Basel II: Nearer Than We Think
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e-business Center PwC&IESE
07/07/04

What do information systems and Basel II have in common? The answer is a lot. The so-called “New Capital Agreement”, approved on 26th June by the Basel Committee and better known as Basel II, demands banks to adopt computer applications capable of measuring “credit risk”. This means having solutions that enable one to set up measuring models (scorings and ratings); pricing models for operations; admission processes that allow one to separate one’s customers according to their risk profile; follow-up systems of live risk; and evaluation models of risk exposure and severity.

All of these characteristics convert the software adapted to Basle II into a set of extremely complex systems, capable of not only measuring the “market risk”, but of evaluating the “operational risk”.

The new agreement signed by the Committee – in which the Central Banks of the principal economies in the world are represented – also forces financial institutions to adopt their systems of calculating capital consumption, apart from modifying their systems on reporting (financial reports) and analysis of information.

Indeed, information is the key to Basel II. Not in vane, the main difficulty in complying with the agreements signed by the Basel Committee – which has been presided by the Governor of the Bank of Spain since February 2003 – is the management of vast data bases, capable of providing exact information to quantify the risks in each operation.

Just to get reliable data, banks base themselves on long series of statistics that are taken from complicated formulae with a multitude of variables. Up to now, these calculations were not so thorough, so the new directives mean a real challenge for banks. What is more, this means right now. Because, although the criteria of Basel II will not be applied till 2008, banks need data for up to seven correlative years.

Highlights

1. The recommendations of the Basel Committee are not legally binding although, in the case of the European Union members, these will be adopted through a directive. In the United States, hardly a score of financial institutions that operate on a global scale will accept the criteria of Basel II.

2. According to a study carried out by SAP, the banks least prepared to adapt to the changes implied by the Basel II agreement are the North American ones and those in Asia and the Pacific region. 60% of European banks already have solutions adapted to the new requisites, while in the United States the rate is as low as 12% and in Asia and in the Pacific region it is 15%.

3. In order to calculate the risk of every operation, Basel II proposes to measure any conceivable source of risk, including those related to computing systems. These dangers range from the bankruptcy of a systems provider to unforeseeable catastrophes. According to BITS, a non-profit consortium that groups together financial enterprises, the sector has an annual allotment of one thousand million dollars to software security and the management of contingencies.

4. The adoption of Basel II will force financial companies to make considerable investments in information systems. SAP’s study points out that the cost for banks with assets of less than 100,000 million dollars will be about 50 million euros. The bigger companies may have to devote between 50 and 100 million euros to the change.
In the face of such demands, it is understood that information systems are key elements to the success of Basel II. Indeed, the banks have accepted as much: even while the main Spanish banks are waiting for the final Basel II document to be delivered they have already invested about 20 million euros, whereas the huge banking corporations can pay out anything between 50 and 100 million euros.

Therefore, everything points to the banks being ready to successfully face the challenge that lies ahead, just as they did with the introduction of the euro. In this case, the new environment promises to improve their stability, working processes and computing transparency.