

Notice of China Banking Regulatory Commission on Printing and Distributing the Guiding Opinions concerning the Implementation of the New Capital Accord by China Banking Industry

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All banking regulatory bureaus, policy banks, state-owned commercial banks, joint stock commercial banks, and China Postal Savings and Remittance Bureau,

For the purpose of stably promoting the implementation of New Capital Accord in China, pushing commercial banks to strengthen their risk management abilities, and enhancing the effectiveness of capital supervision, the CBRC has formulated the Guiding Opinions concerning the Implementation of the New Capital Accord by China Banking Industry, which are printed and distributed to you, please implement them accordingly.

All the banking regulatory bureaus shall forward this Notice to all urban commercial banks, rural commercial banks, wholly foreign-funded banks, Sino-foreign equity joint banks and principal reporting branches of foreign banks within your respective jurisdictions.

February 28, 2007

Guiding Opinions concerning the Implementation of the New Capital Accord by China Banking Industry

In June 2004, the Basel Committee on Banking Supervision (BCBS) released the International Convergence of Capital Measurement and Capital Standards: A Revised Framework (hereinafter referred to as “New Capital Accord”). The New Capital Accord has established three pillars for effective capital supervision, namely, “minimum capital requirements, supervision and examination of the supervisory authority, and information disclosure”, and it represents the development direction of risk management, enhances the risk sensitivity and flexibility of capital supervision, and is good for commercial banks to improve risk management and promote business innovations. Its implementation will promote the progress of banks’ supervisory techniques, reinforce the effectiveness of market constraint and strengthen the safety of international banking system. Based thereon, the BCBS is actively promoting the implementation of New Capital Accord across the world, and there are nearly one hundred countries (regions) having clearly showed that they will implement the New Capital Accord. For the purpose of stably promoting the implementation of New Capital Accord by the banking industry of China, enhancing the effectiveness of capital supervision and strengthening the stability of banking system, these Guiding Opinions are formulated.

I. Strategic significance for implementing the New Capital Accord

i. The implementation of New Capital Accord will provide the impetus and tools for commercial

banks to improve their risk management. The “methods for senior capital charges” as allowed to be adopted by the New Capital Accord is based on risk management theories and practice development, is a revolutionary transformation of traditional risk management model, represents the advanced risk management ideas and technologies of internationally big banks; and provides a direct reference for commercial banks to improve their risk measurement techniques, perfect their risk management organizational frameworks and reorganize risk management procedures; and is good for implementing the scientific and fine management of commercial banks, timely disclosing and dynamically monitoring credit risks, constraining credit granting acts of commercial banks, promoting the transformation of the profit making model and the rationality of business operations of banks, and pushing the continuous and scientific development of the banking industry.

ii. The implementation of New Capital Accord is an inevitable choice for enhancing the international competitiveness of domestic commercial banks. Since the transitional period for China’s entry into WTO has passed, foreign-funded banks will participate in domestic competition in a full scale; within the medium and long term, the large-sized commercial banks of our country will go abroad and seek for international development, in particular, will participate in international competition in a larger scope and in a deeper degree. The promotion of domestic large-sized commercial banks to implement the New Capital Accord will be good for guiding these banks to enhance their risk management abilities, establish the relevant product price fixing mechanism, capital allocation mechanism and performances assessment mechanism, reduce the gap with internationally advanced banks as soon as possible, consolidate and develop precious reform achievements through mechanism construction, strive for winning the advantages in the future international competition of banks, and actually achieve the reform targets of turning large-sized commercial banks into modern commercial banks with strong risk resistance abilities and international competitiveness.

iii. The implementation of New Capital Accord is an inevitable requirement for reinforcing the effectiveness of banking supervision. Along with the increasing complication of the businesses of commercial banks, and the increasing inefficiency of traditional banking supervisory means dominated by external constraint, the supervisory authority shall not be satisfied with the finding of reasons for problems afterwards, but shall try to detect the flaws in the aspect of the management of commercial banks in advance, and shall, while meeting the requirements for market development, further encourage market innovations. The New Capital Accord attaches importance to the comprehensive assessment of the banks’ abilities to recognize, monitor and manage risks, which makes the relationship between the supervision over capital constraint and the risk management ability of commercial banks closer, embodies flexible supervisory ideas, promotes further communications and interactions between commercial banks and supervisory authorities, is in conformity with the “principle-oriented” supervisory ideas of the CBRC, and is significant for improving the supervision over banks of our country.

