THE NEW BASEL ACCORD: TAKING CUES FROM THE ASIAN FINANCIAL CRISIS

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I. INTRODUCTION
We are living in times of uncertainty. Precisely more for the reason that we do not have answers to a lot of questions that the global scenario poses before us. An overview of the current global situation does not bring forth a very healthy image. The crude oil prices are spiraling, the global warming exigency is looming large, prices of food grains and essentials have skyrocketed, the United States still does not seem to be emerging from the throes of the subprime mortgage crisis, and several countries around the world are badly hit by unmanageable inflation rates. So where do we seem to be heading? Honestly to the stage of brinkmanship. So has the doomsday arrived? Or, do we still hold certain possibilities?

Perhaps it is time to take stock of events that have happened in the past. Unforgettably, the years from 1997-1998 were marked by the Asian crisis which had not only severely affected the East Asian economies, but had also wounded the rest of the world. The crisis had like a juggernaut depleted the Asian countries’ savings, and had brought them to the extent of being mere survivalist. This raises certain crucial concerns: will looking back at the Asian crisis even remotely benefit us in any way, what is its relevance ten years after its occurrence, and most importantly what is the link between the Asian crisis and the present global scenario.

This article is not an assessment or not an understanding of the crisis in the hindsight. The need to look back at the Asian crisis has not originated merely from the existing global condition, the slump phase in the international market or the global inflationary toil; though no denial they resurface the importance of closer scrutiny and mechanisms in place to avoid a likely threat in the future. The reason why in the present times an understanding of the Asian crisis becomes necessary is due to the emergence of Basel II and the hassles involved in its implementation, and which is in great proximity and dependence on how the markets function. The strength of the markets will result in better implementation of the new Accord and which in turn will lead to an ever stronger market. The Basel Committee on Banking Supervision constituted after the Herstatt debacle on

June 26, 1974 and the closure of British-Israel Bank of London for insolvent problems, led to the origin of a definitive organization committed to the task of coming out with recommendations and regulations on banking laws, namely, the Basel Committee on Banking Supervision (hereinafter the “Basel Committee”) which operates from the headquarters of Bank for International Settlements (hereinafter the “BIS”). The Basel Committee which originally comprised of the G-10 countries has tremendously expanded in vision and membership over the years.

The Basel Committee comes out with Accords which are subject to adoption by countries. Till date, the Basel Committee has come out with two Accords, which are International Convergence of Capital Measurement and Capital Standards (July 1988) and International Convergence of Capital Measurement and Capital Standards (June 2004). The first Accord chiefly focused on credit risk and capital reserves and decided a figure for the same, being 8%. It divided capital into two tiers, namely, tier 1 and tier 2. It assigned risk weights in which capital was related to different categories of asset or off-balance-sheet exposure, weighted according to broad categories of relative riskiness. It was for the first time when the concept of weighing of risks took place and strict standards were laid down for the same. After more than a decade in the changed circumstances and the occurrence of Asian crisis, which was primarily a bank-driven crisis, a need was felt for changes in the existing Accord; and these two factors paved way for the arrival of Basel II.

The crisis occurred when the Asian economies were booming with funds and capital inflows, and a crisis like situation could not have been even remotely anticipated. So is it the failure of Basel I or is it that the Basel Committee has failed in its initiatives?
Some would seek to answer this question by calling it the problem of laws made by the Committee being soft laws13 and the lacunas related thereto or some would list out its achievements and would call this an accusation. I would like to clarify at the outset that this article is not a critique of the policies and initiatives of the Basel Committee or I am no way even remotely attempting to belittle their efforts. On the contrary, I believe that the Basel Committee has done a lot to restore faith in the global community and has come up with laws democratically and objectively. 14 My only concern is if the Basel Committee did not go wrong then how did the crisis occur? Not that the existence of laws guarantees against occurrence of crises, but this also dispenses with the notion that Basel laws are impregnable. The Asian crisis was a good reminder of the need to have a global mechanism in place that could not only replace Basel I15 but could also overcome its shortcomings and fill the gaps.16 There was a realization felt within the Basel Committee too that Basel I had become obsolete and it was time for it to be replaced. Basel I did not address all concerns and at the same time the banking setup had globally undergone a significant transition. Banking was no more merely about borrowing and lending, banks had started investing too.17

In this article I attempt to highlight the necessity of having laws that can cater to the specific necessity of government defaults and all other inevitabilities that contribute to

14 Anna V. Morner, Financial Services and Regional Integration: A Comparative Snapshot, 7-FALL L. & Bus. Rev. Am. 549. (Looking at the Basel Committee’s initiatives in a different perspective). While these principles may be of considerable influence globally, they also raise a number of issues. First, the “soft law” nature of the principles should be stressed. They do not have any legal force whatsoever, necessitating implementation in each country individually, or, should the appropriate legal framework exist, within the context of a Regional Integration Agreement (RIA). Second, they were designed to be verifiable by supervisors, regional supervisory groups, and the market at large and, therefore, by necessity, their content is not detailed. Furthermore, these principles constitute minimum standards and, in many cases, may need to be supplemented by other measures designed to address particular conditions and risks in the financial systems of individual countries. Also, while the principles may serve as an impetus in the regulatory processes of many countries, they are not designed to affect the legal framework within which financial service providers operate. In many countries, problems relating to inadequate contract laws, property laws, and secured transactions law, for example, would need to be addressed as a matter of urgency.
15 Basel II remains faithful to the original intent of the first Basel Accord which is to protect the banking system as a whole by clarifying regulatory capital requirements, closing loopholes and gaps between this regulatory intent and market developments since the advent of the Basel Accord in 1988. Joseph Tanega, Securitization Disclosures And Compliance Under Basel II: A Risk Based Approach To Economic Substance Over Legal Form: Part 1, J.I.B.L.R. 2005, 20(12), 617-627
17 Historically, most governments and financial market regulators have operated from the premise that financial market stability required limitations on competition and a segmented market structure that segregated banks, securities firms, and insurance companies. This occurred principally due to the functional consistency of institutional operations, and because there were clearly delineated legal and market distinctions among different types of financial institutions. Beginning in the 1970s and particularly in the 1980s, however, technological and financial innovation began to lessen market and institutional segmentation. See Andrew Crockett, The Future of Banking Regulation, EUROMONEY, Sept. 1995, at 272-73; Joseph J. Norton, Christopher D. Olive, The Ongoing Process Of International Bank Regulatory And Supervisory Convergence: A New Regulatory-Market “Partnership”, 16 Ann. Rev. Banking L. 227
the occurrence of crises and how effectively can Basel laws contribute towards mitigating these fears. The concern that arises is can Basel II not only meet the challenges and overcome the fears posed by the shortcoming of Basel I but also situations like the Asian crisis.\textsuperscript{18} Also, given the importance of banking laws in contributing to the market and stimulating growth, their crucial contribution cannot be undermined as they are one of the prime contributor’s in flourishing market oriented growth.\textsuperscript{19}

Further, in this article I will be discussing the roadblocks that can or are likely to come in the way of implementation of Basel II. The emphasis will also be on looking at Basel II from the perspective of various probable factors that can eventually lead to their culmination into a crisis and how assuredly can Basel II prevent such eruptions. At times government’s default or at times the governments turn out to be inefficient. No denial that following its adoption by countries over the world, implementation will become a crucial benchmark to test the efficacy of Basel II on. However, it is to be assessed how strongly does Basel II safeguard the banking sector and how staunchly does it ensure that defaults on the part of the governments and the repercussions of it can be minimized to their possible best. The check will not be how well the supervisors fare or how well the governments show up or how much the IMF and the World Bank contribute? Rather the real test will be how well does Basel II fare. The challenge is to ensure and maintain the delicate balance of its characteristic nature of it being a soft law and the consequent acceptability concerns, and sound breakthroughs.

II. THE ASIAN ECONOMIC CRISIS

The Asian countries though characterized as extremely progressive economies\textsuperscript{20} depicted weak market fundamentals, which came to the forefront during the Asian economic crisis.\textsuperscript{21} In 1997, when the Asian economies were stormed by the crisis, it had spurred a huge public debate over the world, about the probable factors responsible for it.


\textsuperscript{19} Throughout the world, banking is one of the most highly regulated industries largely because of the central role that banking plays in domestic and international financial stability and policy. The importance of a properly functioning banking system-on the domestic level- has been summarized as being 'an essential part of a nation's economic well-being.' Because banks serve as allocates of capital as well as protectors of the national payment system, their importance to a country's economic infrastructure goes far beyond their contribution to the gross national product. The presence of financially secure banks is also important for maintaining public confidence in the economy. Bank failures undermine that confidence and thus have negative consequences for a country's economy that often are disproportionately large compared to the actual harm done to the failed bank's depositors, borrowers and other constituents. Michael S. Bennet, Banking Deregulation in Indonesia: An Updated Perspective in Light of the Asian Financial Crisis, 20 U. Pa. J. Int'l Econ. L. 1, 9 (1999); Art Alcausin Hall, International Banking Regulation Into The 21st Century: Flirting With Revolution, 21 N.Y.L. Sch. J. Int'l & Comp. L. 41


The ability of Japan and other countries to save themselves from being engulfed by it was not a mere iffy consequence but a very likely result. Japan over the years with massive investment in its country post World War – II by the U.S. support, has managed to develop latent robustness. And that precisely is the reason for it being one of the world’s very strong economies. On the other hand, the Asian economies are relatively younger in terms of growth achievements.

The prime reason for discussing the Asian crisis is that if you talk about banking regulations till date and the headways at the international front, taking about it in the context of Basel laws in reference to the Asian crisis becomes indispensable. Though a lot of crises result from bank failures and due to run on the banks, however, the occurrence of the Asian crisis had a very important timing and certainly had a definitive role to play in history.\textsuperscript{22} The crisis was quite instrumental in paving the way for Basel II and made the global community realize that urgency.\textsuperscript{23}

The crucial question that surfaces is the occurrence of the Asian Crisis despite the existence of Basel I and the coming of Core Principles for Effective Banking Supervision released in 1997. This crucial question becomes indispensable when one takes note of the nature of the crisis. The Asian Crisis was not such that could not have been avoided, as starkly the countries gobbled up by the crisis were the one’s which were exhibiting tremendous growth prospects. The crashing of the Asian Tigers had reinforced the biggest fear that crises are contagious and more so in the present times where economies of the world face interdependence and at some point integration.

