



2 September 2004

TO: All Authorised Deposit-Taking Institutions

## IMPLEMENTATION OF BASEL II IN AUSTRALIA

The Basel Committee on Banking Supervision has made the Basel II Capital Framework available for implementation from year-end 2006. However, the advanced internal ratings-based (IRB) approach for credit risk and the advanced measurement approaches (AMA) for operational risk will only be available for implementation from year-end 2007.

APRA has considered the implications of these implementation dates for Australia and believes there is a strong case for a common starting point, which would be from year-end 2007. Amongst other things, this would allow an additional year for institutions adopting the standardised approaches to make the necessary system changes. However, APRA is prepared to consider arguments for an earlier common starting point, from year-end 2006, for the standardised approaches. We would welcome your views on the implementation date for the standardised approaches, by 30 September 2004. Your written response should be addressed to me.

If, on the basis of a strong industry consensus, APRA decides to implement the standardised approaches from year-end 2006, these would not be available to institutions proposing to implement the advanced IRB approach and AMA from year-end 2007. The Basel Committee has mandated a period of parallel calculation for institutions implementing the advanced approaches, during which time the institutions will calculate their regulatory capital using both the existing Basel I and the relevant Basel II methodologies. APRA is of the view that these institutions should focus their resources on this parallel run and it will not countenance their use of the standardised approaches during that period.

APRA has previously stated that authorised deposit-taking institutions (ADIs) implementing either the foundation or advanced IRB approaches for credit risk must also implement the AMA for operational risk. Consistent with this position and the Basel Committee's timetable, the foundation IRB approach will only be available for implementation in Australia from year-end 2007.

In our letter to ADIs of 27 November 2002 (available on the APRA website at <http://www.apra.gov.au/adi/Other-Information-for-ADIs.cfm>), we indicated that full implementation of the conglomerate capital adequacy regime would be postponed until 1 January 2007 to coincide with the timetable of the Basel II Capital Framework. This regime would include new requirements relating to the application of the Extended Licensed Entity (ELE) concept to the measurement of an ADI's stand-alone (Level 1) capital adequacy; inclusion of an ADI's immediate holding company in calculating the ADI's capital adequacy at the consolidated banking group level (Level 2) as per Basel II requirements; capital deduction of all equity investments in other entities unless specifically exempted; and application of the 50/50 Tier 1/Tier 2 deduction approach as per Basel II requirements. The capital base on which large exposure limits are applied would change at the same time. Our intention at this stage remains to implement these changes at the same time as the Basel II Capital Framework. However, as indicated in the 27 November letter, APRA may still apply the new capital deduction rules to an ADI in respect of any new material acquisitions made before this implementation date.

Yours sincerely

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