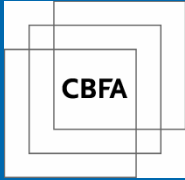


THE BASEL 2 IMPLEMENTATION PROCESS : COOPERATION AND ARRANGEMENTS BETWEEN HOME AND HOST SUPERVISORS

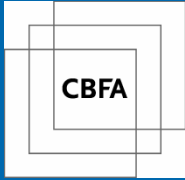
Conference on the Future Regulation
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Rudi BONTE
Banking, Finance and Insurance Commission
Belgium



Outline

1. Cross-border challenges of the Basel 2 process : what it means for banks.
2. Cross-border challenges of the Basel 2 process : what it means for supervisors.
3. How to address the home/host supervisory cooperation ?
4. What does supervisory cooperation involve ?
5. The home/host issue in the supervisory fora.
6. Supervisory coordination in the Basel 2 implementation : a practical approach.
7. To keep in mind ...

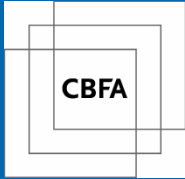


1. *Cross-border challenges of the Basel 2 process : what it means for banks*

- Banks are now integrated groups and need group-wide tools :
 - local business strategies, but common risk and reporting frameworks
 - group-wide internal audit
 - group-wide risk management
 - core responsibilities of group CFO, CRO, COO

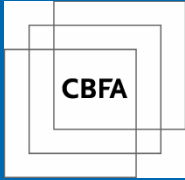
- Intra-group information flows : - focus on the “management letter”
 - ALM reporting
 - loan portfolio analysis

- Group-wide collaboration between the external auditors



2. *Cross-border challenges of the Basel 2 process : what it means for supervisors*

- Need to understand a group's internal strategy, plans and processes for Basel 2
- Focus on the global governance of the group and the arrangements between parent bank/subsidiaries :
 - Key dimensions :
 - internal audit
 - risk management
 - compliance } how interaction between local and group level ?
 - Corporate governance within the group :
 - local and group management
 - local board and parent bank's board
 - committees within the boards
 - Where to rely on when things go wrong ?



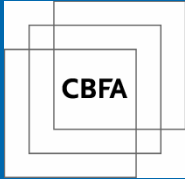
3. *How to address the home/host supervisory cooperation ?*

- Core issue
 - = rely on an efficient and effective framework for the supervision of cross-border groups

- Is the lead supervisory regime the most appropriate way ?

- Some supervisory concerns :
 - domestic laws : statutory responsibility of host supervisors
 - crisis management : implications for lending of last resort, winding down procedures and deposit insurance
 - systemically relevant subsidiaries : need to ensure an adequate treatment (financial stability impact)
 - can the same standard approach be applied to different groups ?

- Strengthening of supervisory cooperation
 - = robust procedures for exchange of information
 - + enhanced role of consolidating supervisor



4. *What does supervisory cooperation involve ?*

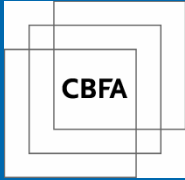
- = Supervisors seeking to
 - coordinate supervisory approaches
 - perform supervisory tasks jointly or on behalf of others
 - communicate relevant and essential information

- = Way to promote convergence of practice (processes and standards)

- = Way towards being more receptive to
 - recognising judgements of others
 - relying on those judgements

- = Should reduce supervisory burden

- = Need to be proportionate and risk based



5. *The home/host issue in the supervisory fora (1)*

The Basel Committee on Banking Supervision :

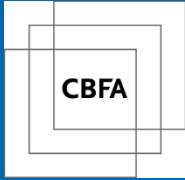
➤ A preliminary response :

The high-level principles for the cross-border implementation of the New Accord (August 2003)

- existing cross-border understandings between home/host will continue to apply
- need to enhance cooperation on a practical basis
- pragmatic approach of mutual recognition
- principles further elaborated in May 2004 press release

➤ Putting the principles into practice :

Work on real case studies by the Accord Implementation Group (AIG) will transit into actual supervisory planning

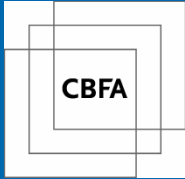


5. *The home/host issue in the supervisory fora (2)*

The Committee of European Banking Supervisors (CEBS) :

will ensure increased convergence of supervisory practices in EU :

- focus on the supervisory review process (pillar 2)
(see consultation paper May 2004)
- home/host issues : work stream on the validation of internal models (quantitative and qualitative dimensions) and the setting of pillar 2 requirements at group and/or local level



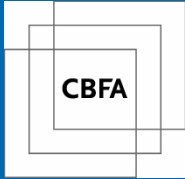
6. *Supervisory coordination in the Basel 2 implementation : a practical approach (1)*

A. Information sharing on how the bank will put Basel 2 into practice :

- Which approach for pillar 1 (credit risk and operational risk) ?
- Which time schedule and roll-out plan ?
- Which project organization ?
- Cross-border models versus local models.
- Model development versus model validation.
- What for pillar 2 (use of economic capital ?) and pillar 3 (public reporting aligned ?) ?

B. Initiatives of the home supervisors :

- Monitoring and analysis of the quantitative impact studies (QIS)
- Follow-up of the project management and the progress made
- Pre-validation audits



6. *Supervisory coordination in the Basel 2 implementation : a practical approach (2)*

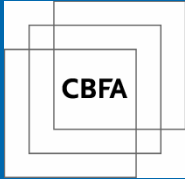
C. Coordinating the cross-border implementation :

- Supervisory focus : is there a strong common methodology and a sound local application ?
- See framework for distribution of supervisory tasks
- Pragmatic approach, but some formalization of the supervisory arrangements is useful

D. Kick-off meetings between home/host supervisors :

Exchange views on :

- Communication (also to cross-border banking groups on respective role of home and hosts)
- Working procedures
- Validation approach



6. *Supervisory coordination in the Basel 2 implementation : a practical approach (3)*

A framework for distribution of supervisory tasks

General methodology

- home validates
- home informs hosts
- marginal review by hosts

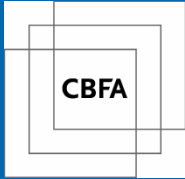
Implementation stage : validation of the models

Central models

- home validates
- home informs hosts
- marginal review by hosts

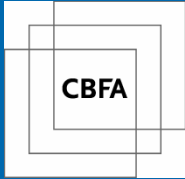
Local models

- hosts validate
- hosts inform home
- marginal review by home



7. *To keep in mind ...*

- Consistent application of Basel 2 across applicable jurisdictions : many supervisors are both home countries and hosts
- Basel 2 is also about judgement (by banks and supervisors) : need for consistent interpretation
- Communication and feedback are necessary :
 - ➔ supervisors ↔ supervisors
 - ➔ supervisors ↔ banks
 - ➔ banks ↔ banks
- Realism needed in dealing with home/host jurisdiction
- Cost effective implementation is in our interest



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