II. Targets and principles for the implementation of New Capital Accord

i. Targets for the implementation of New Capital Accord

By implementing the New Capital Accord and using advanced risk management ideas and methods as reference, the commercial banks of our country will be urged to improve risk

measurement means, perfect risk management organizational system, comprehensively enhance risk management ability, narrow the distance with internationally advanced banks as soon as possible, reinforce the international competitiveness; and simultaneously to perfect their capital supervisory systems, enhance the effectiveness of banking supervision and promote the stable operation and sustainable development of banking system.

ii. Principles for the implementation of New Capital Accord

According to the current development level and external environment, the banking industry of China does not meet the requirements for comprehensively implementing the New Capital Accord within a short period, and the banking industry of China shall adhere to the following principles for the implementation of New Capital Accord:

1. Principle of classified implementation: since domestic commercial banks have a fairly large gap with each other in the aspects of asset scale, business complexity, risk management level, and internationalization degree, etc., it is necessary to treat different banks differentially according to their situations, and there is no need to force all the banks to implement the New Capital Accord. With respect to the large number of small and medium-sized banks, it is proper to adopt the capital supervisory system suitable for their business scale and complexity, so as to reduce the regulation compliance costs for capital supervision; however, with respect to the large-sized commercial banks, the implementation of New Capital Accord is not only good for enhancing their international competitiveness and complies with their long-term development goals, but also has practical technical feasibility and meets the principle of cost and effectiveness in the economic aspect.

2. Principle of promotion level by level: domestic large-sized commercial banks make different progresses in the aspects of developing and constructing the international grading system, risk quantitative model, and risk management organizational framework and procedures, and thus should be at different time periods to implement the New Capital Accord. Therefore, the CBRC encourages commercial banks to actively promote the risk management and adopt the methods for capital charges with high risk sensitivity, however, by considering the different preparation situation of various banks, allows the time differences for various commercial banks to implement the New Capital Accord, so as to facilitate the implementation of New Capital Accord by commercial banks after all the requirements are met and guarantee the effectiveness of the implementation of New Capital Accord.

3. Principle of reaching targets step by step: the New Capital Accord prescribes many conditions for commercial banks to adopt the methods for capital charges with high risk sensitivity, which involve many aspects such as the organizational framework and policy procedures for asset classification, risk quantification and risk management, so the overall up-to-standards is a gradual and long-term process. Commercial banks shall, by taking into consideration their respective actuality, carry out comprehensive planning, and gradually reach the targets by focusing on key aspects stage by stage. Among the credit risk, market risk and operational risk, domestic large-sized banks shall firstly develop measurement models for credit risk and market risk. With respect to the credit risk, the emphasis shall be put on the credit loans (including corporate risk

disclosures and retail risk disclosures) for the time being to promote the construction of internal grading system.

III. Scope for the implementation of New Capital Accord

According to the principle of classified guidance, the CBRC divides all the commercial banks into two types for implementing different capital supervisory systems.

i. Banks for New Capital Accord: large-sized commercial banks which have established business institutions in other countries or regions (including Hong Kong and Macao, etc.) and whose international business occupies a large proportion shall implement the New Capital Accord.

ii. Other commercial banks: this type of commercial banks (including subsidiaries of foreign banks) may voluntarily apply to implement the New Capital Accord; any of the said banks that does not choose to implement the New Capital Accord will continue to implement the current capital supervisory provisions. The CBRC will, by referring to the relevant provisions in the New Capital Accord, revise and improve the current capital supervisory provisions (hereinafter referred to as “revised capital supervisory provisions”), and provide them to other commercial banks for implementation.

