



History of the Basel Committee

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At a glance

The Basel Committee - initially named the Committee on Banking Regulations and Supervisory Practices - was established by the central bank Governors of the Group of Ten countries at the end of 1974 in the aftermath of serious disturbances in international currency and banking markets (notably the failure of Bankhaus Herstatt in West Germany).

The Committee, headquartered at the Bank for International Settlements in Basel, was established to enhance financial stability by improving the quality of banking supervision worldwide, and to serve as a forum for regular cooperation between its member countries on banking supervisory matters. The Committee's first meeting took place in February 1975, and meetings have been held regularly three or four times a year since.

Since its inception, the Basel Committee has expanded its membership from the G10 to 45 institutions from 28 jurisdictions. Starting with the Basel

Concordat, first issued in 1975 and revised several times since, the Committee has established a series of international standards for bank regulation, most notably its landmark publications of the accords on capital adequacy which are commonly known as Basel I, Basel II and, most recently, Basel III.

Laying the foundation: international cooperation between banking supervisors

At the outset, one important aim of the Committee's work was to close gaps in international supervisory coverage so that (i) no banking establishment would escape supervision; and (ii) supervision would be adequate and consistent across member jurisdictions. A first step in this direction was the paper issued in 1975 that came to be known as the "[Concordat](#)". The Concordat set out principles for sharing supervisory responsibility for banks' foreign branches, subsidiaries and joint ventures between host and parent (or home) supervisory authorities. In May 1983, the Concordat was revised and re-issued as [*Principles for the supervision of banks' foreign establishments*](#).

In April 1990, a supplement to the 1983 Concordat was issued. This supplement, [*Exchanges of information between supervisors of participants in the financial markets*](#), aimed to improve the cross-border flow of prudential information between banking supervisors. In July 1992, certain principles of the Concordat were reformulated and published as the [*Minimum standards for the supervision of international banking groups and their cross-border establishments*](#). These standards were communicated to other banking supervisory authorities, which were invited to endorse them.

In October 1996, the Committee released a report on [*The supervision of cross-border banking*](#), drawn up by a joint working group that included supervisors from non-G10 jurisdictions and offshore centres. The document presented proposals for overcoming the impediments to effective consolidated supervision of the cross-border operations of international banks. Subsequently endorsed by supervisors from 140 countries, the report helped to forge

relationships between supervisors in home and host countries.

The involvement of non-G10 supervisors also played a vital part in the formulation of the Committee's [*Core principles for effective banking supervision*](#) in the following year. The impetus for this document came from a 1996 report by the G7 finance ministers that called for effective supervision in all important financial marketplaces, including those of emerging market economies. When first published in September 1997, the paper set out 25 basic principles that the Basel Committee believed should be in place for a supervisory system to be effective. After several revisions, most recently in September 2012, the document now includes 29 principles, covering supervisory powers, the need for early intervention and timely supervisory actions, supervisory expectations of banks, and compliance with supervisory standards.

Basel I: the Basel Capital Accord

With the foundations for supervision of internationally active banks laid, capital adequacy soon became the main focus of the Committee's activities. In the early 1980s, the onset of the Latin American debt crisis heightened the Committee's concerns that the capital ratios of the main international banks were deteriorating at a time of growing international risks. Backed by the G10 Governors, Committee members resolved to halt the erosion of capital standards in their banking systems and to work towards greater convergence in the measurement of capital adequacy. This resulted in a broad consensus on a weighted approach to the measurement of risk, both on and off banks' balance sheets.

There was strong recognition within the Committee of the overriding need for a multinational accord to strengthen the stability of the international banking system and to remove a source of competitive inequality arising from differences in national capital requirements. Following comments on a consultative paper published in December 1987, a capital measurement system commonly referred to as the [*Basel Capital Accord*](#) was approved by the

G10 Governors and released to banks in July 1988.

The 1988 Accord called for a minimum ratio of capital to risk-weighted assets of 8% to be implemented by the end of 1992. Ultimately, this framework was introduced not only in member countries but also in virtually all countries with active international banks. In September 1993, the Committee issued a statement confirming that G10 countries' banks with material international banking business were meeting the minimum requirements set out in the Accord.

The Accord was always intended to evolve over time. It was amended in [November 1991](#) to more precisely define the general provisions or general loan loss reserves that could be included in the capital adequacy calculation. In April 1995, the Committee issued [another amendment](#), to take effect at the end of that year, to recognise the effects of bilateral netting of banks' credit exposures in derivative products and to expand the matrix of add-on factors. In April 1996, [another document](#) was issued explaining how Committee members intended to recognise the effects of multilateral netting.

