Summary of discussions between Basel Committee and IIF representatives – October 20,2003

An informal meeting between representatives of the Basel Committee and the Institute for International Finance (IIF) took place at the offices of Societe Generale on October 20,2003. The purpose of the meeting was for the IIF representatives to express their views on various issues related to the revision of the Basel Accord.

The IIF representatives indicated that they appreciated the Basel Committee's press statement of October 11 and felt that it was a constructive step forward in the revision process. However, the IIF representatives noted several remaining concerns with the proposals.

The IIF representatives expressed disappointment with the limited recognition of diversification effects in the Basel II framework and urged the Committee to reconsider the possibility of introducing additional flexibility in this regard into the new framework. The Basel Committee representatives acknowledged the conceptual arguments in favor of credit risk modeling, but reiterated the view that – in light of the dominant importance of credit risk for banks – practices are not sufficiently converged to incorporate such approaches into a common regulatory framework. The U.S. supervisors present noted that greater recognition of diversification effects within the framework could raise potential competitiveness concerns across different types of banks. The Basel Committee representatives noted that the Committee would continue to devote resources to monitoring the development of risk modeling methodologies, especially the extent to which they were being used for business planning purposes. It was also mentioned that Basel II would be a flexible construct that potentially could eventually incorporate the recognition of internal models similar to the way in which Basel I was modified to include the market risk component.

The IIF representatives stressed their desire that the new framework be simplified wherever possible, especially in relation to the prescriptive nature of many of the qualifying standards. This was seen as a particularly important issue in regard to the validation of inputs to the internal-ratings-based (IRB) approach, where IIF representatives believed that certain of the standards would be very difficult to meet in cases where default data is scarce or for non-material portfolios. The Basel Committee representatives noted that the validation issues are a key agenda item for their Accord Implementation Group (AIG) and that supervisors understood the need to focus implementation energies on those areas most critical to meeting overall objectives. The U.S. supervisors present pointed to the draft corporate IRB guidance released in the U.S. as indicative of the current views of U.S. supervisors on their intended approach to validation, while also noting that comments were welcomed on such guidance. It was agreed that the IIF would provide specific proposals for further simplification of the new Accord to the Basel Committee within the coming weeks.

The IIF representatives stressed the importance of cooperation between home and host supervisors as essential to ensuring that the revised Accord could be implemented in a reasonable fashion. In particular, IIF representatives advocated that the most critical supervisors of an internationally-active bank be encouraged to meet and discuss the relevant implementation issues together, so as to foster a more coordinated approach with less duplication of effort. The Basel Committee representatives indicated that discussions within the AIG had acknowledged these points and that there was a strong understanding of the need to avoid unnecessary burden. The Basel Committee representatives also noted that the AIG may undertake case studies that could help provide both supervisors and the industry with a more concrete sense of how implementation might work in practice. IIF representatives indicated that this would be useful and reiterated their view that the home supervisor should play the most significant role. They also noted the importance of addressing home-host issues in the context of the advanced measurement approach to operational risk.

The IIF representatives welcomed the Basel Committee's proposal to revise the treatment of expected losses within the IRB framework, while noting concerns that it not lead to excessive additional recalibration of the framework. They also indicated that the IAS process introduces some uncertainties into the final impact of the revised framework, given that it could affect banks' provisioning policies in those countries adopting the IAS standards. The Basel Committee representatives indicated that work was underway to assess the potential impact of the proposed modifications and therefore any potential need for recalibration. While acknowledging that the IAS process could affect banks' provisioning policies, Basel Committee representatives suggested that the proposed approach to expected losses in part reflects an effort to insulate the prudential capital framework from differences in provisioning policies, while also underscoring the supervisory interest in robust provisioning approaches.

The IIF representatives indicated that some banks continue to express concerns over specific aspects of proposals in relation to securitization, specialized lending, and the treatment of trading book positions, but did not elaborate.