IV. Methods for the implementation of New Capital Accord

i. Quantitative methods for credit risk capital

1. A commercial bank shall adopt the internal rating method for calculating the credit risk capital requirements. The CBRC encourages commercial banks to implement the senior internal rating method.

2. A commercial bank shall meet the supervisory requirements for adopting the internal rating method, and implement it upon approval of the CBRC.

3. The CBRC allows commercial banks to implement the internal rating method by stages, however, when a commercial bank obtains the approval for using the internal rating method, its asset coverage ratio calculated according to the internal rating method (risk-weighted assets calculated according to the internal rating method)/ (risk-weighted assets calculated according to the internal rating method + risk-weighted assets of other credit risk exposures calculated according to the revised capital supervisory provisions) shall not be lower than 50%, and it shall formulate the plan for the implementation of internal rating method by stages, so as to ensure that the asset coverage ratio reach 80% in three years.

4. The risk-weighted assets for those credit risk exposures that are not covered by the internal rating method shall be calculated according to the revised capital supervisory provisions.

ii. Quantitative methods for market risk capital

1. A commercial bank shall adopt the internal model method to calculate the capital requirements for market risk. If any commercial bank does not meet the requirements for adopting the internal model method at the appointed time, it may adopt the standard method, but shall formulate a transitional scheme to the internal model method, so as to meet the requirements for implementing the internal model method within three years upon implementation of New Capital Accord.

2. Within the transitional period, a commercial bank may combine the standard method and the internal model method to calculate the provisions for market risk capital, however, it can only adopt one method for one type of risks.

3. A commercial bank shall meet the supervisory requirements for adopting the internal model method, and implement it upon approval of the CBRC.

iii. Quantitative methods for operational risk capital

A commercial bank shall have the provisions for operational risk capital. The CBRC will accelerate the process for studying and regulating the supervision over operational risk capital, and promulgate the methods for calculation of operational risk capital suitable for the actuality of commercial banks of our country before the end of 2007. A commercial bank shall strengthen the management of operational risk and accumulate corresponding data and lay a foundation for the provisions for operational risk capital.

iv. Supervision and check of capital adequacy ratio

1. A commercial bank shall establish stable internal capital assessment procedures, establish internal capital targets and formulate the strategies for keeping the capital level. The internal capital assessment procedures shall include such five aspects as the supervision over the board of directors and senior management personnel, sound capital assessment, comprehensive risk assessment, monitoring and reporting system, as well as internal control check.

2. The capital of a commercial bank shall cover all possible substantial risks. Except for the risks included in the first pillar, a commercial bank shall at least carefully assess the following three types of risks: 1. risks mentioned in but not completely covered by the first pillar, such as loan concentration risk; 2. factors not considered in the first pillar, such as the interest rate risk of bank accounts and fluidity risk; and 3. external environment factors of the bank, such as the risks incurred from the effect of economic circle, etc.

3. The CBRC will establish the procedures for supervision over and inspection of capital adequacy ratio, verify the stability of internal risks and capital assessment procedures of commercial banks, and assess the overall risk management ability and the capital adequacy level of commercial banks. Based thereon, the CBRC will adopt proper supervisory measures to promote the commercial banks to improve the risk management and reinforce the risk resistance ability.

v. Market constraint

1. A commercial bank shall establish perfect information disclosure policies, including the methods for deciding the contents for information disclosure and the internal control of information disclosure, so as to ensure the propriety of information disclosure.

2. A commercial bank shall disclose all the important information about the calculation of capital adequacy ratio so as to facilitate the assessment of market participants of the capital measurement prudence and strengthen the effectiveness of market constraint.

