BASEL II IMPLEMENTATION: CHALLENGES AND IMPLICATIONS FOR THE ZIMBABWEAN BANKING SYSTEM (2012-2013)

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A dissertation submitted in partial fulfillment of the requirements for the degree of Master of Business Administration

2013

Graduate School of Management

University of Zimbabwe

Supervisor: Mr. M. Chimwara
DEDICATION

To my husband, Shingirayi and my sons, Andrew and Anotidaishe, for enduring my long absence from home. Thank you very much for the patience, understanding and support. I dedicate this dissertation to you as a token of my appreciation.
DECLARATION

I, Patience N. Chinomona, do hereby declare that this dissertation is the result of my own investigation and research, except to the extent indicated in the acknowledgements, references and by comments included in the body of the report, and that it has not been submitted in part or in full for any other degree to any other university.

Student’s Signature ___________________________ Date____________________

Supervisor’s Signature __________________________ Date____________________
ACKNOWLEDGEMENT

Firstly I would like to thank the Graduate School of Management (GSM) for giving me the opportunity to be part of the degree of Master of Business Administration. Without their consent, I would not have been doing this degree program. In addition, I am grateful to GSM for the valuable dissertation clinics which proved to be vital as referencing material throughout the process of conducting this study.

Secondly, I would like to thank, my uncle, Mr. Takawira Zembe, for believing in me and encouraging me to continue to learn. In academics, you have always wanted me to excel. Thus far the Lord has taken me!

Special thanks to Mr. Chimwara, my supervisor for this dissertation. Without his help I would not have been able to write a good dissertation. His guidance, encouragement, critical remarks and motivation made me reach my goal.

Special thanks to my friends and colleagues who provided me with research material and a better understanding of the subject matter as well as encouragement throughout the whole program.
EXECUTIVE SUMMARY

The overall objective of this study is to establish the challenges and implications of implementing Basel II in developing countries, with particular focus on the Zimbabwean banking system. The main objective is to identify the problems being confronted by banks and the supervisory authority in Zimbabwe, being the Reserve Bank of Zimbabwe, in their journey to Basel II implementation. This purpose arose from the publication on 26 June 2004 of the “International Convergence of Capital Measurement and Capital Standards, a Revised Framework”, commonly known as Basel II, which has been adopted for implementation by the Reserve Bank of Zimbabwe. The Reserve Bank of Zimbabwe set 1 January 2013 as the implementation date for Basel II after which Basel I will no longer be used in Zimbabwe.

Banking institutions in Zimbabwe have been focusing their attention on becoming Basel II compliant since 2012, wherein they started conducting parallel run of the present framework i.e. Basel I with the Basel II rules. The Reserve Bank of Zimbabwe announced in January 2013 that banks will continue with the parallel through 2013, as banks were at various stages of implementing Basel II and there were weaknesses identified which were being addressed. As such Basel II capital rules were not implemented in full as at 1 January 2013 as initially envisaged by the central bank. Very little attention has been paid on the challenges and implications of Basel II confronting the Zimbabwean banking system.

A literature study was undertaken which included a review of the Basel II framework, impact studies, and a review of the relevant literature on the topic. The framework was studied in order to determine the major challenging themes and implications on developing country banks. Once these challenging themes were identified, the literature on those areas of impact was researched.
The study of the Basel II framework identified a number of challenges that banks in developing countries will face. The first implication is that developing countries that choose to adopt Basel II standards will do so at a considerable cost to both their regulators and the banking sectors. Basel II presents a huge compliance burden. Large banks who are able to bear high compliance costs will survive, whilst the smaller banks will be discouraged. Secondly the perceived benefits of investing in Basel II are likely to be minimal because the new capital rules were not designed for, nor are they appropriate for developing economies. In addition, local banks in developing countries will face capital constraints, making them susceptible to mergers and acquisitions by sophisticated international banks that are able to inject fresh capital and bring in the necessary expertise sought by the regulators. Another difficult aspect of implementation is the cross border challenges. Banks that have cross border operations are more likely concerned with home-host supervisory issues largely emanating from differences in implementation timetables; approaches to implementation and interpretation of Basel II.

Another serious challenge is that the success of Basel II depends on strong and well developed financial systems, which include among others, existing regulatory and supervisory frameworks; sustainability of banking sector reforms; existing level of economic development; political stability; depth and efficiency of financial intermediation; a number of which lack developing countries.

