

Conference Call Summary August 7, 2003

Participants

Supervisory Agencies (Risk Management Group, Basel Committee on Banking Supervision): Federal Reserve Board; Federal Reserve Bank of Boston; Office of the Comptroller of the Currency; Federal Deposit Insurance Corporation; Secretariat, Basel Committee on Banking Supervision; Office of the Superintendent of Financial Institutions, Canada; Deutsche Bundesbank, Germany; Banca d'Italia, Italy; Bank of Japan and Financial Services Agency, Japan; De Nederlandsche Bank, Netherlands; Banco de España, Spain; Eidgenössische Bankenkommission, Switzerland; Financial Services Authority, United Kingdom

Industry Representatives (Institute of International Finance Working Group on Operational Risk): Credit Suisse First Boston; Fortis Bank; HSBC Holdings plc; Institute of International Finance (IIF); Royal Bank of Scotland Group; UBS AG; UFJ Holdings, Inc.

Summary

The chair of the Risk Management Group noted that, because the United States is in the official comment period for the recently issued advance notice of proposed rulemaking (ANPR), the conference call—and future discussions during the comment period—must be summarized and placed in the public record in the U.S. pursuant to the Administrative Procedures Act. Industry representatives asked that they be allowed to review the summary of the call to ensure that views expressed during the call were accurately captured, which U.S. representatives agreed would be appropriate. In addition, representatives from the U.S. indicated that the conference call could not result in any final decisions regarding implementation of the new capital framework, as such decisions will not be possible until the comment period has ended and all public comments have been considered.

Supervisors laid out a preliminary overview of issues that have arisen with regard to home-host supervision and capital allocation for operational risk. This overview was not a consensus supervisory view, but rather reflected an initial assessment of issues based on earlier conversations with industry participants and limited empirical work. Because the advanced measurement approaches (AMA) set forth in the third consultative paper (CP3) allow for the recognition of diversification benefits, the allocation of capital requirement to legal entities within a banking group is a key issue. It was noted that requiring each legal entity within a banking group to have its own AMA requirement could be costly and burdensome, and could be difficult to do in a meaningful way because of the scarcity of data at some subsidiaries. A related issue is the extent to which capital can be viewed as transferable (i.e., that an institution is willing and able to transfer capital from a healthy entity to a troubled subsidiary or affiliate).

Conceptually, if capital is freely transferable without restrictions, then a single groupwide capital requirement should suffice, and an institution would not in principle need to calculate operational risk capital requirements at individual legal entities (some supervisors added that there were practical impediments to capital transferability). At the other extreme, if capital is not transferable, then it would be necessary for each legal entity to calculate its own operational risk capital requirement on a stand-alone basis. Finally, if capital is transferable across some groups of entities but not others, then some sort of allocation methodology would be necessary to attribute operational risk capital requirements within a group of legal entities. Among the principles that could guide the choice of a particular allocation methodology are that the methodology should be risk-sensitive, consistent, robust, transparent, and simple. Several potential methodologies were briefly set forth. It was noted that there may be legal impediments to reliance on an allocation methodology because of the requirement in many jurisdictions that insured depository institutions must be adequately capitalized on a stand-alone basis and may not be able to rely on contingent capital commitments.

Industry participants, who circulated a note (attached) in advance of the meeting outlining the preliminary views of the participants, indicated that they envisioned the overall group capital requirement being determined via an AMA that was approved by the home country supervisor (ideally with input from host country supervisors as well). This capital requirement could then be apportioned from the group level to individual legal entities, and host country supervisors would ensure that legal entities held actual capital sufficient to meet apportioned requirements. In addition, host supervisors could, through Pillar 2, require legal entities to hold more capital where specific concerns existed.

In this regard, supervisors noted that issues relating to home-host supervision are a high-priority topic for the Basel Accord Implementation Group (AIG). In addition, it was noted that national regulators have the authority to impose their own capital requirements (industry participants acknowledged this, but noted their hope that this would be the exception rather than the norm under Basel 2).

Supervisors and industry participants discussed whether the question of capital requirements could be separated from the issue of capital transferability, and supervisors suggested that the two issues are inextricably linked. It was suggested that industry participants put forth options for consideration by the Basel Committee. All participants agreed that a key issue will be the comfort of host country supervisors (consistent with other home-host issues, including the treatment of credit risk) in accepting capital requirements based on allocation mechanisms. Industry participants suggested that they could set forth for supervisory consideration the pros and cons of various options in this regard.

A follow-up call is scheduled on September 2; members of the AIG intend to participate on this call as well.

Attachment