The Committee also refined the framework to address risks other than credit risk, which was the focus of the 1988 Accord. In January 1996, following two consultative processes, the Committee issued the [*Amendment to the Capital Accord to incorporate market risks*](#) (or Market Risk Amendment), to take effect at the end of 1997. This was designed to incorporate within the Accord a capital requirement for the market risks arising from banks' exposures to foreign exchange, traded debt securities, equities, commodities and options. An important aspect of the Market Risk Amendment was that banks were, for the first time, allowed to use internal models (value-at-risk models) as a basis for measuring their market risk capital requirements, subject to strict quantitative and qualitative standards. Much of the preparatory work for the market risk package was undertaken jointly with securities regulators.

Basel II: the new capital framework

In June 1999, the Committee issued a proposal for a new capital adequacy framework to replace the 1988 Accord. This led to the release of a revised capital framework in June 2004. Generally known as "Basel II", the [revised framework](#) comprised three pillars:

1. minimum capital requirements, which sought to develop and expand the standardised rules set out in the 1988 Accord
2. supervisory review of an institution's capital adequacy and internal assessment process
3. effective use of disclosure as a lever to strengthen market discipline and encourage sound banking practices

The new framework was designed to improve the way regulatory capital requirements reflect underlying risks and to better address the financial innovation that had occurred in recent years. The changes aimed at rewarding and encouraging continued improvements in risk measurement and control.

The framework's publication in June 2004 followed almost six years of intensive preparation. During this period, the Basel Committee consulted extensively with banking sector representatives, supervisory agencies, central banks and outside observers in order to develop significantly more risk-sensitive capital requirements.

Following the June 2004 release, which focused primarily on the banking book, the Committee turned its attention to the trading book. In close cooperation with the International Organization of Securities Commissions ([IOSCO](#)), the international body of securities regulators, the Committee published in July 2005 a [consensus document](#) governing the treatment of banks' trading books under the new framework. For ease of reference, this new text was integrated with the June 2004 text in a comprehensive document released in June 2006: [*Basel II: International convergence of capital measurement and capital standards: A revised framework - Comprehensive version*](#).

Committee members and several non-members agreed to adopt the new rules, albeit on varying timescales. One challenge that supervisors worldwide faced under Basel II was the need to approve the use of certain approaches to risk measurement in multiple jurisdictions. While this was not a new concept for the supervisory community - the Market Risk Amendment of 1996 involved a similar requirement - Basel II extended the scope of such approvals and demanded an even greater degree of cooperation between home and host supervisors. To help address this issue, the Committee issued [guidance on information-sharing](#) in 2006, followed by advice on [supervisory cooperation and allocation mechanisms](#) in the context of the advanced measurement approaches for operational risk.

Basel III: responding to the 2007-09 financial crisis

Even before Lehman Brothers collapsed in September 2008, the need for a fundamental strengthening of the Basel II framework had become apparent. The banking sector entered the financial crisis with too much leverage and inadequate liquidity buffers. These weaknesses were accompanied by poor governance and risk management, as well as inappropriate incentive structures. The dangerous combination of these factors was demonstrated by the mispricing of credit and liquidity risks, and excess credit growth.

Responding to these risk factors, the Basel Committee issued [Principles for sound liquidity risk management and supervision](#) in the same month that Lehman Brothers failed. In July 2009, the Committee issued a further package of documents to strengthen the Basel II capital framework, notably with regard to the treatment of certain complex securitisation positions, off-balance sheet vehicles and trading book exposures. These enhancements were part of a broader effort to strengthen the regulation and supervision of internationally active banks, in the light of weaknesses revealed by the financial market crisis.

In September 2010, the Group of Governors and Heads of Supervision (GHOS) [announced](#) higher global minimum capital standards for commercial

banks. This followed an agreement reached in July regarding the overall design of the capital and liquidity reform package, now referred to as "Basel III". In November 2010, the new capital and liquidity standards were endorsed at the G20 Leaders' Summit in Seoul and subsequently agreed at the [December 2010 Basel Committee meeting](#).

