



# Basel II Implementation Risks

## EXECUTIVE SUMMARY

- A Survey by the Professional Risk Managers' International Association (PRMIA)

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## ABOUT PRMIA

PRMIA is the Professional Risk Managers' International Association. Formed in January of 2002, PRMIA is the higher standard for risk professionals with more than 60 chapters around the world and over 40,000 members from more than 175 countries. A non-profit, member-led association of professionals, PRMIA is dedicated to advancing the standards of the profession worldwide through the free exchange of ideas. PRMIA offers the only globally endorsed Professional Risk Manager (PRM™) certification program, pursued by over 2,000 active candidates from more than 90 countries, more than any other risk certification program. More information can be found at [www.PRMIA.org](http://www.PRMIA.org).

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## Basel II Implementation Risks; Executive Summary

With implementation of the controversial Basel II banking regulation looming, the Professional Risk Managers' International Association (PRMIA) asked its members who are involved in this area to discuss possible risks around implementation. Our questions concerned the overall impact expected from Basel II implementation, what distortions or unforeseen risks might arise from it, how well prepared banks, regulators and the investing public were for the regulation and whether it was a good idea in the first place.

The survey was conducted over three weeks in June and July of 2007, concluding on July 13, 2007.

## RESPONDENT PROFILE

Over 1,000 PRMIA members, bankers (750) consultants (290) and regulators (88) active in Basel II implementation, participated in the survey. Survey participants reside in 89 different countries, with 59% of bankers who participated reporting that they represent institutions that are among the largest in their country.

- 14.5% of respondents came from the US, 11.4% from the UK and a total of 43.4% from the G-10 countries. Among emerging markets, India was most prominently represented with a total of 7.4% of responses coming from that country, followed by Poland (4.2%) and the Philippines (2.8%).
- Of the bankers, 12.2% identified themselves as Chief Risk Officers, 10.4% said they lead their bank's Basel II implementation program and 4.7% are other C-Level officers. In addition, 23.4% are involved in the technical development of Basel II at their bank and 20.9% are involved in the managerial roll-out of Basel II.
- Of the consultants, 19.7% are partners or senior partners, 30.5% are consulting on the technical roll-out of Basel II, 21.1% are consulting on the managerial roll-out and 13.3% are building models for their clients.
- Fewer than 100 regulators participated. Of those, 33% are involved in policy development, 23% in large/complex institution supervision and 15.9% in other oversight functions.

## KEY FINDINGS

### FINANCIAL STABILITY

- Over 90% of bankers feel that the application of Basel II norms for all players in the market promotes better risk management.
- Almost 80% of respondents believe that Basel II implementation will make the banking system sounder (more stable), while just 4% thought the system would be less sound (less stable).
- At the same time over 50% say their capital requirements will fall under Basel II.
- 36% of bankers say their capital requirements will fall by more than 10% and just over 13% say they will increase by more than 10%.
- Among those identifying themselves as coming from the largest banks in their countries, 42% said they expected their capital requirements to fall by more than 10% under Basel II, while just 12% expect required capital to increase by more than 10%.

### READINESS

- 89% of bankers say that there is at least a 50% chance they will be ready for Basel II when their regulator requires them to be ready. But, only 56% say that they definitely will be ready.
- Just 14% of regulators say all of the banks they supervise will be ready on time, but 55% say that the important ones will be ready. 30% believe their banks, including some important ones, will not be ready in time.
- 74% of bankers feel that “the market” doesn’t understand risk management sufficiently to differentiate between publicly disclosed models and data that use different methodologies.
- 62% of bankers feel that their regulator does not have sufficiently trained supervisors to effectively implement advanced models. Even within the G-10, 48% felt their supervisors were not sufficiently trained. Regulators themselves agree overall, with 58% suggesting the lack of training is a problem, although less so in the G-10.
- Only 28% of bankers feel that they fully understand the elements to be included in the additional disclosure requirements which banks must provide to regulators and/or the public.

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## OTHER ISSUES

- Bankers are concerned about some distortions that Basel II will create:
  - 66% believe that Basel II will create differential treatment across the banking and trading books that distorts business decisions. Regulators think the problem is less broad, but still almost 50% agree with the bankers.
  - 45% believe that banning the ratings of foreign external credit rating agencies will adversely affect the quality of risk management.
  - 34% are concerned about home-host discrepancies, while an additional 40% report that they are still concerned, but less so than they used to be.
- 77% of bankers feel that the lack of consistent global accounting definitions impedes the goal of creating global bank capital adequacy standards.
- 54% of regulators feel that Basel II is overly dependent upon quantitative measures like VaR for measuring risk and capital adequacy. 48% of bankers and 44% of consultants agree.
- Bankers and Consultants agree that the models being used for Basel II differ from those they use internally for economic capital with 15% saying they are very different, 47% saying they are somewhat different and just 6% saying they are the same.
- Almost 20% of respondents think that Basel II implementation has created substantial economic value for the banking industry, with over 50% saying that some economic value has been created. Just 7% said that the costs have greatly outweighed the benefits.
- 72% of bankers and 69% of regulators answered “Yes” to the question ‘Do we need Basel III?’. Consultants, not surprisingly, chimed in with an enthusiastic 81% agreeing.