Notwithstanding the foregoing, many developing countries feel they are left with no choice but to adopt Basel II, as without it developed country regulators may deny their banks market access. Thus developing countries are in a “Catch-22” situation; compliance implies that developing country local banks may make themselves vulnerable to take-over by advanced international banks; non-compliance would evade this, however, they would be excluded from international financial markets.
This will have serious implications on globalization efforts, in particular distribution of income as financial services play an essential role in post industrial economy.

This paper investigates the challenges and implications of Basel II implementation in developing countries, specifically in Zimbabwe. It begins by giving a brief background of the Zimbabwean banking system and an overview of Basel I and Basel II. This is followed by a discussion of the implications and challenges of Basel II and the reasons for its widespread adoption in developing countries.
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1. CHAPTER ONE – INTRODUCTION

1.1. INTRODUCTION TO THE STUDY

Banks are a critical component of any economy and fulfill a unique role within a modern economy because banks are entrusted with depositors’ funds, which they use to conduct their business. They perform an intermediation function, a process whereby an economy’s savings are transformed into capital investment. Banks provide access to payment systems and are expected to make credit and liquidity available at a moment’s notice in difficult market conditions. The consequences of a failure to manage risks are usually more fatal to a bank than any other financial institution. Default by one banking institution can spread to undermine other bank and non-bank institutions resulting in contagion or systemic risk (Saidenburg and Schuermann, 2003:1).

The government and monetary authorities play a complementary, albeit essential role, in the financial intermediation process. They focus on the protection of depositors and the overall safety and soundness of the financial system. For this and other related purposes, financial intermediaries are supervised and financial markets regulated. Thus, the purpose of banking supervision is to ensure that banks hold adequate capital and reserves to support the risks that arise in the nature of their business (Styger and Vosloo, 2005:2).

The need for banks to maintain adequate capital gave impetus to the formation of the Basel Committee on Banking Supervision1 (BCBS/Committee) in 1975. Notably, the failure of Bankhaus Herstatt in West Germany in 1974 resulted in central bank

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1 “The Basel Committee on Banking Supervision is a committee of banking supervisory authorities that was established by the central bank governors of the Group of ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, German, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the Bank for International Settlements, where its permanent Secretariat is located”
governors of the Group of Ten countries seeking to establish a forum that resolved capital erosion in their banking systems (BCBS, 1988). During the 1970s and 1980s, volatility in exchange and interest rates coupled with the Latin American debt crisis led to erosion of the capital base of most banks worldwide. Capital ratios of active international banks were deteriorating against growing international risks. Consequently, the BCBS devoted most of its time in capital adequacy measurement standards as member countries had a broad consensus of the overriding need to strengthen the stability of the international banking system.

Following several consultative forums, the Committee issued its first capital adequacy standard in July 1988, the “International Convergence of Capital Measurement and Capital Standards” commonly known as “Basel I or the 1988 Capital Accord” (BCBS, 1988). The primary objective of the Basel I framework was to provide a minimum capital adequacy ratio and a uniform definition of capital for internationally active banks. The uniform measurement of capital was viewed to increase competitive equality among international banks as differences in national capital requirements was believed to be the source of competitive inequality. The 1988 Accord was progressively adopted not only in member countries but in over 150 jurisdictions across the world without restricting it to active international banks, thus making it a globally accepted standard. Zimbabwe is among the non-member countries that adopted the Basel I capital standards according to the Reserve Bank of Zimbabwe (RBZ) (RBZ Monetary Policy Statement, January 2011).

Overtime, the 1988 Accord lagged behind, as banks’ balance sheet continued to evolve in response to product innovations, financial markets deregulation and globalization. Banks assumed more complex risks to the extent that the Basel I capital requirements could no longer match a bank’s true risk profile (Ferguson, 2003a:2). The Federal Reserve Board Vice Chairman, Roger Ferguson had this to say about Basel I:
"Basel I ignores techniques that the largest banks have adopted to mitigate risk. Its overly simple risk weights induce large banks to game the rules by shifting to the market those exposures that the market judges to require less capital than the regulations do and by retaining the exposures with a regulatory charge that is lower than the market perceives is necessary" (Ferguson, 2003a:2).

