



Press release

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Ref no:

11 April 2005

Basel Committee and IOSCO propose solutions for certain trading-related exposures and double default effects under Basel II

The Basel Committee on Banking Supervision has today issued a paper for public comment outlining proposed capital requirements for banks' exposures to certain trading-related activities. This includes a treatment for counterparty credit risk. The proposals also contain a solution for double default effects, or the risk that both a borrower and guarantor default on the same obligation.

The paper, [The application of Basel II to trading activities and the treatment of double default effects](#), represents a milestone in international capital standards-setting in that it was prepared jointly by the Basel Committee and the International Organization of Securities Commissions (IOSCO). It is available on the IOSCO website (www.iosco.org) and on the BIS website (www.bis.org), together with a summary of responses received on a survey of banks' and investment firms' trading books that provides background material ([Trading book survey: a summary of responses](#)).

The proposals are intended to improve the sensitivity of the capital rules to the underlying economic risks associated with such exposures in a manner that is compatible with the Basel Committee's revised capital framework for banking organisations. That framework, also known as "Basel II," was endorsed by the central bank governors and the heads of bank supervisory authorities in the Group of Ten countries in June 2004.

Given the interest of securities firms in the proposals related to trading activities, the Basel Committee had agreed with IOSCO in March 2004 to establish a joint working group. That group is co-chaired by Messrs Oliver Page (Director of Major Financial Groups Division at the UK Financial Services Authority) and Michael Macchiaroli (Associate Director at the US Securities and Exchange Commission). The joint group has held extensive discussions with industry representatives and has worked diligently to formulate the proposals.

"When we issued the text of Basel II last summer, the Committee pledged to ensure that Basel II remains forward-looking and to monitor developments and advances in risk management practices," noted Mr Jaime Caruana, Chairman of the Basel Committee and Governor of the Banco de España. "These proposals

honour that promise. Our close working relationship with IOSCO is ensuring that the capital framework reflects the advances achieved across the financial services sector in measuring and managing the risks associated with these instruments and activities.”

“IOSCO is pleased to be working closely with the Basel Committee on these important proposals,” stated Mr Andrew Sheng, Chairman of both the IOSCO Technical Committee and of the Securities and Futures Commission of Hong Kong SAR. “We endorse the proposals and look forward to continuing our discussions with the industry during the consultation period.”

The proposals address five issues in particular:

- the treatment of counterparty credit risk for over-the-counter derivatives, repurchase agreements and securities financing transactions, and of cross-product netting arrangements;
- the treatment of double-default effects for covered exposures, in relation with trading book, but also banking book;
- the short-term maturity adjustment, in the internal ratings-based approach under Basel II, for some trading book-related items;
- improvements to the current trading book regime, especially with respect to the treatment of specific risks; and
- the design of a specific capital treatment for unsettled and failed transactions.

After reviewing and responding to public comments, the Basel Committee intends to incorporate the proposals in the Revised Framework prior to its implementation in member jurisdictions. Because of time constraints associated with national rule-making processes and the ongoing preparations underway in banking organisations, the Committee aims to release final rules in summer 2005.

The Basel Committee and IOSCO thank representatives of the industry for their cooperation during discussions with the joint working group.

How to comment on the proposals

The Basel Committee and IOSCO welcome comments from the public on all aspects of the proposals by **27 May 2005**.

Comments should be addressed to both:

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

and

International Organization of Securities Commissions
Oquendo 12
SP-28006 Madrid
Spain

Alternatively, comments may be sent by e-mail to baselcommittee@bis.org and mail@oicv.iosco.org.