the **meaning and impacts** of BASEL II figures
- ❖ Sound analysis of
  - How to implement systems and
  - How to retrieve the figures from the **existing** processes / data bases by **minor** modifications



**Merci et bonne journée**

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