V. Timetable for the implementation of New Capital Accord

i. The CBRC will, before the end of 2008, continuously promulgate the supervisory provisions on implementing the New Capital Accord, revise the current capital supervisory provisions, and solicit the opinions inside the banking industry.

ii. The CBRC will conduct the quantitative impact measurement in 2009 so as to assess the impacts of the implementation of New Capital Accord to the capital adequacy ratio of commercial banks.

iii. Banks for New Capital Accord shall implement the New Capital Accord from the end of 2010, if any said bank could not reach the minimum requirements as prescribed by the CBRC, it can suspend the implementation of New Capital Accord upon approval of the CBRC until the end of 2013.

iv. A commercial bank shall file a formal application for the implementation of New Capital Accord at least half a year in advance, and implement the New Capital Accord upon approval of the CBRC. The CBRC will begin to accept the applications for the implementation of New Capital Accord of banks for New Capital Accord from the beginning of 2010.

v. Other commercial banks may file the applications for the implementation of New Capital Accord after the year of 2011, and shall apply the same application and approval procedures as those for the banks for New Capital Accord.

vi. Other commercial banks will begin to implement the revised capital supervisory provisions from the end of 2010. At that time, if any bank for New Capital Accord has not implemented the New Capital Accord, it may also apply the said capital supervisory provisions.

VI. Main measures for promoting the implementation of New Capital Accord

The implementation of New Capital Accord is a systematic project with complicated techniques, oriented by policies and related to the overall situation, and the supervisory authorities and the commercial banks, the senior management personnel in particular, shall further enhance the understanding of the implementation of New Capital Accord and its affects, reinforce the awareness of urgency, strengthen the cooperation, and practically do a good job in various preparations for the implementation of New Capital Accord.

i. Strengthening the organization of and leadership to the work on implementing the New Capital Accord

Preparations for the implementation of New Capital Accord are very professional, involve a large scope and need the input of a large amount of sources. The board of directors and the senior management personnel of a bank for New Capital Accord shall attach great importance to the implementation of New Capital Accord, establish a “leading group for the project on implementation of New Capital Accord” with the main person in-charge as the group leader as soon as possible and corresponding working bodies (or designate a special department to take the charge), plan its work on implementing the New Capital Accord as a whole, prepare the required

sources and ensure the orderly and stable operation of various preparations. The board of directors of a commercial bank shall be responsible for examining and approving the plans for implementation of New Capital Accord and relevant important policies, regularly heed the reports of the senior management personnel, and supervise the preparations; and the senior management personnel of a commercial bank shall be responsible for designing and implementing the scheme on the preparations for New Capital Accord, deeply comprehend the actual operation of internal rating system, risk quantitative model, and maintain the normal operation of risk maintenance and management system.

ii. Formulating a practical and feasible plan for the implementation of New Capital Accord

The implementation of credit risk internal rating method and market risk internal model method involves the improvement of risk measurement techniques of commercial banks, the reorganization of business procedures and the rebuilding of risk culture, etc., and can not be accomplished in an action, and shall be promoted by stages, with emphasis and order. A bank for New Capital Accord shall, according to these Guiding Opinions and the relevant provisions in the New Capital Accord, make a disparity analysis, and formulate its plan on implementing the New Capital Accord based thereon. The said plan shall at least include the methods for the provisions for credit risk, market risk and operational risk and the timetable for implementation of such measures (including the transitional scheme); contents, targets, scheduling and segmental key points of all the sub-projects to be initiated as planned; corresponding guarantee of sources and relevant organizational leadership, etc. Each bank for New Capital Accord shall, at the end of October 2007, complete the compilation of the plan, and report it to the CBRC for archival filing.

iii. Strengthening the supervision over and inspection of the preparations of commercial banks for implementing the New Capital Accord.

