Press release

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Basel Committee and IOSCO finalise solutions for the application of Basel II to some trading-related exposures and the treatment of double default effects

The Basel Committee on Banking Supervision has today issued a paper setting forth capital requirements for banks' exposures to certain trading-related activities, including counterparty credit risk, and for the treatment of 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*, was prepared by a joint working group of the Basel Committee and the International Organization of Securities Commissions (IOSCO)[1].

The proposals are intended to bring the capital treatment of trading activities and double default effects abreast of the Basel Committee's revised capital framework for banking organisations, also known as "Basel II".

The rules supplement some aspects of Basel II and of the 1996 Market Risk Amendment by addressing five issues in particular:

- treatment of counterparty credit risk for over-the-counter derivatives, repurchase agreements and securities financing transactions, and of cross-product netting arrangements;
- treatment of double-default effects for covered exposures, relating to the trading book and banking book;
- 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

[1] The working group was 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).

to the treatment of specific risks; and

- the design of a specific capital treatment for unsettled and failed transactions.

"The rules on the application of Basel II to trading activities and the treatment of double default effects will significantly increase the risk-sensitivity of regulatory capital requirements for these specific exposures," noted Mr Jaime Caruana, Chairman of the Basel Committee and Governor of the Banco de España. "We are pleased that, owing to our close working relationship with IOSCO, it has been possible to set out these new rules in a relatively short timeframe."

Mr Andrew Sheng, Chairman of the IOSCO Technical Committee and the Securities and Futures Commission of Hong Kong SAR, said "IOSCO fully endorses these new rules, which represent a significant step forward in the regulation of capital requirements for trading activities. We are looking forward to continuing our cooperation with the Basel Committee during their implementation."

The paper is available on the BIS website (*www.bis.org*) and on the IOSCO website (*www.iosco.org*). It results from a consultative document, released in April 2005, which elicited comments from around 40 banks, investment firms, industry associations, supervisory authorities and other organisations. The Basel Committee and IOSCO wish to thank all the commentators for their fruitful remarks on the consultative document.