In retrospect, the Asian fall was resultant of several factors and not one in specific.\textsuperscript{24} Here I would mention in brief the factors responsible for the Asian crisis. The most touted reason for the downfall is considered the pegged exchange rates of the Asian economies,


\textsuperscript{23} Some believe that the Asian crisis occurred in part because of Basel I. Basel I encouraged short-term loans to other banks because it assigned a 20% risk-weight to short-term loans to banks, instead of the 100% risk-weight assigned to loans to non-banks. This choice is believed to have contributed to the crisis, as Asian banks took advantage of the increased borrowing opportunities and the rest of the world took advantage of lending to banks. “Sixty percent of the $380 billion in international bank lending to Asia at the end of 1997 had a maturity of one year or less” because loans under a year in length required no capital need regulations. W. Ronald Gard, George Bailey In The Twenty-First Century: Are We Moving To The Postmodern Era In International Financial Regulation With Basel II?, 8 Transactions: Tenn. J. Bus. L. 161

\textsuperscript{24} The Asian Economic Crisis that erupted in Thailand in mid-1997 and proceeded to spread throughout East Asia had exchange rate elements to it, but was far more of an economic crisis. It was a crisis brought on by excessive borrowing and lending, inefficient domestic financial sectors, crony capitalism, and a loss of confidence in the region by foreign investors and creditors. The depreciation of the yen beginning in mid-1995 provided a further twist in the Asian context. As the 1990s progressed, East Asian economies began moving increasingly into the high-tech exports market, where they were forced to compete with Japan. However their exchange rates were, for the most part, pegged to an appreciating US dollar while from mid-1995 onwards, their principal competitor enjoyed a depreciating currency. Ross P. Buckley, The Essential Flaw In The Globalization Of Capital Markets: Its Impact On Human Rights In Developing Countries, 32 Cal. W. Int'l L.J. 119
symbolic of their dependence. In order to facilitate the rise in these investments, the Asian countries worked to dole out incentives to investors which came in the form of aligning the exchange rate with dollar and a few other currencies. In general, the Asian Tigers had been growing at rates of 5 to 10% per year in the eighties.\(^5\) There was huge reliance on the U.S. dollar market for the absorption of exports made to U.S. from this region. This necessitated flow of foreign direct investments in the region, trade link-ups and capital flows through both, from the gains of trade as well as through investments by U.S. investors; as the pegged exchange rate system gave them some degree of confidence and assurance about their investments not turning sour.

The Asian region, following trade liberalization and globalization had been drastically opening up and inviting investments.\(^26\) The service sector has been one of the biggest achievers of globalization, and on the same lines this sector registered good growth levels in the Asian region too. Similarly, the financial service sector had sprung up consequent to this growth saga; though it was highly unregulated and unbridled.

The pegged exchange rate system coupled with poor administration resulted in creation of the impression that markets are sturdy. However, it was this false belief that had resulted in the Asian economies striving to maintain the exchange rate, even though it held no synchronization with the market trends. By the end, as investors pulled out and there was a run on the banks, the governments were still struggling to maintain the exchange rates. Moreover, devaluation of the currency by countries becomes a political stigma and this might have compelled them to maintain the exchange rates even at the cost of selling off foreign exchange reserves. The primary reason for the panic was that with the pegged exchange rate it always gave the impression to the investors that there is guaranteed or assured value to be earned on exchange. It gave them the confidence to go for external commercial borrowings and was easier to raise money from foreign banks.\(^27\) However, the pegged exchange rates were facing the toil of non-responsiveness to the monetary policies. So although there was apparent assurance, there lied beneath a stark reality. Though the corporations stretched out to hedge their external debts by hoarding U.S. dollars, it further stimulated deeper devaluations.

Another crucial detrimental factor was what happened to the banking regime in these countries.\(^28\) The banking setup was marked by gross mismanagement followed by excessive and unchecked lending.\(^29\) In order to satisfy the investment-guzzling economy

\(^{25}\) Supra, Note 20


\(^{27}\) The Asian Crisis: Causes and Cures (IMF Staff), IMF's World Economic Outlook, May 1998 (Washington).


\(^{29}\) See And South-East Asia Thinks It's All Over, Economist, Nov. 8, 1997, at 41 (indicating that one cause of Asia's financial crisis is the lack of an effective banking supervision system rather than an unstable economic system); Lawrence L. C. Lee, The Basle Accords As Soft Law: Strengthening International Banking Supervision", 39 Va. J. Int'l L. 1
the markets opened to heavy borrowing and lending. The business culture in Asia has always thrived on reliance on banks to meet their investment needs, instead of opening out to the public through stocks and bonds. In order to meet the requirements, the Asian banks borrowed excessively from banks abroad, in the form of short-term loans. These borrowed loans were further loaned out to domestic businesses. The setup got distributed as the economy was running on borrowed funds and the markets were highly leveraged. The borrowed funds were meant to be eventually paid back and relying on good growth figures markets went on to absorb capital. The most questionable element of these loans was the investments by the businesses in the real estate sector. By the time investments would have yielded result it was time for the banks to re-pay. The failure of these banks to repay their loans resulted in an immediate withdrawal of fund flows into the region. As the loans turned sour the region destabilized. It is this fallacy which resulted in these countries bearing the brunt, a cost massive enough to engulf them in a crisis. The crisis was further aided by inefficient governments which could not instill confidence, as international banks hardened to prevent the rolling over of short term loans.

To add on to this the speculators had a major role to play in the pull down as they withdrew their funds and massively invested them back in U.S. when the Asian

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31 Supra, Note 20
32 "At the end of 1996, the U.S. banks reported $29.1 billion in loans outstanding to Indonesia, South Korea, Malaysia, the Philippines, Taiwan, and Thailand. There was an additional $14.4 billion loaned to Hong Kong and Singapore for a total of $57.9 billion. This amounted to 34.9% of all U.S. international lending (including offshore banking centers). The greatest U.S. exposure was in Hong Kong and South Korea. As for other major lending countries the United Kingdom reported 50.8% of its loans to these eight Asian economies and Germany 33.6%....... Japan's bank exposure was particularly high. It reported 62.3% of its international lending to these Asian countries. In the offshore centers, Japan reported $87.5 billion in Hong Kong and $58.8 billion in Singapore. For Thailand, Japan reported $37.5 billion in claims and more than $20 billion each in Indonesia and South Korea". See Supra, note 20
34 See Jaret Seiberg, Basel Panel Seen as Too Slow In Reacting to Global Crisis, Am. Banker, Dec. 8, 1998
35 See Alvin K. Lim, Note, The S&L Crisis Revisited: Exporting an American Model to Resolve Thailand's Banking Problems, 9 Duke J. Comp. & Int'l L. 343, 366; Girding the Infrastructure of Finance, Bus. Times (Singapore), May 21, 1999, available at 1999 WL 18750289 (referring to lopsided investments and gross absence of proper channels of investments)
37 Soonruth Bunyamanee, Economy: Bad Loans Forecast to Fall by End of Year, Bangkok Post, Oct. 18, 1999, available in 1999 WL 28663976
38 Real estate values began to plummet, leaving Thai bank loans under collateralized and eventually non-performing.
economies needed them the most. A lot of this resulted from the hedge funds and investments through derivatives which further made the market volatile.

These factors got an impetus due to the balance of payment problems registered by these countries. The prime factor was the appreciation of the U.S. currency and the consequent deviation of these currencies’ worth from the underlying market value due to the pegged exchange rate system. As the current account deficits went on widening, the countries took note of the downfall, although by then it was quite late and aid from IMF and ASEAN could not have helped much.

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42 The Asian Market Crisis of 1997-1998 brought a long overdue international recognition of the hedge fund industry's significant role in the plight of Asian emerging markets and a sense of urgency to the implementation of global hedge fund regulatory efforts. Victimized by that time period’s infiltration of elitist investment growth and acquisition, these Third World economies’ unsuccessful attempts to stabilize in response to wavering investor confidence levels were exacerbated by the leveraging blows of havoc-wreaking U.S. hedge funds. Sherry M. Shore, Sec Hedge Fund Regulatory Implications On Asian Emerging Markets: Bottom Line Or Bust, 13 Cardozo J. Int'l & Comp. L. 563
43 “To one degree or another, most of these countries have been facing difficulties with their balance of payments, over-expansion of production capacity, rising real estate values, overvalued equities, and excessive bank lending...... The effect of a slowdown in growth on a nation's exchange rate is not immediately obvious. It affects both trade and capital accounts in opposite ways. On one hand, lower growth usually causes a nation's trade balance to improve, since imports decline relative to exports (unless demand in export markets is falling faster). This could strengthen a nation's currency. In the Asian case, however, growth was continuing at a level high enough that trade and current accounts tended to remain in deficit. Even in Thailand, the slowdown had not improved its balance of trade.
On the capital account side, a slowing growth rate generally causes problems for a nation's debtors who have borrowed to finance production facilities or have invested in real estate or equities and are faced with repayment schedules. Lower growth means lower demand, possible lower profits, and a leveling off or fall in real estate and stock values. As the slowdown intensifies, interest rates usually fall. This can cause international lenders to look elsewhere for investment for financing opportunities and may cause a weakening of a nation's currency. Recessions also cause loans to turn sour and may further drive away foreign lenders. As the Asian financial crisis has developed, forecasters have lowered their outlook for growth in these countries. The securities firm, J.P. Morgan, for example, lowered its forecast for economic growth for ASEAN (Indonesia, Malaysia, Singapore, Thailand, Philippines, Brunei, and Vietnam) for 1998 from 5.9% in June 1997 (before the crisis began) to 2.2% in November 1997. Forecasters expect economic growth in South Korea to drop from 5.9% in 1997 to around -1.5% in 1998... The IMF considers that when current account deficits reach 5 to 8% of GDP, they merit close monitoring. This deficit was the primary reason for the downward pressure on the baht. By the time Thai authorities tightened economic policies, investors-both foreign and domestic-were pulling funds out of the country, and the currency crisis had already developed......The primary reason that the deteriorating current account balance for these nations had not placed severe downward pressures on their exchange rates earlier was that foreign capital was flowing in from other countries. Foreign investors, businesses establishing manufacturing subsidiaries, international banks lending to local borrowers, and others were providing a steady stream of foreign exchange and a positive balance on financial account. This tended to offset the current account deficits.” See Supra, note 20
Though several authors accuse the financial packages by IMF for having resulted in a moral hazard, however as the focus is only on the occurrence of the crisis and the claimed moral hazard might have worsened or stagnated the crisis, it cannot be taken to be a decisive factor when analyzing the factors that could have resulted in its eruption.46