The CBRC will, on the basis of the research and planning group for implementing the New Capital Accord, improve the working mechanism, and strengthen the guidance to the preparations of commercial banks for implementing the New Capital Accord. The supervisory organ shall incorporate the preparations of commercial banks for implementing the New Capital Accord into its daily supervisory work, and supervise and inspect the plans for implementing the New Capital Accord by all the banks. When carrying out the supervisory rating of commercial banks, the CBRC will take into account the positive impacts of the implementation of New Capital Accord on corporate governance and risk management, actively probe for supervisory and incentive measures, and provide incentives for commercial banks to implement the New Capital Accord.

iv. Strengthening the communications and cooperation, and reducing the costs for implementing the New Capital Accord

The implementation of New Capital Accord is a complex systematic project, and the CBRC will attach great importance to the information exchanges with commercial banks, and encourage the cooperation between commercial banks so as to exert their combined forces. Firstly, the CBRC will take the lead in organizing the exchanges with overseas advanced banks and overseas supervisory authorities, and adopt the successful experiences of other countries (regions) for the implementation of New Capital Accord. Secondly, the research and planning group for the implementation of New Capital Accord shall play a full role and organize guild experts to tackle

some common technical problems; and the commercial banks shall probe for effective cooperation approaches in the aspects of data sharing, model development and technical transfer, etc., with each other and jointly overcome the difficulties encountered in the implementation. Thirdly, the transparency of the supervisory rules and systems for implementing the New Capital Accord shall be enhanced, the participation of banking industry shall be strengthened and the pace of regulation compliance shall be accelerated so as to provide guidance for commercial banks to improve their internal risk management system, reduce difficulties and save costs.

v. Strengthening the basic work on implementing the New Capital Accord

The years 2007 and 2008 are the initial stage for the implementation of New Capital Accord, and all kinds of preparations shall be done in these two years.

1. Reinforcing the data basis: the internal rating method puts forward definite requirements for data quality, integrity and historical observation period. In order to ensure the scheduled implementation of New Capital Accord, the commercial banks shall accelerate the data cleaning and supplement, establish complete, rigid and coherent data standards and corresponding data processing platform in line with the New Capital Accord, formulate the rules for data quality management, and ensure the timeliness, readiness and integrity of the data.

2. Accelerating the development of internal rating system and risk measurement model: commercial banks shall promote the work on developing the internal rating system according to the dimensions, structure, standards and methods for internal rating system as prescribed in the New Capital Accord; and shall, in view of their respective asset portfolio, develop measurement models for credit risks and market risks, conduct the reverse check of the risk measurement models as developed, and enhance the model anticipation ability and stability. Commercial banks shall actively promote the application of risk quantitative results in the formulation of strategies and plans, the calculation and management of risk exposures and the improvement of reporting system, etc.

3. Promoting the risk management organizational system and procedures reorganization: in order to implement the internal rating method, a commercial bank shall establish perfect operational procedures and organizational systems, and ensure the independence, equity and coherence of internal rating results; and shall, in combination with the internal institutional reorganization, establish business procedures and organizational systems meeting the requirements of New Capital Accord.

4. Strengthening the construction of management information system: the management information system is the most important basic equipment for implementing the New Capital Accord, and the effectiveness of internal rating system and risk measurement model relies on the stability and efficiency of the operation of information system to a large degree. International experiences show that the expenses of information technologies are the most principal costs. Each bank shall incorporate the relevant database and information system for the implementation of New Capital Accord into the overall IT construction plan so as to save the implementation costs.

5. Enhancing the documentation level: the New Capital Accord puts forward a higher requirement for the documentation of internal risk management system, and a commercial bank shall establish corresponding documents to record the design and operation details about internal rating system and risk measurement model as well as the conditions on compliance with minimum standards. Written documents are not only the basis for commercial banks to improve their internal risk management but also the basis for the supervisory authorities to check the commercial banks' compliance with the minimum requirements. Each bank shall, according to the relevant provisions in the New Capital Accord, implement rigid management to the documents formed during the course of developing and building the internal risk management system.

6. Attaching importance to the preparation and cultivation of talents: the implementation of New Capital Accord involves many technical difficulties, so the establishment of a high-quality talent team is significant for the development, construction, use and maintenance of the internal risk management system. On one hand, a commercial bank shall hire professionals from various channels, optimize the talent structure and establish a professional risk analysis team; on the other hand, it shall strengthen the trainings, formulate the training plan for various levels of talents and put them into force, strengthen the understanding of professionals to the New Capital Accord, and enhance the applicability of internal risk management system.