Such capital arbitrage undermined the usefulness of regulatory capital ratios for large banks and provided little valuable information to the supervisor and the public.

The Committee refined the 1988 Accord to address the identified weaknesses, which culminated in the release of a new capital adequacy framework in June 2004 known as the “International Convergence of Capital Measurement and Capital Standards, a Revised Framework” (widely known as Basel II or the Revised Framework) (BCBS, 2004b:1). The major objectives of the Revised Framework are to better align regulatory capital with underlying risks, continue to enhance competitive equality among internationally active banks but suitable for banks of varying levels and sophistication. The framework also provides incentives for banks to adopt stronger risk management practices, which is viewed as one of its major benefits (BCBS, 2004b:2).

The Basel II framework consists of three mutually reinforcing pillars. The first pillar presents the calculation of minimum capital requirements which aim to develop and build on the standardized rules laid in the Basel I framework. The second pillar, the supervisory review process, discusses the supervisory principles of reviewing an institution’s internal assessment processes and capital adequacy. The third pillar, market discipline, provides a set of disclosure requirements which are viewed to promote safe and sound banking practices. Collectively, these three elements were considered by the Committee to be the fundamental elements of an effective capital framework (BCBS, 2004a:1).
The Basel II framework provides a menu of approaches that banks can adopt depending on their levels of sophistication. For calculation of the capital charge for credit risk, banks have a choice between two broad methodologies. The first option is to calculate minimum capital requirements for credit risk using the Standardized Approach, supported by external credit assessments. The Standardized Approach was refined to overcome the shortcomings of Basel I. The other methodology is to allow banks to use their internal rating systems to for credit risk, which method is however subject to explicit supervisory approval. There are two variations of the Internal Ratings Based (IRB) approach, the foundation approach and advanced approach.

The Revised Framework sets out three measurement methodologies for capital requirements for operational risk in a “continuum of increasing sophistication and risk sensitivity”: the Basic Indicator Approach; the Alternative Standardized Approach; and the Advanced Measurement Approaches. Banks are encouraged to first adopt the simplest approaches, the Basic Indicator Approach, and then move along the spectrum of available approaches as they develop more advanced operational risk measurement systems and practices.

The President of the European Central Bank and Chairman of the G-10 group of heads of supervisory authorities and central bank governors, Jean-Claude Trichet explained Basel II as follows:

“The Basel II embraces a comprehensive approach to risk management and bank supervision. It will enhance banks’ safety and soundness, strengthen the stability of the financial system as whole and improve the financial sector’s ability to serve as a source for sustainable growth for the broader economy” (BCBS, 2004a:1).

A number of countries have shown interest in implementing Basel II standards, including non-member countries owing to the perceived benefits.
THE ZIMBABWEAN PERSPECTIVE

The RBZ noted the following on Basel II implementation in Zimbabwe:

*The Reserve Bank of Zimbabwe adopted a gradual approach to Basel II implementation to allow for a smooth transition and enable banking institutions to build the requisite capacity to operate in a Basel II environment. The Reserve Bank laid the foundation for Basel II Implementation through the rolling out of Risk Based Supervision (RBS) and issuance of a number of Prudential Guidelines focusing on specific aspects of Pillars I to III. With effect from 2004, all banking institutions were required to allocate capital for Market risk and Operational risk using the standardized approach of the current Basel II. Some of the main guidelines covered Corporate Governance, Risk Management, Securitization, and Financial Disclosure. To date, the only outstanding component towards full implementation of Basel II in Zimbabwe is Credit Risk (RBZ Monetary Policy Statement, July 2011:23-24).*

In January 2011, the RBZ then issued **"Guideline No.1-2011/BSD: Technical Guidance on the Implementation of the Revised Capital Adequacy Framework in Zimbabwe"**, a policy framework that provides technical guidance on the full implementation of Basel II in Zimbabwe (RBZ Monetary Policy Statement, January 2011). Banking institutions were required to adopt at a minimum, the standardized approaches for credit, operational and market risk. Due to the absence of external credit rating agencies in Zimbabwe, the RBZ developed a Modified Standardized Approach for credit risk. The RBZ announced that banks would commence parallel run of both Basel I and Basel II frameworks on 1 January 2012 and will continue throughout the year 2012. This meant that banks will be reporting their quarterly financial statements for the reporting periods 31 March, 30 June, 30 September and 31 December 2012 using both frameworks. The RBZ advised that by 1 January 2013, all banks would be expected to be fully compliant with the Revised Framework after which Basel I will no longer be used in Zimbabwe (RBZ Mid-Term Monetary
Policy Statement, July 2011:24). During the pre-implementation period and the parallel run, banks’ internal plans for Basel II implementation will be reviewed and continuously monitored by the RBZ Bank Licensing, Supervision and Surveillance Division.