Also, it is not that the crisis did not affect other countries in the world; at least the economies that had been trading with this region and the economies that were massively investing in it till some time before the eruption of the crisis had become most susceptible to face recession. As these countries battled hard to avoid the contagion, they did not remain completely unaffected. For example, in 1997, the Asian turmoil reduced Citicorp's pretax earnings by about $250 million. The Bank of America reported that as of December 31, 1997, it had assets of $24.0 billion in Asia (up from $20.4 billion in December 1996), but net income from Asia had dropped from $224 million in 1996 to $218 million in 1997. During the fourth quarter of 1997, J.P. Morgan designated as nonperforming approximately $587 million of its total $5.4 billion in loans, swaps, and debt investment securities in Indonesia, Thailand, and South Korea. The bank reported charge-offs of $24 million during the quarter-mostly related to Asia, and considered about 60% of its total allowance for credit losses of $1.081 billion to be related to exposures in the three troubled Asian countries.47

The crucial part about this crisis is that it affected only certain countries of the south-east Asian region.48 Not only countries of this region were hit by the crisis; interestingly, the crisis had then spiraled to Russia and Brazil. Just the way Japan managed to save itself from the Asian crisis and the way rest of the countries of the south-east Asian region escaped it, if not for Thailand, Malaysia, Indonesia and Korea; the crisis had a lot to reflect.49 Surprisingly, the three East Asian economies which underwent the crisis were the one’s who had registered more sordid and bullish growth.50 Probably that became the reason for their vulnerability and latent weaknesses.

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49 Stign Claessens (World Bank) and Kristin Forbes (M.I.T. and NBER), International Financial Contagion: An Overview of the Issues and the Book, Chapter 1, 26-39, available at www1.fee.uva.nl/fm/PAPERS (applauding the "contagion" analogy used to depict the Asian Financial Crisis, as aptly demonstrative of the period's novel indication that "country-specific crises" could have international implications). See also IMF, World Economic Outlook, A Survey by the Staff of the IMF, at 3 (May 1998), available at www.imf.org (defining the Asian Financial Crisis's contributing factors as "exacerbated by contagion and spillovers among the countries involved").
50 Many speculative theories arose to address the ensuing bewilderment, as Southeast Asian economies had been some of the most promising emerging markets as far as growth and living standard improvement prior to the Asian Financial Crisis. One commentator writes, Nations that had only a short while ago been hailed
The Asian countries eventually recovered, and could recover not for the fact that they were resilient but for the reason that they were not impoverishe before the crisis. What happened to East Asia, if it had been faced by any other brittle economy could have resulted in its exhaustion? Though the Asian countries had lost out on their reserves and looked gloomy, but they had relatively basic infrastructure in place to recover. After all, the economies which till sometime back from then had been called the Asian tigers could not have died by the stroke of one crisis. Though no denial the crisis was insurmountable in magnitude and had shook them badly, but unarguably the Asian countries were better off than many to face it. Also, the Asian region has been blessed with huge manpower resource to thrust it back in the absence of other resources; and in times of adversity, it is this human capital that proves buoyant.

The brunt of the crisis was burdened by few countries and their governments had a crucial role to play in the same. Some apprehend that the widespread acceptance of the first Accord was also contributory in this direction as Basel I encouraged short-term lending. As a consequence, there were rampant short-term loans loaned by international banks to the banks in these countries. I believe, that even if Basel I stimulated massive short-term lending, it cannot be off such a magnitude that devoid of any other factor it will result in the occurrence of the crisis. However, some question the first Accord probably as economic miracles have had their currencies depreciated, millions thrown out of jobs as their economies sink as fast as the Titanic, and their poverty rates exploding together with social and political upheaval. Martin Khor, Globalization, Sustainable Ireland, World - Global and Local Issues (Oct. 4, 2004), http://www.sustainable.ie.resources/globalisation/art01.htm.

51 See Group of Ten, The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors Prepared under the Auspices of the Deputies (1996), available at http://www.bis.org/publ/gten03.pdf (discussing how to resolve foreign financial crises). “Following the Mexican financial crisis of 1994-95 and the United States-led international rescue operation that followed, leaders of the developed economies recognized the need to develop mechanisms to deal with the potentially systemic dangers of such crises. In response to an initiative at the Lyon summit of the G-7 in June 1996, representatives of the G-10 countries and of emerging and transition economies jointly sought to develop a strategy for fostering financial stability through the analysis of experiences in previous crises and to elucidate basic standards and principles to guide individual economies in the development of stronger financial systems, going far beyond the initial efforts published in May 1996. The primary conclusion to emerge from this study was that a financial system that is robust is less susceptible to the risk of a crisis in the wake of real economic disturbances and is more resilient in the face of crises that do occur…… In its report, the G-10 focused on three central elements necessary to the development of a robust financial system: (1) creation of an institutional setting and financial infrastructure necessary for a sound credit culture and effective market functioning; (2) promotion of functioning of markets so that owners, directors, investors, and other actual and potential stakeholders exercise adequate discipline over financial intermediaries; and (3) creation of regulatory and supervisory arrangements that complement and support market discipline. The World Bank and regional development banks were given a leading role in providing technical assistance to countries seeking to build robust financial systems.”

due to tremendous faith exhibited by the world community in it. Nonetheless, the crisis turned out to be significant in a way that it encouraged the world community to realize the need of a new Accord, as it was felt that the first Accord required massive changes which had become the need of the hour by then,

III. BASEL I BREATHES ITS LAST IN ESSENCE
It was after the Asian crisis when for the first time the realization of the old Accord’s incompleteness was felt. The world realized that though Basel I was here to stay, but it stemmed apprehensions about its redundancies. However, the old Accord failed in one aspect which was its progressiveness. The old Accord could not interpret the penetration of the international banks in domestic economies of the countries. Probably it failed to rise up to the occasion or probably the old Accord suffered from the lack of a comprehensive focus.

Not that Basel I has been completely eliminated, the Accord still holds good and has been implemented and followed by many countries and their banks. Probably it is due to the reason that Basel I is easier to adapt and implement, with its lesser stringent requirements. Though Basel I was not only necessary and crucial, it was largely indispensable. It came at a time when mighty banks were damaging the financial markets. Though instances like Herstatt were like triggers, it is important to understand why all of a sudden markets take an erratic turn. It is not surprising that markets at times fail or get imbalanced. For the same reason the existence of laws is not an assurance that markets will not fail. The reason why the failure of Basel I is discussed so much is that the Basel Committee had done a remarkable job in bringing together the different banking segments existing in various parts of the world. The first Accord was the first initiative in the direction. It had successfully managed to address a lot of concerns of the time. Banks require certain minimum capital ratios as reserves with them, so that if there is any default on loans, the banks do not automatically collapse. Banks should have the strength in them to fight these odds. The first Accord was a landmark as it championed the cause of providing a level playing field.

However, it could not have been expected out of Basel I to have longevity. The new Accord was a success in its own ways. For the first time the concept of minimum capital requirements was introduced, just like never before. The Accord had made a crucial headway. For the same reason, it is not that the Accord jaded, it was primarily the change in circumstances; and which is precisely the reason for its touted obsolescence. The old Accord had certain crucial contributions to make, one being tackling off-balance sheet engagements. Basel I came out with its own formula for the same, which was the one on the same lines as that described in the Committee’s report on the supervisory treatment of off-balance-sheet exposures issued to banks in March 1986. It provided that all categories of off-balance-sheet engagements, including recent innovations, will be converted to credit risk equivalents by multiplying the nominal principal amounts by a credit
conversion factor, the resulting amounts then being weighted according to the nature of the counterparty.\footnote{Basle Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards, July 1988. Available at http://www.bis.org/publ/bcbs04a.pdf?noreferrer=1}

At the same time, Basel I still continues to be followed by many countries, including those who have decided to implement the new Accord. In essence, Basel I addressed a lot of challenges of its time. The arrival of the new Accord is not to be taken as mere replacement, but as an expected addition, in consonance with the new circumstances. The arrival of Basel II will be discussed by me in greater detail in the subsequent sections.

IV. BASEL II ARRIVES
On June 2004, the new Basel Accord titled International Convergence of Capital Measurement and Capital Standards (June 2004)\footnote{Basle Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards, June 2004. Available at http://www.bis.org/publ/bcbs107.pdf?noreferrer=1} was introduced. The Asian crisis is not only relevant in discussing the first Accord, but also in analyzing the new Accord. The characteristic origin of Basel II, post occurrence of the Asian crisis and the way the world has been marred by crises that have occurred in the past and questioned the worth of Basel I, which requires of us to look back at the Asian crisis. This crisis is a classic example of unpredictability which can be specifically noticed from its nature as it can be easily distinguished from the other callous previous financial crises where governments over borrowed and over inflated until a fall out was inevitable. Moreover, unlike other crises, in the Asian crisis banks and international banks had an important role to play in the downturn, which in turn makes the discussion over this crisis inevitable when discussing the Basel laws. It is to be seen how far Basel II addresses these challenges and Asian crisis like situations.

