



Islamic Finance and Basel II

Panel on International Regulatory Standards for Islamic Finance:
Implementation Issues and Challenges

Kuala Lumpur 28 March 2007



Outline

- Basel Committee on Banking Supervision
- What exactly is Basel II
- Basel II – a global framework
- Some implementation issues
- Rules for Islamic Finance and Basel II



Basel Committee – an overview

- Established at the end of 1974 by Central Bank Governors of G10
- Reports to G10 Governors/Heads of Supervision
- Members are senior bank supervisors from G10, Luxembourg and Spain
- Chairman: Nout Wellink
- Secretariat hosted by the Bank for International Settlements (BIS)
- Meets four times a year (mainly) at the BIS
- Work undertaken through several Groups/sub-groups



Committee's outreach to other countries

➔ A key element of the Committee's strategy going forward

- Committee has developed over time close ties with non-members
 - Tries to address issues relevant for all jurisdictions worldwide
 - Created International Liaison Group (includes 16 jurisdictions, IMF, WB)
 - Close contacts with
 - Regional groups of banking supervisors and
 - Other standard setters
 - International Conferences of Banking Supervisors (ICBS)
- Relationship with IFSB



What is Basel II?

- Basel II is a reflection in the rapid change in:
 - Financial market innovations
 - Advances in risk management
 - Enhanced supervisory approaches
- Basel II's goals are:
 - Improving risk management
 - Providing direct incentives for stronger corporate governance and greater transparency
 - Maintaining a reasonable level playing field for all banks



Basel II – A Global Framework

- Committee involved non-member countries to a great extent in developing Basel II and continues to do so during implementation
- Aim was to make Basel II applicable to banks worldwide independent of
 - banking system
 - size and
 - sophistication
- It is expected that Basel II will become the new yardstick for assessing global banks' financial soundness




Time schedule for implementation

- Basel II text sets out time schedule for Committee member countries
- For other jurisdictions
 - Only national authorities can decide
 - Timing should be determined by a country's own circumstances
- Step-by-step approach would be appropriate
 - Regarding the three pillars
 - Regarding different approaches to measuring risks



Some implementation issues

- Implementation is a domestic issue
 - National discretion areas provide room for adaptation to national (or a banking system's) circumstances
 - Committee will not judge any jurisdiction's implementation
 - IMF and World Bank (through FSAPs) will judge against text of Core Principle 6
 - Differentiates between internationally active and other banks
 - Refers to „prudent and appropriate minimum capital adequacy requirements“
-  There is not one way to implement Basel II



Basel II and Islamic Finance

- IFSB's Capital Adequacy Standards of December 2005
 - "primarily based on the BCBS documents with the necessary modifications and adaptations"
 - Based on standardised approach for credit risk and Basic Indicator Approach for operational risk
 - Work on Pillar 1 continues in "Working Group on Special Issues in Capital Adequacy"
 - Exposure Drafts for implementing Pillars 2 and 3 out for comment
 - On-going process
- Basel II needs to be adapted for islamic finance
- Principles of Basel II are important



**Basel II is more a journey
than a destination**



What are the Committee's main themes for the future?

- Maintaining a strong capital foundation
- Getting the basic supporting infrastructure in place (e.g. Core Principles, sound accounting standards)
- Promoting proportional policy responses
- Proactive outreach to non-member jurisdictions and industry



Concluding remarks

- Basel II is about improving risk management
- Prudent amount of capital is aim
- Current phase: implementation
- Global and flexible framework
- Committee welcomes implementation in other jurisdictions/
banking systems