

ABOUT BASEL II

WHAT IS BASEL II?

Basel II is an international Accord developed by the Basel Committee on Banking Supervision to establish a global standard for how banks and other financial institutions measure and recognize risk.

Basel II is based on a framework of three pillars - minimum capital requirements, supervisory review and market discipline.

PILLAR I: MINIMUM CAPITAL REQUIREMENTS

Standardized assessment of credit, market and operational risk.

PILLAR II: SUPERVISORY REVIEW

Ability to hold additional capital for risk assessment above and beyond Pillar I.

PILLAR III: MARKET DISCIPLINE

Sets a framework for public disclosures that banks must make that lend greater insight into the adequacy of their capitalization.

WHAT IMPACT IS BASEL II MAKING?

Many banks and other financial institutions are still preparing for Basel II. Companies are shifting resources, implementing programs and making strategic hires in order to address the regulations outlined in the directive.

The credit risk measurement part of Basel II focuses on institutions internal risk ratings. Institutions adopting the Internal Ratings Based (IRB) approach to Basel II are taking a hard look at the structure, accuracy, stability and usability of their internal ratings. As part of this process many institutions have found that Basel II provides an opportunity to upgrade internal rating systems not only to meet regulatory requirements but also to increase their competitiveness.

Another key aspect of Basel II is an institution's overall capitalization relative to both regulatory requirements and actual risks undertaken. Because of certain assumptions in the Basel II framework, firm-wide regulatory capital is not consistent with a firm's economic risk. This latter risk is typically known as economic capital and plays an important role in Pillar two.

HOW IS MOODY'S KMV HELPING?

Moody's KMV believes that all lending institutions, whether or not they are required to comply with the new regulations, should carefully consider the credit policy issues and recommendations raised by the Basel Committee in the context of managing risk and measuring customer profitability. Moody's KMV offers several products and services that help banks develop comprehensive solutions that meet regulatory requirements and contribute to improved business performance:

- RiskAnalyst™ allows institutions to create and deploy internal risk rating models based on both quantitative and qualitative criteria.
- Moody's KMV Portfolio Manager provides economic calculations at the asset level, at the firm level, and every point in between.
- Moody's KMV RiskCalc®, CreditEdge®, and Credit Monitor® produce Moody's KMV EDF™ (Expected Default Frequency) credit measures for individual borrowers. That are a key component of many Basel II internal rating systems.
- Moody's KMV LossCalc™ produces estimates of loss in the event of default.
- Moody's KMV Professional Services provides implementation, modeling, validation and calibration, stress test and scenario analysis, portfolio advisory and benchmarking services for the banking industry.