A. SETTING UP OF THE NEW STAGE
The Basle Committee stated four objectives of the new Accord: (1) improving “safety and soundness in the financial system,” (2) promoting “competitive equality,” (3) establishing “a more comprehensive approach to addressing risks,” and (4) making the requirements “suitable for application to banks of varying levels of complexity and sophistication.”\footnote{Basle Committee on Banking Supervision, A New Capital Adequacy Framework (June 1999) <http://www.bis.org/publ/index.htm> (outlining a major revision to the 1988 Accord), pp. 6}

The new Accord aims towards comprehensiveness and a much broader approach. It realized the growing significance of international banks that operated in more than one region. The target is to cover such banks by consolidation\footnote{There may be instances where it is not feasible or desirable to consolidate certain securities or other regulated financial entities. This would be only in cases where such holdings are acquired through debt previously contracted and held on a temporary basis, are subject to different regulation, or where non-consolidation for regulatory capital purposes is otherwise required by law. In such cases, it is imperative for the bank supervisor to obtain sufficient information from supervisors responsible for such entities.}, and is primarily meant to
cover all banking entities, securities entities and other financial entities. When it comes to insurance entities, a bank that owns an insurance subsidiary bears the full entrepreneurial risks of the subsidiary and should recognize on a group-wide basis the risks included in the whole group. The present Accord focuses on minimum capital requirements, which is Pillar 1 of the Accord. In addition, it also makes provision for supervisory regulation and market discipline, which are Pillar 2 and the Pillar 3 of the new Accord respectively. The new Accord does not significantly deviate from the previous Accord. The basic foundation of the new Accord has been to develop on the previous Accord.

Both the Basel Accords have realized that banks need to be regulated, and the new Accord goes on to recognize that markets too are to be regulated. The success of the new Accord lies in its implementation. Basel II offers certain approaches, and countries and regulators in order to zero in on that require doing certain assessment of their laws, infrastructure, reserves, financial and market strength, ability to absorb the transition. On the same lines the Basel Committee realizing this concern in its paper on Implementation of Basel II: Practical Considerations, released on July 2004 has set out certain criterions, which are—

- identify the current range of practice in risk management techniques and internal capital assessment at eligible banks;
- raise awareness of both banks and supervisors of what the new minimum capital standards and their implications for risk management will mean in practice;
- assess readiness of banks for Basel II, including identifying key gaps and implementation challenges, and
- inform the domestic rule-making process and preparation of examiner guidance.

It further provides that supervisors must develop a comprehensive process for achieving these objectives. This process should include both bilateral discussions with banks, as well as exploration of the broader issues.

57 Examples of the types of activities that financial entities might be involved in include financial leasing, issuing credit cards, portfolio management, investment advisory, custodial and safekeeping services and other similar activities that are ancillary to the business of banking. See Supra, Note 7, pp. 7
58 Supra, Note 7, pp. 8
59 Because of the dynamic function of free enterprise, imprudent firms are disciplined not by the government, but by the market. This reasoning is perhaps the most persuasive argument against the necessity of capital adequacy standards. Many economists and legal scholars believe that the market alone, and not the government, should regulate bank capital. Before the government ever considered comprehensive capital regulations or mass deposit insurance, the market was solely responsible for the task: Before governments protected banks' depositors from loss, banks were subject to market discipline much like other corporations. Except for minimum capital requirements at the time a bank was chartered, the amount of its capital was determined by the market. If depositors believed that a bank had insufficient capital to protect the par value of their deposits, they could withdraw their funds. That threat encouraged banks to maintain sufficient capital, commensurate with their portfolio risk, to ensure the continued confidence of their depositors, thereby avoiding a run on the bank that might put it out of business. Heath Price Tarbert, Are International Capital Adequacy Rules Adequate? The Basle Accord And Beyond, 148 U. Pa. L. Rev. 1771
60 Basle Committee on Banking Supervision, Implementation of Basel II: Practical Considerations (July 2004). Available at http://www.bis.org/publ/bcbs109.htm, pp. 13
61 Ibid
The momentum does not end here; the Committee has come up with means by which the banks and regulators can co-ordinate, so that the regulators are in a position to introduce the new Accord in certain banks initially. The methods that the supervisors may use include self-assessment, targeted visits and horizontal reviews. The supervisors are further encouraged to prepare additional guidance for banks and examiners. At the same time, as part of this process, banks should conduct in-depth self-assessments of their internal systems and develop comprehensive plans for enhancing those systems to meet the requirements of the chosen approaches. The Committee further provides that supervisors should also communicate their expectations as to when banks should begin to provide parallel calculations of capital charges under the 1988 and the new framework. This process will also help give banks and supervisors confidence in the resulting capital charges and assist in identifying outstanding implementation issues.

The three Pillars of the new Accord compliment each other paving way for the coming of a sound banking system which can develop as a consequence of good supervision coupled with market discipline. Otherwise, minimum capital requirements mostly end up being on paper without much compliance. If the new Basel framework demands market discipline, it envisions greater degree of stability. As a healthy market will be in a better position to revive a sagging bank and can enable it to recover from the shock. Further, requirements of effective supervision greatly bring forth the emphasis of skilled professionals who can overview the market performance and ensure the applicability of minimum capital requirements by meeting these standards.

The adoption of Basel II by countries requires the fulfillment of certain prior conditions, before they set out to implement these recommendations. The new Framework requires that supervisors implement it in a manner that suits their national circumstances. The countries are required to have the necessary infrastructure in place, before introducing and implementing these guidelines into their system. The Basel Accord II ensures that countries adopt the new Accord only when they are in a position to benefit from it, and the implementation of it calls for an effective Baseline supervisory system in place. The Accord is subject to adoption by countries who have not adopted it so far, but aim to adopt it after building up the necessary key infrastructure. Also, the new framework does not require the implementation of the new Accord to all banks in a jurisdiction. The beneficial part of this approach is that it rests a lot on the assessment of national priorities by regulators, signifying the freedom assigned to each country and in recognition of their sovereignty.

62 Ibid, pp. 13 (fn. 50)
63 Ibid, pp. 13
64 Ibid, pp. 13
65 Ibid, pp. 13
66 Rolf H. Weber, Douglas W. Arner, Toward A New Design for International Financial Regulation, 29 U. Pa. J. Int'l L. 391 “Supervisors will also need to assess the legal-regulatory infrastructure in place, human resources, the current disclosure regime, as well as the status of corporate governance, accounting and provisioning practices.”
B. PANACEA FOR BASEL I

Basel II largely does away with the supposed obsoleteness of the 1988 system. Here was a completely new setup, premised in the present times. Though in certain aspects, Basel II looks over-ambitious, however the flexibility of Basel laws does away with this notion to a significant extent.® Countries will have a lot of determination to be done before implementing Basel II. The determination will pertain to the specific definitions, approaches, or thresholds they wish to adopt in implementing the proposals of the new Accord.™ Moreover, for the supervisors it will not be all about making crucial determinations, they will also have to set certain prudential standards and rules to operationalise various Basel II principles.®

Unlike Basel I, the new accord covers operational risk. For valuing the operational risk the banks have introduced three choices which are a Basic Indicator Approach, a Standardized Approach, and an Internal Measurement Approach.® The new Accord proposes harmonization.® The host and the home country governments have different

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® Developing international financial standards as soft law has some advantages. This type of law is flexible and allows the parties to consider specific national conditions or attributes in implementing the standards. For instance, the Core Principles are sensitive to the fact that bank regulatory structures differ greatly among nations. U.S. Census Bureau, Statistical Abstract of the United States 872 tbl.1376 (2003).

™ Supra, Note 60, pp. 12

® For example, under the standardized approach, supervisors should evaluate whether the 35% risk weight for residential mortgages is adequate given the loss experience in their jurisdictions, as well as considering as to what are the “strict prudential criteria” that must be met to qualify for the 35% risk weight. Supervisors intending to implement IRB will also be required to develop specific standards and processes for IRB validation / certification. Basle Committee on Banking Supervision, Implementation of Basel II: Practical Considerations (July 2004), http://www.bis.org/publ/bcbs109.htm, pp. 12


® The Minimum Standards stated that all international banks should be subject to consolidated supervision by their home country regulators. This required that the home country regulator receive reliable information on the global operations of the particular international bank. Supervisors then would assess this information in monitoring the safety and soundness of international banks. Under the Minimum Standards, home country bank regulators could prevent the creation of corporate affiliations that undermined the application of consolidated supervision or hindered effective regulation, and also could prevent the opening of banking establishments in foreign jurisdictions if they were not satisfied with the host country supervision. Host country regulators likewise had the responsibility to ensure that the home country regulators had the ability to meet these standards. The Minimum Standards required that international banks receive permission from both home and host country regulators before opening cross-border banking establishments. The approval of any new banking establishment was contingent upon a multilateral agreement among regulators allowing each to gather the information necessary for effective supervision. The Minimum Standards allocated supervisory responsibilities between home and host country regulators in a similar manner as the Revised Concordat, except in cases where the regulators decide that that allocation is inappropriate. If, in a particular situation, one regulator determined that such allocation was inappropriate, then it could reach an explicit agreement with its counterpart on a more appropriate allocation of supervisory responsibility. In the absence of an agreement to the contrary, the Minimum Standards continued to allocate supervisory responsibilities.

The host country regulator had responsibility for determining whether the international bank in fact would be subject to consolidated supervision in the home country. If the host country regulator found that the bank was not receiving effective supervision from the home country regulator, the host country regulator could prevent the opening of the new banking establishment. Alternatively, in its sole discretion, the host country regulator could allow the establishment of branches subject to any regulatory restrictions it deemed necessary and appropriate, but then would have to supervise any such establishment on a “stand alone
In order to harmonize, there is requirement of convergence at some point, if not intrinsically, at least broadly. The primary reason for focus of the new Accord on harmonization is due to the surge in international banking. There is requirement on parts of countries over the world to co-ordinate. The new Accord realizes that banking and investments are not restrained by State boundaries. Investments are taking the global turn towards money flowing in and out of countries. If that was not enough investments are taking place through options other than bank deposits to more lucrative one’s, such as derivatives and hedge funds. The Regulations need to attend to consolidated basis”. Duncan E. Alford, Core Principles for Effective Banking Supervision: An Enforceable International Financial Standard?, 28 B.C. Int'l & Comp. L. Rev. 237


Taeho Kim, International Money and Banking 31, 36 (1993), pp. 283

Dale D. Murphy, Interjurisdictional Competition and Regulatory Advantage, 8 J. Int'l Econ. L. 891. As international trade has grown, each nation's banking system has likewise become more international. World merchandise trade increased from US$ 579 billion in 1973 to US$ 6,272 billion in 2002. International bank loans increased from US$ 2,713.7 billion in 1985 to US$ 20,212.9 billion in 2003 --a 744% increase. Duncan E. Alford, Core Principles For Effective Banking Supervision: An Enforceable International Financial Standard?, 28 B.C. Int'l & Comp. L. Rev. 237


