

Implementation of Basel II

1. To promote the implementation of Basel II , Financial Supervisory Commission (FSC) in May 2002 established a joint research team made up of members representing the competent authorities and industry experts. The purpose of the team is to provide venues where bankers can share their experience and build the consensus, and carry out three quantitative impact studies to assess the impact of Basel II upon domestic banks. The FSC implemented Basel II from 2007, which went very smoothly.
2. The framework of Basel II is based on three pillars: minimum capital requirements, supervisory review process, and the effective use of market discipline. On 4 January 2007, the FSC issued the amendments to the "Regulations Governing the Capital Adequacy of Banks" and the "Tables and Instructions for Calculation of Regulatory Capital and Risk-weighted Assets of Banks" to introduce First Pillar (regulatory capital) requirements. Then the regulations of the Second Pillar (supervisory review) and Third Pillar (market discipline) of the Basel II Accord became effective from January 1, 2008. In order to respond more effectively to the evolution and development of the financial market and to cope with the international regulations, the FSC issued amendments twice to the "Regulations Governing the Capital Adequacy of Banks". On 30 June, 2009, the amendments were renamed as the "Regulations Governing the Capital Adequacy Ratio and Capital Category of Banks."
3. First Pillar: The calculation of the Ratio of Regulatory Capital to Risk-weighted Assets. The "Total Risk-weighted Assets" shall mean the sum of the risk-weighted assets for credit risk and the capital requirements for market risk and operational risk multiplied by 12.5. Domestic banks are allowed to choose, depending on the complexity of their operations, a method to calculate capital charges. For credit risk they can choose between the standardised approach, the foundation internal ratings-based approach, and the advanced internal ratings-based approach. For operational risk they can choose between the basic indicator approach, the standardised approach,

and the advanced measurement approaches. The FSC encourages banks to adopt the internal ratings-based approach and more precise methods of risk measurement, and to bring about improved risk management capabilities of domestic banks.

4. **Second Pillar:** In order to establish a risk-based supervisory system, the FSC has asked banks to regularly file business plans, internal capital adequacy assessments, and explanations of their own risk indicator self-assessments beginning in 2008. These filings will help the FSC carry out periodic evaluations of the risk management performance of individual banks. Through implementation of the Second Pillar, the FSC seeks to ensure that banks' capital charges will be commensurate with their risk exposures, and that banks will take necessary measures when their capital decreases to inadequate levels.
5. **Third Pillar:** The FSC has directed banks to set up a special "capital adequacy and risk management" section on their websites since April 2008 for the disclosure of qualitative and quantitative risk management information. The FSC amended the disclosure requirement on 28 March 2011. This type of disclosure will enhance the power of market discipline, provide for better oversight of corporate operations and governance, and contribute to more sound development of the financial industry.
6. By implementing Basel II, the FSC is seeking to strengthen capital adequacy and risk management of banks in line with the international regulations, and enhance the soundness and competitiveness of banks.