The RBZ reported that banking institutions were at various stages of implementing the Revised Framework and should continue with the parallel run through 2013 until further advices from the supervisory authority (RBZ Monetary Policy Statement, January 2013:30). The Central Bank indicated that significant progress had been registered in complying with Basel II requirements and weaknesses found were being addressed. The weaknesses found that resulted in banks not fully implementing the Revised Framework by the set date of 1 January 2013 were, however, not provided.

1.2. BACKGROUND TO THE STUDY

The Zimbabwean macroeconomic environment has undergone serious disturbances which have had adverse effects on financial sector stability. The banking crisis experienced during 2003 and 2004 resulted from an unfavorable macroeconomic environment characterized by rising inflation and monetary expansion, supply side constraints and relatively high interest rates. These conditions negatively affected banking institutions’ performance, notably, asset quality, prudent liquidity and funds management. In response to the rapidly deteriorating environment, banks diverted from core business of banking in terms of the Banking Act [Chapter 24:20] to conducting non-permissible activities such as parallel market dealings and trading on the stock market.

Due to weak corporate governance practices and poor risk management systems, a number of banks that diverted into non-core business faced serious liquidity and
solvency challenges which threatened the stability of the banking system (RBZ Bank Licensing, Supervision & Surveillance Division Annual Report, 2005). The obtaining environment presented the RBZ with regulatory and supervisory challenges. The central bank was forced to institute a number of measures to restore financial sector stability, among them placing nine banks under recuperative curatorship and instituting liquidation proceedings against three banks. The institutions placed under liquidation were Rapid Discount House, Barbican Asset Management and Century Discount House, whilst the following financial institutions were placed under curatorship (RBZ Mid-Term Monetary Policy Statement, July 2004):

- Intermarket Banking Corporation
- Intermarket Building Society
- Intermarket Discount House
- Barbican Bank Limited
- Royal Bank of Zimbabwe Limited
- CFX Bank Limited
- CFX Merchant Bank
- Trust Bank Corporation Limited
- Time Bank of Zimbabwe Limited

The economic situation in Zimbabwe, however, continued to deteriorate and worsened during the period 2007-2008, to the extent that it was described as a “dysfunctional economy” owing to the performance of the following macroeconomic variables:

- multiple exchange rates, which were escalating at corresponding rates;
- hyperinflation, which the World Bank estimated at 500 billion per cent by the end of the December 2008; and
- multiple interest rates, which were in the region of 100% to 10,000%.

The International Monetary Fund (IMF) (Public Information Notice No.09/53 May 6, 2009) reported that the Zimbabwean banking system contracted, as reflected in deposits that declined from almost US$1 billion at end 2005 to about US$300
million (of which local currency-denominated deposits amounted to an equivalent of US$6 million) at end 2008. To curb the hyper-inflationary period, the National Budget of 29 January 2009, effectively adopted the use of a multiple currency monetary framework with the United States dollar as the reference currency.

The introduction of the multi-currency system presented downside risks to effective financial intermediation: inadequate capitalisation increasing banking institutions vulnerability to minor market shocks; market illiquidity mainly attributable to limited availability of lines of credit and short term transitory deposits; and low interest income against high operational costs. Inadequate capitalisation and chronic liquidity challenges has seen a number of banks being placed under curatorship or surrendering their operating licences. Renaissance Merchant Bank and Interfin Merchant Banking Corporation Limited were placed under recuperative curatorship by the RBZ in June 2011 and June 2012, respectively. Genesis Investment Bank Limited and Royal Bank Limited voluntarily surrendered their banking licences to the RBZ in June and July 2012, respectively, following failure to comply with minimum capital requirements.