While the Basle Committee on Banking Supervision has constructed a basic supervisory programme of co-operative arrangements for international bank activities, the collapse of Barings Bank in the United Kingdom and the losses suffered by Daiwa in the United States powerfully demonstrate the gaps in these arrangements and the complete absence of any similar mechanisms in the related securities field. The need to create an effective coordinating facility is confirmed by the continued growth in the use and increased complexity of financial conglomerates in international markets. The development of conglomerate business structures raises a large number of very difficult supervisory and regulatory issues. The most important of these, from the perspective of effective market supervision, is the coordination of all of activities of the independent national and international authorities involved. In light of the importance attached to this issue in recent international discussion, this article considers the possible nature and operation of such an arrangement. In so doing, the existing cooperation models currently in place are noted and the extent to which other historical precedents may assist in the development of such a new type of more formal co-operative supervisory facility is considered. Some of the principal operational issues which arise are noted, and the potential advantages available are set against the establishment and operational difficulties involved. Conclusions regarding the possibility of the early adoption of such a facility are also made with some suggestions to ensure that a sufficient interim response is available in the event that its formal confirmation is either delayed further or ultimately impossible to agree upon. George A. Walker, Conglomerate Law And International Financial Market Supervision, 17 Ann. Rev. Banking L. 287

The flight of deposits from banks to more lucrative investments is well-documented. That large business borrowers are abandoning banks for the capital and commercial paper markets is equally well-recognized. This conjunction between shrinking deposits and a diminishing loan base has led many to speculate that the traditional business of banking is dead. Amy C. Bushaw, Small Business Loan Pools: Testing The Waters, 2 J. Small & Emerging Bus. L. 197. See also, Credit Availability to Small Businesses, 1993: Hearing Before Senate Comm. on Small Bus., 103d Cong. 10 (1993) (statement by David W. Mullins, Board of
this progress and the new Accord realizing this has stringently focused on all supervisory concerns which are to be met by supervisors in the home and the host country. The home and the host country supervisor’s are to ensure that banks, and specifically international banks, do not escape regulation. Banks are required to maintain minimum capital requirements and provide adequate disclosures as per the Basel laws. So that international banks do not evade compliance, the supervisors of home and the host countries have to ensure timely and comprehensive co-ordination. The new Accord lists down the mechanism by which such co-ordination can be facilitated.77

C. THE END PRODUCT
The new Accord certainly looks forward to responsiveness from countries after its set of researches and deliberations. Believing so, the Basel Committee is required to focus on the implementation part. By its efforts it is conspicuously noticeable that the Basel Committee is striving hard to increase the influence of the new Accord. However, the successful implementation will be a question yet again of circumstances and as driven by necessity. The readiness to adopt the new Accord will hinge on the respective country’s requirements and will be conditioned around the country’s own socio-economic circumstances.

1. ALL WHAT INVESTED
The new Basel Accord has been instrumental in maintaining the spirit of the Basel Committee’s legacy. It came with several additions, changes and necessary exclusions too. For instance, countries have found the respite in Basle Committee’s proposal in the new Accord abandoning the current rule that allocates no risk to loans made to OECD central governments.78

The Basel Committee has not confined itself to the two Accords; it has come out with a number of other Regulations and Principles, dealing with different aspects of banking. Such as the Committee’s paper titled Supervisory Guidance on Dealing with Weak Banks (March 2002)79 provides that the supervisors are to provide remedial action if capital starts dipping. The supervisors are to ensure that they intervene at an early stage. For this each supervisor should clarify the steps that it will need to follow in the event of a decline in a bank’s capital, heading towards the minimum.80

The efforts made by the Committee become significant as they supplement the Basel Accords and at the same time cover several aspects, not specifically covered by the Basel Accords.

79 Basle Committee on Banking Supervision, Supervisory Guidance on Dealing with Weak Banks (March 2002), http://www.bis.org/publ/bcbs88.htm
80 Ibid
2. EXPECTATIONS TO BE MET

The new Accord has entered the world stage with a lot of promises, which are crucial as it has a lot to prove and a lot at stake. At the same time, there are very high expectations from the Accord. It has to undo the loss of the previous Accord, on a very separate note it has to establish a trend, and if not a trend, at least a premise by which banks can be regulated globally. The new Accord has sought to address a lot of concerns, though certain aspects of it have been questioned. More importantly, the new Accord gives importance to various institutions and does not put all the eggs in one basket. It recognizes the worth of central banks, rating agencies, supervisors, banks, markets and governments.

For instance, the central bank of every country has a crucial supervisory role to play; though central banks perform umpteen numbers of functions, but financial stability to a very large degree and an extremely great level depends on them. In modern times their responsibilities are not merely confined to regulating monetary policies but have tremendously expanded in scope and breadth, and have made them the custodians of financial stability. Realizing this significance is the need of the hour and it is to be seen till what extent the Basel laws address that. Many studies have suggested that greater central bank independence yields more monetary and price stability. The second and the third Pillar of Basel II provide for supervisory review process and market discipline respectively. Market discipline can only be instilled if there are sound monetary and fiscal policies that regulate and balance the market, letting it reach the desired equilibrium, as propounded and propagated by the laissez-faire approach, essentially the cornerstone of free market economies. For the “market discipline” aspect the central banks do certainly have a role to play, but that too partially, as the markets are regulated not only by monetary policies, but by fiscal policies too. Also, the level of independence that the central banks enjoy is a very country-specific issue and this level of freedom differs from country-to-country. And, as far as the argument of supervisory review process is concerned that crucially becomes the domain of central banks, in the absence of a central supervisory body or any other setup that caters to it; which yet again makes it a very country-specific regime.

Therefore, a lot of expectations out of the Accord are to be met and reciprocated by the governments in the form of laws they frame and till which extent they develop on the new Accord, because the new Accord is in the form of minimum requirements, as propounded by the Basel Committee. Therefore the onus is on the governments not only at the stage of implementation of the Accord but also of its interpretation.

V. SURVIVAL OF THE NEW ACCORD
The survival of the new Accord and its place in present times, has tremendous value attached to it as the test of its worth. What difference will the new Accord bring if it is not successfully implemented by countries across the world? Unarguably, the new Accord will have its own shortcomings. Will it be able to bring the necessary respite through the replacement? All these questions are attempted to be answered by me in this section of the article.

A. RESCUING REGIME
The new Accord was full of realizations.\(^\text{82}\) Also, it considerably focuses on international banking. As it tried to massively tap international investments and international banks, the Accord primarily laid focus on empowering the host country and the home country supervisors. The new Accord makes one crucial change through Pillar I; it comes up with two mechanisms to decide upon the capital requirements. Though the 8% limit still holds good, it takes a deeper plunge and more comprehensively tries to assess all possible risks that banks are likely to face. Certain risks that Pillar I does not set out to cover, fully or partially, come in the loop of Pillar II. For instance, credit concentration risk, interest rate in the banking book, liquidity, business, strategic and reputation. Factors external to the bank (e.g. business cycle effects) are also to be captured through Pillar 2.\(^\text{83}\)

Basel II is different from Basel I in that it focuses on specific variables, rather than broad categories for determining credit risk.\(^\text{84}\) The new Accord keeps up with two trends of the old Accord, namely, the two tier structure and the 8% capital requirement. But when it comes to calculating the risk weight for assets, the new Accord takes a more complicated approach. Primarily, there are two approaches, namely the standardized approach and the internal ratings based approach.\(^\text{85}\) As there are two kinds of internal ratings based

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\(^\text{82}\) The ‘one-size-fits-all’ approach of the first Basle Accord was adequate for a time. However, the increasing complexities of the international banking sector, along with a greater than ever emphasis on risk, have proved the first Accord too unsophisticated for twenty-first century corporate finance. Basle II’s requirements will provide a more sophisticated structure within which to evaluate investment risk, injecting a degree of prudence into the financing equation with the objective of promoting greater stability in the international banking community. Peter Measures, Angelo L. Rosa, Outpacing The Tempest The Consequences Of Basle Ii On Institutional Lending In Shipping Finance Transactions, 6 Transactions: Tenn. J. Bus. L. 93

\(^\text{83}\) Supra, Note 60, pp. 17


approach, in turn it becomes three approaches.\textsuperscript{86} The standardized approach involves fixed risk-weighing categories, and through the new Accord certain new categories have been added. Also, a qualitative component through external credit ratings “to evaluate corporate risk exposures” has been added.\textsuperscript{87} IRB approach focuses more on the qualitative aspect.\textsuperscript{88} The simplified aspect looks at the loan default aspect, whereas the complicated approach considers and brings into perspective all the risks associated with the particular transaction.\textsuperscript{89}

The new layout comes with several advantages. It helps in making a qualitative analysis of bank’s choices, unlike the earlier Accord.\textsuperscript{90} It also involves banks in the risk-calculation process, makes them involved in the process and does not leave everything to outside agencies.\textsuperscript{91}

The paper on \textit{Implementation of Basel II: Practical Considerations (July 2004)} lays emphasis on initial assessment on impact of Basel II. It provides for countries to do an initial assessment about whether to implement the new Accord or not. This type of analysis should achieve the following objectives:

- provide banks with a fully operational version of the rules;
- evaluate the impact of the rules on capital ratios, concentrating on those components which contribute to significant changes;
- allow banks to assess how the changes resulting from the new rules fit into their overall risk profile, and
- enable banks to discuss issues as they arise through a continuous dialogue with their supervisors to ensure that the rules are interpreted accurately and consistently.

It further provides that if the impact study shows that adoption of the chosen approaches will change the aggregate level of capital (at a given bank and/or within the system),

\begin{itemize}
\item \textsuperscript{86} Ibid
\item \textsuperscript{87} Ibid
\item \textsuperscript{88} Ibid
\item \textsuperscript{89} Ibid
\item \textsuperscript{90} Ibid
\item \textsuperscript{91} Basel II is also responsible for a doctrine many consider counter-intuitive: “a bank's capital should not be established by regulatory fiat; rather, it should be created by the bank's own evaluation of its financial structure.” The heart of Basel II is that the government regulators evaluate a bank's management structure. The drafters of Basel II believed that a bank's own sense of its solvency and risk should determine its capital, which requires a well-run bank by competent managers. The CBS recommends that national financial authorities implement Basel II by no later than 2007. The United States has delayed implementation of Basel II to 2012. However, the general belief is that Basel II's sophistication makes it appropriate for only the largest banks. Furthermore, when it becomes local regulation, Basel II will only be adopted by approximately fifteen banks.
\end{itemize}

The Accord has, with appropriate local amendments, been adopted as the capital standard of most sophisticated banking economies. This is, of course, the direct result of the people who worked in the CBS and the stature it has achieved with the local bank regulators and legislatures. Considering that it has no legal binding force, the success of the Accord is remarkable.

