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Joint Statement by
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On January 28 and 29, 1992, the Technical Committee of the International Organisation of Securities Commissions and the Basle Committee on Banking Supervision for the first time held a joint meeting of principals to consider proposed minimum capital rules for internationally active banks and securities firms. Important preliminary understandings were achieved on a wide range of fundamental issues. (*)

These discussions reflected both ongoing internationalization of global capital markets and the similarity of market risks undertaken by both banks and securities firms.

Current Situation

In addressing capital standards, the two Committees have sought to address certain issues with respect to existing capital standards. Among banks, the Basle risk-weighted capital standards have been in place since 1988 to address credit risks in bank assets. However, to date there have not been any international capital standards to take account of interest rate risk of tradeable securities and price risk in the equity positions held by banks. The proposed capital standards would for the first time close this important gap in existing international bank capital standards.

Among securities firms, interest rate and credit risk have long been measured on a continuous daily basis in most major markets. However, there have been important differences in the level of required capital and in the measurement techniques utilized between different markets and types of firms. These differences create a risk of distortion of trading patterns and significantly varying levels of protection (both through capital levels or diversification of portfolios) for firms from different countries against both local and global market volatility. The proposed capital standards would seek to create agreed minimum levels of capital that every securities supervisor would be obliged to follow or exceed as a buffer against market instability.

(*)
Participants were aware of the on-going discussions of this subject within the European Community, and recognized the desirability of general consistency between the two sets of discussions.

Debt Securities

In establishing a proposed standard for holdings of traded debt securities, the discussions led to development of a single methodology for computation of both general market and specific issuer risks. This methodology, called the "building block approach", would be utilized by all supervisors.

Minimum levels of capital and maximum permissible allowances for potentially off-setting positions were defined by the Committees, subject to reservation by one country. At the same time, the Committees also agreed to allow use of an alternative "duration" methodology that would utilize a somewhat different technique where a supervisor can demonstrate the equivalence of resulting capital charges.

Equity Securities

In addressing the measurement of capital for equity positions, the Committees recognized that two alternative approaches would be utilized. For bank supervisors and for some securities supervisors, the "building block" methodology for debt would also be adapted to equity positions. A general consensus was reached on the respective percentages to be used for the "x" and "y" factors (general and specific risks) applied to gross and net portfolio values, subject to certain reservations by a small number of supervisors.

However, many securities supervisors that have long successfully applied a "comprehensive" methodology would continue to do so. Any supervisor utilizing the comprehensive approach would undertake to demonstrate that its specific application of the comprehensive methodology would yield capital requirements that were consistently equal to or greater than the capital that would be required under the building block approach.

Definition of Capital

Substantial progress was also made in reaching mutually acceptable definitions of capital. The securities regulators have agreed that securities firms' use of short term subordinated debt, with a "lock-in" clause for capital purposes, should be limited to 250% of equity capital. A clear majority of the Basle Committee is prepared to entertain an approach to a definition of capital for market risk purposes of a banks' trading portfolio that would, in economic terms, closely approximate the approach followed by the securities regulators.

Implementation

Each supervisor has agreed to undertake its best efforts to develop and implement necessary requirements promptly following completion of a consultative process. Where supervisory standards already exceed the proposed minimums, such standards would not be the subject of any proposed change as a result of the agreements.

All parties expressly agreed that the proposals represent minimum standards. Any supervisor would remain free to impose higher requirements.

Future Plans

On the basis of the preliminary understandings reached at the joint meeting, the Committees expect to be in a position to issue publicly consultative papers in the summer of 1992.