

Introduction and executive summary

The new capital adequacy proposals published in January this year, known as the Basel Accord and replacing the 1988 Accord, have significant and far-reaching implications for the financial services industry. The aim of the new Accord is to make the international financial system more stable; to put in place incentives for banks to adopt better risk management, risk mitigation and risk pricing techniques; and to align the holding of capital more closely with economic risk. It also recognises the advances in risk management technology, gives more flexibility to the supervisors to ensure the soundness of the financial system and increases the role of the market by stipulating more rigorous disclosure requirements.

This report is divided into three sections: the first reviews the background to and structure of the new Accord; the second reviews the results of a European-wide survey of banks; and the third considers the implications of the proposals on banks specifically, and on the financial system as a whole.

As well as attempting to consolidate the many views about the Accord — the 250 or so submissions that are now posted on the BIS website are evidence of this — the report has sought to garner an industry-wide perspective on the new Accord. To do this, the Institute of Financial Services (ifs) in association with Teradata, a division of NCR, surveyed a cross-section of European banks to find out how familiar they are with the proposals and how prepared they are to meet their requirements.

Some of the key findings are summarised below:

- Smaller or more specialised banks are less familiar with the proposals.
- There is considerable confusion about the introduction of the new Accord. In some instances this is because of uncertainty over definitions such as operational risk and, hence, over how it should be measured and the data required in doing so. In others, it is a concern of how the rules should be interpreted.
- To meet the 2005 deadline, the most pressing problem for banks is sourcing the appropriate data. The second biggest concern for banks is putting the IT resources in place in order to acquire it.
- Despite uproar about the unreasonable timetable for implementing the proposals, only 21 per cent of respondents said this was their main concern.
- Larger banks are more concerned about the timetable than smaller ones.
- Our research suggests that the risk methodology adopted by banks depends both on their size and on the availability of requisite data, especially historic.

- For some banks the benefits to be gained from giving over more resources to using more sophisticated risk techniques are not enough to make doing so worthwhile.
- According to 58 per cent of respondents the incentive to improve risk management is considered the main benefit arising from the new Accord; another 37 per cent see risk management as the second most important benefit. But only 21 per cent of respondents expect capital requirements to be reduced as a result of the new Accord and, in all cases it seems, it is the smaller banks who think this.
- Small and medium-sized banks will be adopting the basic indicator approach to calculating operational risk; and nearly 11 per cent of organisations say they are undecided about which methodology to adopt — the main concern being whether to choose between the standardised and internal measurement approaches. Even some of the largest banks remain undecided about which approach to adopt.
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