In addition, the CBS has issued other papers, including papers on risk management and electronic banking, the latter of which was published in 2003. In general, the papers were accepted in concept by the local banking regulators and imposed an increased consistency to international banking.
supervisors need to ensure that the change is considered appropriate for both banks and the banking system as a whole, and if so, that banks develop appropriate capital plans as part of the Pillar 2 process.  

Moreover, as the emphasis has been a lot on international banking, supervision which is a Pillar II impetus has to be soundly coordinated and becomes a responsibility of supervisors from both the host country and the home country. The Committee encourages exchange of views between supervisors of different countries. This is in order to encourage better parity in relationships between home country and host country supervisors, and also to instill better implementation culture over jurisdictions. Through the interaction countries can realize and understand the best possible ways for the implementation of the new Accord. The Committee had for the same taken the initiative to begin a process for an exchange of views between non-G10 supervisors represented in the Core Principles Liaison Group and Committee members. The information-sharing becomes particularly vital in the context of cross-border supervision of banking institutions.

B. ASSESSING ITS OWN WORTH

Basel II recognizes the importance of and strengthens corporate governance, and specifically when it comes to risk management. A bank following and implementing the IRB approach will have to in turn considerably rely on its board and the senior management to facilitate the successful implementation of Basel II. The bottom line becomes how soundly corporate governance principles are implemented. Corporate governance itself strengthens the banks internally, and its strong principles that can guide the bank will certainly pave way for sound risk management.

Implementing Basel II will require countries to translate the new Accord, if not entirely, but to a certain extent into national laws for its successful implementation. The new Accord lays considerable emphasis on supervisors, recognizing their role in making the banks more secure. The rating agencies or the in-built mechanisms will aid banks in realizing the potential threats in lending to a specific corporation. This requires greater emphasis on making the rating agencies being subject to not only greater scrutiny but also on ensuring that the rating agencies follow and implement high degree of professionalism, integrity and have qualified staff to ensure the absence of any discrepancies. Other aspects to be taken care of call for the nature of the banking setup existent in a country. In a country the banking setup will comprise of its banking laws, nature and extent of supervisory controls and essentially the kind of banking institutions, national or international, government-controlled or private banks, limited or unlimited banks, number of banks functioning as subsidiaries, etcetera that operate. A country’s laws and policies will fashion around the banking setup to a grave extent because the laws of a

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92 Ibid
93 The Basel Committee has published high-level principles which explain in broad terms how home and host supervisors might communicate and share information. Basel Committee on Banking Supervision, High-level principles for the cross-border implementation of the New Accord (August 2003)
94 Supra, Note 60, pp. 16
95 Ibid
96 Ibid
country are homogenized in its socio-economic circumstances. Given this premise, the Basel Committee has to strive harder to ensure that Basel laws get recognition by countries around the world. More than that implementation and compliance aspects will be roadblocks. A lot of circumstances get re-shaped and re-modeled courtesy negotiations. The Basel Committee will have to break the ice, just like OECD and other organizations encourage co-operation among member States, on very similar lines the Basel Committee will have to rise into prominence. Though there have been reasons for the Committee’s docility, but when the Committee has toiled hard to come out with the new Accord, the failure of its introduction and implementation by countries around the world will wilt the entire purpose.

Also, the new Accord encourages flexibility. In stark contrast to unfriendly imposition, Basel II encourages countries to adopt the new Accord by the time they are in a position to accommodate the change. The new Accord does not pester the countries to implement the new Accord on all banks in its jurisdiction; until it is assured that the specific bank has the potential to introduce the new setup. Significantly, the Basel Committee has in its paper on Implementation of Basel II: Practical Considerations has emphasized on criteria’s to locate banks capable of adopting the new setup. It prescribes the following factors when determining the population of banks to which Basel II would apply:\textsuperscript{97}

- size of the bank (e.g., share of assets in the banking system);
- nature and complexity of its operations;
- involvement in significant activities or business lines, such as settlement/clearing activities, or possession of a sizeable retail base);
- international presence (e.g., proportion of assets held in/income from overseas offices);
- interaction with international markets;
- bank’s risk profile and risk management capabilities, and
- other supervisory considerations, such as resources which will be available for initial validation and ongoing monitoring, and the trade-off between the additional complexity of implementing and validating these approaches vis-à-vis the increased sensitivity of the resulting capital requirements.\textsuperscript{98}

The Committee also gives independence to supervisors in these countries to elaborate on these factors at the national level.\textsuperscript{99} The implementation of the new Accord requires endeavors on part of sovereign States as well as banks, regulators and rating agencies.\textsuperscript{100}

\textsuperscript{97} Ibid, pp. 8
\textsuperscript{99} Ibid, pp. 8
\textsuperscript{100} The shift followed the oil crisis and then the international debt crisis of that time. More recently, BIS provided finance to the stabilization programs the IMF led for the default loans of Mexico in 1982 and Brazil in 1998, and in the Asian crisis in 1997, and more. All the above crises, as well as the issue of financial stability in the wake of economic integration and globalization, have received considerable attention in the international banking community. This has brought the issue of regulatory supervision of internationally active banks to the attention of BIS, which resulted in the Basel Capital Accord and its
The new Accord has brought into prominence rating agencies for the first time. States will be further required to do tedious assessments on their part before setting out to implement the new Accord. The new Accord seeks to address the same concern of minimal capital requirements and capital adequacy of the banks as the old Accord. However, the new Accord takes a fresh perspective on it.

To implant market discipline supervisors are required to collect all additional information they can from banks. At times to meet certain regulatory or auditor requirements banks end up making available certain information. Moreover, a lot of vital facts and statistics pertaining to a bank are provided during assessments by rating agencies. Banks also end up making information available through online mediums on their websites about themselves and also through their respective corporate governance reports and disclosures. The supervisors are to ensure their access to the information and putting the trends to better use by inculcating market discipline.

In order to establish effective market discipline supervisors and governments will have to vouch for greater corporate governance standards, increased transparency, strengthening of the economy through better regulations and legal compliances, a sound legal system, securities listing requirements, and all other essentials that can contribute in making the markets more secure.

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101 The decision to implement a particular approach to capital regulation should not be driven by a bank’s desire to minimize regulatory capital requirements. At the same time, banks and supervisors must evaluate what the differences between Basel I and Basel II will mean in practice, and assess the costs and benefits of making such a transition. Supervisors should give particular consideration to the increased risk management requirements incorporated into the Basel II framework, and the additional benefits these could bring beyond simple capital adequacy calculations. Id., pp. 9

102 “Capital adequacy of banking institutions refers to the minimal level of capital for such an institution, viewed as necessary or desirable by the bank regulator for the ‘safe and sound’ operation of the institution.” This is a statement by P. Jaans, then the Commissioner of Banks, Luxembourg: ‘The specific concern of the supervisor with regard to capital is that it should be at any time sufficient to ensure the ultimate solvency of a bank, that is its ability to meet all its obligations arising from borrowed funds and guarantees granted and other contingent liabilities.’ See Jaans, Measuring Capital and Liquidity Adequacy for International Banking Business, 24 Int’l Conf. of Banking Supervisors, London July 5-6, 1979 REC. PROC. 24.

103 Joseph Jude Norton, Capital Adequacy Standards: A Legitimate Regulatory Concern for Prudential Supervision of Banking Activities?, 49 Ohio St. L.J. 1299


105 This is given that the defining characteristic of modern securities markets is that they are organized and regulated primarily on a national basis. Samuel Wolff, Recent Developments in International Securities Regulation, 23 Denv. J. Int’l L. & Pol’y 347

106 The shift followed the oil crisis and then the international debt crisis of that time. More recently, BIS provided finance to the stabilization programs the IMF led for the default loans of Mexico in 1982 and Brazil in 1998, and in the Asian crisis in 1997, and more. All the above crises, as well as the issue of financial stability in the wake of economic integration and globalization, have received considerable attention in the international banking community. This has brought the issue of regulatory supervision of internationally active banks to the attention of BIS, which resulted in the Basel Capital Accord and its revision in 2004, Basel II. Carl Felsenfeld, Genci Bilali, The Role Of The Bank For International Settlements In Shaping The World Financial System, 25 U. Pa. J. Int’l Econ. L. 945
The Pillar III requirements are to a great extent dependant on Pillar I and Pillar II requirements, as the Committee itself recognizes that they are more in the nature of being complementary to the other two Pillars. A large edifice of this is premised on disclosures by banks. Through disclosures the supervisors are better equipped to see the direction of market forces and how best can the markets contribute to a sordid and thriving banking setup. This is primarily for the reason that a stable market steams up economic growth, and initiating the chain reaction of investments, higher savings, lending by banks and other financial institutions and then further investments, leading to sprucing up of the spiral of economic growth and prosperity of markets. The essence of it becomes that banks and the markets are dependant on each other for their growth. Realizing the same, the Committee just merely does not leave it till the point of encouraging countries to inculcate market discipline, rather it goes beyond that and looks for means towards this end. The Committee recognizes in the new Accord the various means by which disclosures can be achieved by the supervisors. The new Accord also works towards avoiding conflict with requirements under accounting standards. The Accord further encourages banks to provide all information they can to the degree feasible.