In order to protect the safety and soundness of the banking system, the RBZ announced new minimum capital requirements for banking institutions in July 2012 as follows:

### Table: 1.1 Minimum Capital Requirements for Banking Institutions

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<tr>
<td>Microfinance Banks</td>
<td>5,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Finance Houses</td>
<td>60,000,000</td>
<td>7,500,000</td>
</tr>
<tr>
<td>Discount Houses</td>
<td>60,000,000</td>
<td>7,500,000</td>
</tr>
<tr>
<td>Building Societies</td>
<td>80,000,000</td>
<td>10,000,000</td>
</tr>
<tr>
<td>Merchant Banks</td>
<td>100,000,000</td>
<td>10,000,000</td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>100,000,000</td>
<td>12,500,000</td>
</tr>
</tbody>
</table>

Source: Adapted from RBZ Mid-Term Monetary Policy Statement of July 2012, page 52.
The RBZ proposed a phased plan for compliance with the minimum capital requirements as follows: 25% by 31 December 2012; 50% by 30 June 2013; 75% by 31 December 2013 and full compliance by 30 June 2014. The Central Bank announced that 14 banks out of 22 operating banking institutions had complied with the 25% minimum capital requirements stipulated for 31 December 2012 (RBZ Monetary Policy Statement, January 2013:32). This reflects that capitalization remains a serious challenge for institutions operating in Zimbabwe, yet capital adequacy is the major underlying principle of Basel II.

During the first quarter of 2013, the RBZ circulated a draft Banking Amendment Bill to banking institutions which seeks to make drastic amendments and new incorporations to the Banking Act to make it deal more effectively with developments in the financial sector. In particular, the draft amendment bill aims to:

- allow banking regulators to monitor and regulate bank holding companies;
- increase co-operation between the different financial regulatory authorities;
- improve corporate governance of banking institutions; and
- provide for the establishment of an international financial centre among other various amendments (Banking Amendment Bill, 2012)

The proposed amendments were expected to become effective by 31 March 2013, following adoption by the legislature. The RBZ also circulated a Revised Troubled and Insolvent Banks Policy, a policy framework for timely and effective responses to banking problems during the same period.

In view of the foregoing, it seems apparent the banking sector has not yet embraced sound principles of capital management, whereby risk exposures are systematically related to capital requirements as evidenced by banks being placed under curatorship and some surrendering their operating licences. A culture of strong risk management practices is not yet fully embedded as poor risk management systems has been cited by the RBZ as a significant factor in all bank failures in Zimbabwe. In
addition, regulatory structures in Zimbabwe seem to lack comprehensive systemic oversight as there is inconsistent cooperation among the regulators of the financial system namely: Reserve Bank of Zimbabwe; Deposit Protection Corporation (DPC); Insurance and Pensions Commission (IPEC); and the Securities Commission (SEC).

The existence of fragmented supervision between the Central Bank and other financial sector regulators presents potential loopholes and fertile ground for regulatory arbitrage to the detriment of financial sector stability. The RBZ has been calling on for a Multi-Disciplinary Financial Stability Committee comprising all the four regulators of the financial system in a bid to close the regulatory gaps. The RBZ reported that a Memorandum of Understanding had been signed by the four financial services regulators to formalize their cooperation and a Multi-Disciplinary Financial Stability Committee constituted (RBZ Monetary Statement, January 2012:38).

Further, the legal/regulatory infrastructure and corporate governance practices still require radical enhancements in Zimbabwe, which presents regulatory authorities with challenges as regards enforcement and supervision. The RBZ has just issued a draft amendment bill during the first quarter of 2013 which seeks close these gaps.

There has been much debate both locally and globally that the new Basel Capital Accord is highly technical in nature to the extent that developing countries might not have the capacity or may fail to implement it. They argue that financial systems in emerging and developing economies largely do not comply with the Basel Core principles for effective banking supervision which is a key precondition in implementing Basel II. Others argue that for emerging and developing economies to compete successfully they need to apply international best practices. They believe that Basel II constitutes a global standard not merely a standard of a particular
interest group. The menu of approaches provided under the Basel II framework is suitable for both the least sophisticated and most complicated banks.

