

## **Basel II capital framework enhancements announced by the Basel Committee**

**13 July 2009**

At its 8-9 July meeting, the [newly expanded](#) Basel Committee on Banking Supervision approved a final package of measures to strengthen the 1996 rules governing trading book capital and to enhance the three pillars of the Basel II framework.

The package is part of the Basel Committee's broader programme to strengthen the regulatory capital framework. The programme aims to introduce new standards to

1. promote the build-up of capital buffers that can be drawn down in periods of stress,
2. strengthen the quality of bank capital and
3. introduce a leverage ratio as a backstop to Basel II.

Under this programme, the Committee is also taking measures to mitigate any excess cyclicity of the minimum capital requirement and to promote a more forward-looking approach to provisioning. It will issue a consultative proposal on this broader programme by the first quarter of 2010.

The Committee's recently agreed trading book rules ( [Revisions to the Basel II market risk framework](#) and [Guidelines for computing capital for incremental risk in the trading book](#) ), which take effect at the end of 2010, introduce higher capital requirements to capture the credit risk of complex trading activities. They also include a stressed value-at-risk (VaR) requirement, which the Committee believes will help dampen the cyclicity of the minimum regulatory capital framework.

Under the [Basel II enhancements](#) approved at the July meeting, the Committee is strengthening the treatment for certain securitisations in Pillar 1 (minimum capital requirements). It is introducing higher risk weights for resecuritisation exposures (so-called CDOs of ABS) to better reflect the risk inherent in these products, as well as raising the credit conversion factor for short-term liquidity facilities to off-balance sheet conduits. The Committee is also requiring that banks conduct more rigorous credit analyses of externally rated securitisation exposures.

The Committee is issuing supplemental guidance under Pillar 2 (the supervisory review process) of Basel II. This guidance addresses the flaws in risk management practices revealed by the crisis. It raises the standards for:

- firm-wide governance and risk management;
- capturing the risk of off-balance sheet exposures and securitisation activities;
- managing risk concentrations; and
- providing incentives for banks to better manage risk and returns over the long term.

The supplemental guidance also incorporates the *FSF Principles for Sound Compensation Practices*, issued by the Financial Stability Board (formerly the Financial Stability Forum) in April 2009. The Committee, through its Standards Implementation Group, will begin work immediately on the practical implementation of these principles.

The Basel II package includes enhancements to the framework's third pillar (market discipline) to strengthen disclosure requirements for securitisations, off-balance sheet exposures and trading activities. These additional disclosure requirements will help reduce market uncertainties about the strength of banks' balance sheets related to capital market activities.

Banks and supervisors are expected to begin implementing the Pillar 2 guidance immediately. The new Pillar 1 capital requirements and Pillar 3 disclosures should be implemented no later than 31 December 2010. The Committee also agreed to keep in place the Basel I capital floors beyond the end of 2009.