C. BOTTLENECKS
One crucial concern that closes up the application of the new Accord is multiple approvals required under the new setup. For use of certain approaches prior permissions might be required by enterprises or their subsidiaries operating in more than one country. The approvals, in certain circumstances, are to come from both the host country and the home country. This can become a severe deterrent in introduction, if not so in the successful implementation of the new Accord. Not only this, the success of this setup

107 The purpose of Pillar 3 — market discipline is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). The Committee aims to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the institution. The Committee believes that such disclosures have particular relevance under the Framework, where reliance on internal methodologies gives banks more discretion in assessing capital requirements. In principle, banks’ disclosures should be consistent with how senior management and the board of directors assess and manage the risks of the bank. Under Pillar 1, banks use specified approaches/methodologies for measuring the various risks they face and the resulting capital requirements. The Committee believes that providing disclosures that are based on this common framework is an effective means of informing the market about a bank’s exposure to those risks and provides a consistent and understandable disclosure framework that enhances comparability. Supra, Note 7, pp. 175

108 The Committee is aware that supervisors have different powers available to them to achieve the disclosure requirements. Market discipline can contribute to a safe and sound banking environment, and supervisors require firms to operate in a safe and sound manner. Under safety and soundness grounds, supervisors could require banks to disclose information. Alternatively, supervisors have the authority to require banks to provide information in regulatory reports. Some supervisors could make some or all of the information in these reports publicly available. Further, there are a number of existing mechanisms by which supervisors may enforce requirements. These vary from country to country and range from “moral suasion” through dialogue with the bank’s management (in order to change the latter’s behaviour), to reprimands or financial penalties. The nature of the exact measures used will depend on the legal powers of the supervisor and the seriousness of the disclosure deficiency. Supra, Note 7, pp. 175

109 Supra, Note 7, pp. 175
hinges on greater co-operation and co-ordination between the regulators in the two countries. There are a variety of supervisory responsibilities under the New Accord, including: (1) initial approval and validation of “advanced” approaches (example, IRB, AMA) under Pillar 1; (2) the supervisory review process under Pillar 2; and (3) ongoing assessments to verify that banking groups are applying the New Accord properly and that the conditions for “advanced” approaches continue to be met.\(^\text{110}\)

Banks following the Internal Ratings Based (hereinafter “IRB”) approach will have to ensure that they have an efficient team of supervisors. For this the bank may have to involve hiring more qualified staff and enhancing training programmes.\(^\text{111}\) This will come as an additional cost for a bank, as banks will have to additionally hire staff for internal supervision. Though these checks and supervisions are to a bank’s benefit, at times the cost element can surge as a deterrent in their implementation. Moreover, for these risk assessments the requirement of qualified personnel becomes another constraint.

Another aspect to be looked after is the ability of the supervisors to exercise effective supervision over foreign institutions operating in their jurisdictions.

The biggest obstacle will come in the implementation of capital adequacy assessment process (CAAP), especially if they presently manage risk on an individual basis and do not have procedures for integrating these risks into an overall assessment of capital adequacy.

Also, the new Accord comes with its own set of worrisome concerns. According to some the Accord is subject to exploitation or not to its successful implementation. For instance, a host country supervisor can still let an international bank function whose home country supervisor has not complied with the Basel requirements.\(^\text{112}\) As the Basel requirements have been kept open-ended and the flexibility requirements well met, the host country regulator is to impose restrictions it deemed “necessary and appropriate” on the establishment. Moreover, the Basel laws do not make provisions as to how they view the implementation of the new Accord retrospectively. Though the new Accord recognizes that it is not to be implemented by all banks and for that matter it is for the countries to implement it themselves. For the very same reason, the new Accord has specifically focused on new branches.\(^\text{113}\) As a consequence, it fails to cover a large segment of banks.

Competitiveness is another concern, as Basel laws implementation is subject to adoption by individual countries, it being soft laws.\(^\text{114}\) The adoption of Basel laws by some

\(^{110}\) “High-level principles for the cross-border implementation of the New Accord”, Basel Committee on Banking Supervision, Banks for International Settlements, August 2003

\(^{111}\) Ibid, pp. 6


\(^{113}\) Duncan E. Alford, Core Principles for Effective Banking Supervision: An Enforceable International Financial Standard?, 28 B.C. Int'l & Comp. L. Rev. 237

\(^{114}\) Although these Principles are only recommendations and serve as a “basic reference” on banking regulation and supervision, they have certainly gained recognition on a global level. However, their non-binding character hinders implementation and enforcement, especially in developing countries. Developing
countries and not by the other, can give the latter comparative advantage as the banks in
the latter countries will have lesser compliances, lesser monetary constraints and lesser
expenditure on meeting the standards.\footnote{See Thomas F. McInerney III, Note, Towards the Next Phase in International Banking Regulation, 7 DePaul Bus. L.J. 143, 170 (1994) (“Naturally, the tighter the regulatory structure, the less attractive a country becomes for foreign banks.”).}

Another concern is the definition of regulatory capital. Some nations favor rules
restricting regulatory capital to equity instruments, while others prefer including more
debt with less residual attributes in the ambit of regulatory capital.\footnote{Heath Price Tarbert, Are International Capital Adequacy Rules Adequate? The Basle Accord And Beyond, 148 U. Pa. L. Rev. 1771} Moreover, the Basel Accord has provided no justification for the 8\% benchmark till date.\footnote{Ibid} Further, writers and commentators have their own takes on whether the Accords can simply by
“regulation” achieve its aimed vision.\footnote{Ibid}

The emphasis of the new Accord on rating agencies has been taken as very questionable,
as starkly after the Asian crisis the momentum for introducing the new Accord had taken
off and given the contributory role of the rating agencies in the crisis. The rating agencies
in the past have not performed impressively and at the same time the lack of sufficient
number of efficient agencies to meet the needs will be a troubling factor in the concept’s
not so successful implementation.\footnote{An inherent conflict of interest between the agency and its rated client is a significant, problem. Rating agencies are only successful today because the public is confident in their ability both to accurately and impartially assess individual entities. The Basle proposal could threaten this equilibrium since “increasing the reliance on ratings for setting prudential standards in bank regulation creates an incentive for ratings agencies to serve the interest of the borrowers being rated, and thus subverts the original purpose credit ratings were intended to serve.” Heath Price Tarbert, Are International Capital Adequacy Rules Adequate? The Basle Accord And Beyond, 148 U. Pa. L. Rev. 1771}

Significantly, apprehensions over the new Accord’s realistic potential are being raised.
Commentators worry that the new Accord has a lot of false concerns and gives a lot of
VI. CONCLUSIVE REMARKS
High amount of investments, both monetary and non-monetary will be required to be made by the governments to ensure that the overall setup functions on expected lines. The crucial task will be when banks involve third parties, such as external auditors, internal auditors and consultants, to assist in carrying out some of the duties under Basel II. The new Accord gives considerable attention to supervision. At the same time the supervisors are to be regulated. There is requirement of assurance that the supervisors have objectivity and the necessary proficiency and expertise to successfully implement the new Accord. It is crucial to note that in principle supervisors are appointed following necessary aspects being taken care of, regarding their qualifications, sincerity, objectivity, and other vital considerations that can become instrumental in their appointment and selection. Nevertheless, governments over the world have to resolve to successfully implement the new Accord. For this reason, the governments should ensure on their behalf that there are no lacunas in the appointments of supervisors and which is to be sufficiently supplemented with constant evaluation of their performances.

The gratulatory part about the new Accord is that it signifies the realization of the Basel Committee to grapple with the changing needs. The prime reason for introducing the new laws was the obsoleteness of the previous Accord and the occurrence of the Asian crisis. The Committee has been a big achiever and a high flyer. Its efforts have proven in its successful replacement of the previous Accord with the new one, and in its ability to come up with other regulations and draft papers that can individually cater to the specific circumstances. The Committee’s efforts have been a process of rich negotiations. All this can similarly be understood from the tremendous success and approval that the Committee has attained over the world.

122 The significance and importance of BIS recommendations in the national banking systems around the world is illustrated by the 100 to 120 countries that have already implemented the 1988 Basel Accord. For example, from 1988 to 1996, almost ninety-two percent of banks and other financial institutions increased their capital requirements. In addition, seventy-six percent of banks raised their risk-weighted assets base. Furthermore, between 1988 and 1996, banks increased their risk based capital ratios from approximately 9.3 percent up to 11.2 percent. Basel II is in the process of implementation by countries. Carl Felsenfeld, Genci Bilali, A Speculation On The Future Of The Bank For International Settlements, 18 Transnat'l Law. 231
123 For an assessment of the Committee’s performance, see, Daniel E. Ho, Compliance and International Soft Law: Why Do Countries Implement the Basle Accord?, 5 J. Int'l Econ. L. 647
124 The recommendations of the committee—whose work has been immensely influential in the area of inter alia capital adequacy standards—do not have legal force, but have been adopted by many regulatory and supervisory authorities globally. In that sense, the recommendations constitute a prime example of soft law. Anna V. Morner, Financial Services and Regional Integration: A Comparative Snapshot, 7-FALL L. & Bus. Rev. Am. 549.
125 “...the success of the Basle recommendations on own funds and capital ratios can already be seen in the number of countries with substantial international banking communities where that target has been met by many institutions a year or more early, while many other institutions have been making strenuous and very
There is requirement of independent appraisal to estimate property prices and asset values. Banks like other organizations and institutions maintain their own set of properties, invest in other properties, which in turn provide the back-up to the loans doled out by them. These investments and properties are to be to rightly assessed in their worth. Certain standards and measures are used to gauge the property prices. These standards need to be correctly ascertained, in order to ensure there is no inflationary bubble in the market or market choking due to improper asset valuation.

In a tech-savvy world, where money and information changes hands rapidly, the banking system needs to be more zealously guarded. Where barricades of communication and access to other markets have largely smoldered, the picture seems better than ever before. However, the technology aided and market competition fumed easy access does not ensure against the occurrence of exploitation and misuse. Markets expensive attempts to meet the interim target of 7.25 per cent and, subsequently, the 8 per cent figure. It should also be remembered that these costly measures are being taken even though the Basle Committee's recommendations themselves have no direct statutory authority in any country, merely having been endorsed by all the Group of Ten Central Bank Governors. That so many countries are placing the Basle recommendations on a statutory basis is further evidence that regulators generally recognize the benefits of global standards for regulating the provision of capital. Few question that the maintenance of capital, whether in the form of equity, reserves, general provisions against default or subordinated debt, aids stability in the international banking community and helps to guard against the default of individual institutions.”