The IMF advised countries not to hurriedly implement Basel II when they are not yet ready because of the risks associated with the “too quickly and too ambitious” approach of moving towards Basel II. To support this notion, the IMF indicated that Financial Sector Assessment Programmes (FSAPs) will not negatively score countries that have not adopted Basel II. The IMF advised that it will assess the quality of implementation for those countries that would have decided to implement Basel II. The risks of adopting Basel II standards when a country is not ready may include: negative financial sector assessments from IMF; limited access to international finance and foreign investment; and rating downgrades from rating agencies (IMF Public Information Notice No.05/154, 2005).

The BCBS (2004c) supported these sentiments by the IMF and added the following on implementation of Basel II:

“A key element that countries should consider before moving on to Basel II is whether a good baseline supervisory system is in place. Supervisors may need to assess the degree to which their jurisdiction has successfully implemented the Basel Core Principles for Effective Banking Supervision (BCP), including its “preconditions” - which can serve as a baseline upon which to build the infrastructure of Basel II. The Financial Sector Assessment Programme (FSAP) or stand-alone BCP assessments can provide useful input into this “baseline” phase of the project. 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” (BCBS, July 2004c:2)

The Revised Framework is not aimed at enforcing compliance with a new set of capital rules. Rather, it seeks to build on a solid foundation of bank supervision,
prudent capital regulation and market discipline as well as enhanced risk management practices and a stable financial system. The Committee acknowledged that while the Revised Framework is applicable to all banks, its adoption in non-member countries may not be the first priority for all supervisors. The committee advised of the need for supervisors to conduct wide consultations and impact assessments to determine implementation of the framework.

It is against such background where the generally accepted preconditions for the implementation of Basel II seem to be less developed yet banking institutions were required to fully implement Basel II standards by 1 January 2013.

1.3. RESEARCH PROBLEM

Banking institutions in Zimbabwe have been focusing their efforts on becoming Basel II compliant. The way in which banks will operate in future will be largely defined by rules under Basel II. Such rules, which were initially designed for internationally active banks, have changed drastically and become more complex under Basel II. The effective adoption of this new international and supervisory architecture is confronted by many challenges and issues. With Zimbabwe being a developing country, as banks try to adjust to the new way of doing things, this definitely has got implications on the way they do business and presents a number of challenges.

Very little attention, if at all, has been paid on the issues, implications and challenges of Basel II implementation in Zimbabwe. In view of the divergent views on Basel II implementation in developing countries, the problem statement for this study can then be defined as “to establish the challenges and implications of Basel II implementation on the Zimbabwean banking system?”
1.4. **RESEARCH OBJECTIVES**

The purpose of this study is to investigate the effect of Basel II implementation on the Zimbabwean banking system. This will be achieved by assessing the challenges, issues and implications being encountered by banks and the supervisory authority in their efforts to embrace the revised capital rules. The research will also evaluate the extent to which the banking system was ready to fully implement Basel II by 1 January 2013 as announced by the central bank. The objectives can be summarized as follows:

1.4.1. To identify the challenges, issues and implications of Basel II implementation on the Zimbabwean banking system.
1.4.2. To identify key gaps on the state of readiness for both the banks and the supervisory authority to implement Basel II by 1 January 2013.
1.4.3. To establish the relevance to and appropriateness of Basel II standards in Zimbabwe.
1.4.4. Provide policy recommendations on the impact of Basel II implementation in Zimbabwe.

1.5. **RESEARCH QUESTIONS**

In order to carry out the research, the following questions will be asked:

1.5.1. What are the challenges faced by banks and the implications of implementing Basel II in Zimbabwe?
1.5.2. Was the Zimbabwean banking system and supervisory authority ready to implement Basel II by 1 January 2013?
1.5.3. Is Basel II standards relevant to and appropriate for Zimbabwe?
1.5.4. What are the areas, if any, that need further enhancement to ensure successful implementation of Basel II?
1.6. RESEARCH PROPOSITION

The Zimbabwean banking system is facing challenges in implementing Basel II standards.

1.7. JUSTIFICATION OF THE RESEARCH

Adequately capitalized and well-managed banks are more stable and better able to withstand periods of distress, thereby allowing the financial sector to play a more significant and more productive role in the sustainable growth of the broader economy. A sound and efficient banking system constitutes a necessary prerequisite to a healthy and growing economy. Thus, adoption of Basel II standards is envisaged to bolster the safety and soundness of Zimbabwean banks, and result in a more efficient and effective banking system.