The proposed standards were issued by the Committee in mid-December 2010 (and have been subsequently revised). The December 2010 versions were set out in [Basel III: International framework for liquidity risk measurement, standards and monitoring](#) and [Basel III: A global regulatory framework for more resilient banks and banking systems](#). The enhanced Basel framework revises and strengthens the three pillars established by Basel II, and extends it in several areas. Most of the reforms are being phased in between 2013 and 2019:

- stricter requirements for the quality and quantity of regulatory capital, in particular reinforcing the central role of common equity
- an additional layer of common equity - the capital conservation buffer - that, when breached, restricts payouts to help meet the minimum common equity requirement
- a countercyclical capital buffer, which places restrictions on participation by banks in system-wide credit booms with the aim of reducing their losses in credit busts
- a leverage ratio - a minimum amount of loss-absorbing capital relative to all of a bank's assets and off-balance sheet exposures regardless of risk weighting
- liquidity requirements - a minimum liquidity ratio, the Liquidity Coverage Ratio (LCR), intended to provide enough cash to cover funding needs over a 30-day period of stress; and a longer-term ratio, the Net Stable Funding Ratio (NSFR), intended to address maturity mismatches over the entire

balance sheet

- additional requirements for systemically important banks, including additional loss absorbency and strengthened arrangements for cross-border supervision and resolution

From 2011, the Committee turned its attention to improvements in the calculation of capital requirements. The risk-based capital requirements set out in the Basel II framework were expanded to cover:

- in 2012, capital requirements for banks' exposures to central counterparties (initially an interim approach, subsequently revised in 2014)
- in 2013, margin requirements for non-centrally cleared derivatives and capital requirements for banks' equity in funds
- in 2014, a standardised approach for measuring counterparty credit risk exposures, improving the previous methodologies for assessing the counterparty credit risk associated with derivatives transactions
- in 2014, a more robust framework for calculating capital requirements for securitisations, as well as the introduction of large exposure limits to constrain the maximum loss a bank could face in the event of a sudden failure of a counterparty
- in 2016, a revised market risk framework that followed a fundamental review of trading book capital requirements
- a consolidated and enhanced framework for disclosure requirements to reflect the development of the Basel standards

The Committee completed its Basel III post-crisis reforms in 2017, with the [publication](#) of new standards for the calculation of capital requirements for credit risk, credit valuation adjustment risk and operational risk. The final reforms also include a revised leverage ratio, a leverage ratio buffer for global systemically important banks and an output floor, based on the revised

standardised approaches, which limits the extent to which banks can use internal models to reduce risk-based capital requirements. These final reforms address shortcomings of the pre-crisis regulatory framework and provide a regulatory foundation for a resilient banking system that supports the real economy.

A key objective of the revisions was to reduce excessive variability of risk-weighted assets (RWA). At the peak of the global financial crisis, a wide range of stakeholders lost faith in banks' reported risk-weighted capital ratios. The Committee's own empirical analyses also highlighted a worrying degree of variability in banks' calculation of RWA. The revisions to the regulatory framework will help restore credibility in the calculation of RWA by enhancing the robustness and risk sensitivity of the standardised approaches for credit risk and operational risk, constraining internally modelled approaches and complementing the risk-based framework with a revised leverage ratio and output floor.

Implementation

Under its Charter, Committee members agree to implement fully Basel standards for their internationally active banks. These standards constitute minimum requirements and BCBS members may decide to go beyond them.

In January 2012, the GHOS [endorsed](#) a comprehensive process proposed by the Committee to monitor members' implementation of Basel III. The [Regulatory Consistency Assessment Programme \(RCAP\)](#) consists of two distinct but complementary workstreams to monitor the timely adoption of Basel III standards and to assess the consistency and completeness of the adopted standards, including the significance of any deviations from the regulatory framework.

Under the RCAP, the Committee publishes [semiannual reports](#) on members' progress in implementing Basel standards, in addition to regular updates to

G20 Leaders. This monitoring is accompanied by a programme of [peer reviews](#) that assess members' implementation. Between 2012 and 2016, the Committee reviewed all member jurisdictions' implementation of the risk-based capital framework, during which many jurisdictions took steps to improve the consistency of their domestic regulations with the Basel requirements. Similar reviews on the LCR were completed during 2017. In due course, these assessments will be extended to other standards.

Further reading on the history of the Basel Committee

Basel Committee on Banking Supervision (2013): [Basel Committee on Banking Supervision \(BCBS\) Charter](#).

Goodhart, C (2011): *The Basel Committee on Banking Supervision: A history of the early years 1974-1997*, Cambridge University Press.

Toniolo, G (2005): *Central bank cooperation at the Bank for International Settlements 1930-1973*, Cambridge University Press.