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127 Taeho Kim, International Money and Banking 31, 36 (1993)
131 Before the communications revolution, long-term investment was often the only sensible approach to foreign investment. Today, however, an investment portfolio in Brazil can be managed as aggressively and intensively as if it were a portfolio in one's own country, yet the sources of information upon which investment decisions will be based are far less diverse than if it was in one's own country, with predictable consequences for investor behaviour. Gerhard Aschinger, Why Do Currency Crises Arise and How Could They be Avoided?, 36(3) Intereconomics 152, 153-54 (2001)
132 The electronic medium of communication known as the Internet is rapidly becoming the home of a new virtual economy. Using the Internet, a consumer has the ability to purchase products and receive goods in the privacy of the home. This new ability to buy and sell goods online is quickly becoming a major component of electronic commerce. It is within electronic commerce that financial institutions have shifted to Internet-based electronic banking. Internet-based electronic banks and Internet banking open the doors for financial institutions to attract new customers and lower the institutions' overall costs. Jacqueline Marcucci, The Brave New World Of Banking On The Internet: The Revolution Of Our Banking Practices, 23 Nova L. Rev. 739
over the world have shown helplessness in times of bank failures, as economies have struggled hard to be resilient and recover. These facts make us realize of the need to rise up to the occasion. The faith in economies and markets requires a large contribution from the banks, which in turn demands responsiveness from regulators and governments. No denial that the new Accord can have its own set of flaws as discussed above. But this no how comes in the way of its successful implementation. The Accord is in the nature of minimum requirements, and a lot is expected out of governments, as they have a significant contribution to make in the form of framing of laws and bringing up stringency in their application.\textsuperscript{134}

No doubt that any piece of law comes with its own ifs and buts. Though existing as soft laws, Basel laws have the potential to significantly wiggle the global setup.\textsuperscript{135} Questioning Basel II as being unrealistic when it comes to application, a grave error is being committed in not realizing the rapidity of the changing times. From the time when the first Accord was introduced and to the time the new Accord sprung up, the global economy registered a remarkable change, not only in the way it functioned but also in the way it looked. One of the very crucial factors in the wilting of Basel I was its obsoleteness. In order the new Accord does not meet the same fate, the BIS and the Basel Committee has responsibly tried to simply look beyond managing the banks internally, but it also has envisioned seeing them in the market perspective. The new Accord aims to regulate banks inertly and also through strengthening the overall system so as to

\textsuperscript{134} Amy C. Bushaw, Small Business Loan Pools: Testing The Waters, 2 J. Small & Emerging Bus. L. 197
\textsuperscript{135} The Basle Committee is relatively unknown, in comparison to its indisputable influence. This is partly by design. The Basle Committee is neither a national organization of any country, nor an official international regulatory agency like a United Nations committee or one created by treaty. Apart from its significance in regulating bank capital, the Basle Committee is redefining the field of international law. David Zaring, International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations, 33 Tex. Int'l L.J. 281, 282 (1998).

Several countries in Asia were the first non-G-10 countries to incorporate the risk-weighted capital ratios into their national banking regulations. Commercial banking authorities in East Asia also mandated the Basle standards. Hong Kong, which has nearly always been an international financial center, adopted the Basle Accord after the Hong Kong Monetary Authority ("HKMA") decided incorporating the new standards would be beneficial to the state. In 1997, when the Asian financial crisis was at its pinnacle, the International Monetary Fund suggested to some countries that adoption of the Basle standards would help bring stability to their national banking systems. "[U]nder the IMF-supported reform program, Korea pledged . . . to set a timetable for all [of its] banks to meet or exceed Basle standards on capital adequacy . . . ." Some nations, such as Singapore, adopted the basic standards of Basle but increased the capital ratio to provide a greater capital cushion against credit risk. "[T]o maintain the financial soundness of locally-incorporated banks, local banks were statutorily required to maintain a minimum Tier-1 capital adequacy ratio of twelve percent even though the [Basle Accord] was set at eight percent (based on Tier 1 and Tier 2)."

indirectly bolster up the bank’s functioning. Moreover, this emphasis gets strongly supported as markets have a tendency to reach the equilibrium; this tendency of markets in turn affects all institutions in it. For the same reason, concentration of Basel II on banks and beyond becomes beneficial. The flexibility of the Basel laws and their open-endedness at some point cannot be confused with their ability to benefit banks, markets and countries the world over.

Interestingly, the laws have an apparent bias; as it is discernible the world is seen divided into three complex divisions of the developed, developing, emerging and transition economies. However, at the international level the laws that exist become applicable to all countries falling in any of these segregations, regardless of the ability of some to even meet the basic requirements or fulfilling the minimum essentials in order to be covered by the gamut of international regulations. However, I am no how attempting to vouch for laws being made that can cater to this compartmentalization. Instead, my emphasis is on highlighting the strength of the Basel laws in enabling the homogenization of the world. The Basel laws look objectively drafted and exhibit an ability to balance the compelling needs of the three divisions of the world. Accepted that Basel laws cannot be introduced by all countries in their systems and implemented by banks, however, at the same time they try their level best to ensure that the major concerns that destabilize the international setup are taken care of to their possible best. At least the banks try to empower the host country supervisors to an extent that they access information from the home country supervisors. Besides, the significant aspect of these laws is that they have not been thrust or imposed on the global community, and on the contrary welcome the paradigm of adoption. The members of the Basel Committee and the ever-increasing list of non-members who have adopted these laws exhibit the potential of these laws to convince the governments the world-over of their inherent significance. For this very reason, the regulations of Basel II though not being implemented by all countries over the world and also in countries implementing Basel II they are being confined to certain banks, which have the potential to implement these regulations, yet these countries can be looked forward to have a change of mind and to re-think over adoption of the new Accord.

Amongst the several apprehensions the biggest concern being voiced is the extent of the new Accord’s application. The new Accord itself provides criteria by which the regulators are to judge a bank when introducing it in its system, as to whether the bank has the necessary infrastructure and other essentials to successfully introduce the new Accord in its system. As implementation of Basel II involves certain pre-requisites, the supervisors have to ensure themselves of a bank’s capacity of introducing the same into

136 Moreover, unlike Basel I, not everyone is poised to adopt the new standards. In fact, the U.S. has decided that only its top ten international banks will be required to adopt Basel II, with an additional ten having the option to choose between Basel I and Basel II. As the Federal Reserve explained, Basel I was a major step forward in capital regulation. Indeed, for most banks in this country, Basel I is now--and for the foreseeable future will be--more than adequate as a capital framework. . . . Basel I is too simplistic to adequately address the activities of our most complex banking institutions. See Testimony of Vice Chairman Roger W. Ferguson, Jr., U.S. House of Representatives, Basel II, before the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, Committee on Financial Services, February 27, 2003, http:// www.federalreserve.gov/boarddocs/testimony/2003/200302272/default.htm
its system. Because of these constraints, it is being observed that not many banks will be in a position to follow the new Accord.\textsuperscript{137}

Basel Accords and more specifically Basel II follow a top-down approach which cannot be confused with heavy-handedness or any nature of an existent bias. Basel II is two steps ahead of Basel I, it not only worked on the capital requirements standards but also made two vital additions that have the potential and ability to largely mould the international financial market into a more secure regime.

I believe when a crisis strikes several factors which individually could not have resulted in the outbreak get clustered and result in a downturn. However, the occurrence of a crisis is largely a result of certain prime conspicuous factors. And if these factors are not closely and regularly monitored, they can result in another such outbreak as the Asian crisis.

The world is moving towards centralization. We started with region-oriented trade through free trade agreements and other like arrangements, then the world further converged with globalization and liberalization. Conclusively, this trend of heading towards homogenization globally, though in disparate and not so obvious ways, has stemmed the need for an international organization to regulate banks and banking globally. Some countries are voicing this demand in the form of creation of the “World Financial Authority”.\textsuperscript{138} However, the formation of an organization such as the World Financial Authority is doubtful as many countries still believe that Basel laws sufficiently meet their needs. Some suggest the transformation of the Basel Committee into the World Financial Authority, to which countries have their own reservations.\textsuperscript{139}

In essence, the Basel Committee has strived hard over the years. At least it gave a direction to the banking regime and has attempted to make it uniform. Forthrightly it cannot be presumed that Basel II will get tremendous recognition immediately, it will take it own course. The countries that had adopted Basel I if cannot be presumed that they will adopt Basel II are expected to at least follow the first Accord, and to try to implement the new Accord as much as in principle they can.

Integrated and dependant markets serve the purpose well. In my opinion, it is the onus of the developed world to first introduce and adopt these laws, and involve them in their banking systems. As countries are dependant on each other due to trade and investments, the following of Accord II by one country will pave way for the introduction of the new accord in other countries too; as the countries that have implemented the first accord would prefer their trading partners to have the same level and extent of compliances.

\textsuperscript{137} W. Ronald Gard, George Bailey In The Twenty-First Century: Are We Moving To The Postmodern Era In International Financial Regulation With Basel II?, 8 Transactions: Tenn. J. Bus. L. 161
\textsuperscript{139} Ibid
Banks are the future of tomorrow. They are the fountainhead of all investments. The Basel Committee has done a responsible job, in introducing these Accords. And now it is for the countries to decide how much they want to benefit from it. How much do they want to safeguard their system? Till what extent are they willing to build up on Basel II requirements? In addition, till what extent they consider themselves fit and capable to introduce the new Accord, and if not what roadmap are they willing to follow for the same. Obviously, neither the BIS nor the Basel Committee has answers to such perplexing questions and more than that it is not their responsibility or mandate to ensure that countries reciprocate.

It is yet to be seen in all practicalities how many countries go for the new accord. It is largely been advertised as the European Community’s idea and has not been extended a warm welcome by the United States. Basel II had an effective date of December 2006 and so far has not received that much implementation as the earlier accord. The Accord has been applied so far in the European banks and in U.S. to just ten of the largest U.S. banks. Therefore, it largely becomes a very country-specific issue. For the same reason denouncing or negating the worth of Basel II will yield no result. For instance, a lot of countries are not applying Basel II as they consider themselves not in a position to implement it or some consider their requirements well met with the earlier Accord.

In conclusion, it is for the countries to individually decide for themselves. However, I consider the Accord a great success in terms of its numerous initiatives and most importantly its emphasis on not being a deviation but an addition to the earlier Accord.