

Brussels, 27 November 2006

Circulation: Associates
Executive Committee

23rd MEETING OF THE ASSOCIATES
- Brussels, 7 December 2006 -

ITEM 7 OF THE AGENDA: BASEL II: LATEST DEVELOPMENTS AND FUTURE PERSPECTIVES

The new Basel II capital adequacy rules are about to be implemented in the EU and in most other Basel Committee countries. Much of the current discussion focuses on the implementation delay in the US and on possible divergences in the US rules as compared to the choices made by most other countries. Furthermore, there are some EU-internal concerns as regards notably convergence of practices and the relationship between home and host supervisors.

In the US, the Notice of Proposed Rulemaking on the Basel II rules was finally issued for official consultation in mid-September, with a mid-January deadline for comments. This was half a year after its first unofficial publication, during which only one substantial change was made to the draft Notice. At the same time, some voices called for much further-going measures. *Inter alia*, Sheila Bair, Chairman of the Federal Deposit Insurance Corporation (FDIC) suggested the international introduction of a leverage ratio, i.e. a ratio of capital to unweighted assets.

Whilst objecting to far-reaching measures such as these and stressing in the first place the need for the US to implement Basel II swiftly and in agreement with the spirit of the Accord, the industry identified a range of specific areas where the US proposal diverged significantly from the versions adopted in other jurisdictions. This concerns in particular the definition of default, the interpretation of Pillar 2, the definitions and floors of EAD and LGD and the treatment of intra-group exposures. However, there remains a high possibility that the industry will not only have to deal with divergent rules during the gap year but that the

final divergences will be substantial, as well. Possible compromises will become apparent over the coming months but might build on the application of the respective local rules for retail exposures, and on the consistent application of home rules for wholesale exposures.

Regarding EU-internal implementation, it will become apparent in the near future to what extent the guidelines agreed by the Committee of European Banking Supervisors (CEBS) and the work of the European Commission Capital Requirements Transposition Group were successful in delivering convergence of practices. CEBS has agreed to make convergence its first and foremost aim, but in light of their practical experiences banks are sceptical and underline also the timing aspect. The currently preferred solution consists in the introduction of the consolidating supervisor model in the coming years, according to which the consolidating supervisor would be considered the main contact point for an international group.

In addition, there are some areas where the industry has already identified a need for urgent changes to the Directive, for example in the area of securitisation. A debate is also ongoing on the rules for large exposures, as well as on liquidity risk management and the definition of Own Funds.

Ms. Uta WASSMUTH, EBF Adviser and Mr. Wilfried WILMS, EBF Senior Adviser will give a presentation on the latest developments in the BASEL II during the meeting.