Very little research has been carried out on readiness of banks for Basel II, including identifying key gaps and implementation challenges in Zimbabwe. It is anticipated that the study will provide insight into the practical implementation challenges faced by the banking system in adopting Basel II standards. In addition, it is hoped the research will prompt the supervisory authority to adopt a more holistic approach to the implementation of Basel II. This means not only requiring banks to adopt Basel II, but ensuring that the preconditions for effective banking supervision and enabling regulatory and supervisory system are in place. Further, it is anticipated that the research will assist future scholars and fellow students by widening their knowledge base on Basel II.
1.8. SCOPE OF RESEARCH

The research will focus on the practical implementation, issues and implications on the Zimbabwean banking system (banking institutions and the supervisory authority) in implementing Basel II, in particular Pillar 1 – Minimum Capital Requirements.

The banking sector comprises 22 operating institutions, which include 16 commercial banks, 3 building societies, 2 merchant banks and 1 savings bank. The research will also focus on the regulatory and supervisory body responsible for bank supervision namely the Reserve Bank of Zimbabwe. All the targeted banks have their head offices situated in Zimbabwe hence the study will be based in Harare.

1.9. ETHICAL ISSUES

Most of the information required for this study is confidential information governed by company policy. As such, a number of respondents will be hesitant to complete the questionnaire. The researcher will overcome this challenge emphasizing to the respondents in the sampled population that the information will be solely used for academic purposes.

1.10. LIMITATIONS TO THE STUDY

The study will investigate the issues, challenges and implications of Basel II implementation on the Zimbabwean banking system and does not attempt to reach
conclusions on the impact on banking systems around the world. The research study focuses on the impact of Pillar 1 – Minimum Capital Requirements of the Revised Framework and does not cover Pillars 2 and 3 on the Zimbabwean banking system.

In addition, the outcome of this research cannot be applied everywhere in the world. It is an analysis done for a specific country, which in this case is Zimbabwe, with its own economic environment, its own financial and banking system that differs from other countries, although the Basel II regulation has been developed to be applied internationally.

1.11. DISSERTATION STRUCTURE

The research is organized as follows:
Chapter 1 provides the background on the evolution of the Revised Capital Adequacy Framework, commonly known as Basel II, starting from Basel I which culminated into the Revised Framework. The chapter gives a situational analysis of the banking sector in Zimbabwe, the rationale for carrying out the study and the significance and scope of the research.

Chapter 2 reviews literature on the impact of Basel II in emerging and developing countries. The major findings of the latest Quantitative Impact Study (QIS3) will be reviewed and conclusions drawn. Chapter 3 covers the methodology applied to collect data for the research study and limitations thereof. Chapter 4 presents and analyses the collected data whilst providing an interpretation of the results. Chapter 5 outlines the major findings of the study, formulates conclusions and recommendations and poses questions whether there are any areas of further study.
1.12. CHAPTER SUMMARY

Chapter one provided the background information giving rise to the formation of the Basel Committee on Banking Supervision which culminated in the release of the first capital adequacy framework in July 1988, and later the revised capital accord in June 2004 commonly known as Basel II. The chapter provided a brief background of the Zimbabwean banking system, underscorining the various challenges it has experienced since 2003 in view of the RBZ requirement to implement Basel II by 1 January 2013. The objectives of the research and questions to be addressed have also been highlighted.
2. CHAPTER TWO - LITERATURE REVIEW

2.1. INTRODUCTION

The chapter begins by analyzing the Basel II framework so as to determine the major impact themes which will form the basis for developing the literature review. The study of the Basel II framework identified a number of implications and challenges that banks in developing countries will face. The first implication is that developing countries that choose to adopt Basel II standards will do so at a considerable cost to both their regulators and the banking sectors. The second major implication is the expected increase in minimum capital requirements. Closely related to this is that local banks in developing countries will face serious capital constraints, making them susceptible to mergers and acquisitions by sophisticated international banks that are able to inject fresh capital and bring in the necessary expertise sought by the regulators. Another challenge is that the perceived benefits of investing in Basel II are likely to be minimal because developing country banks follow different bank lending practices as opposed to the underlying assumptions about the nature of the relationship between a bank and its counterparties incorporated in Basel II.

Further, the success of Basel II depends on strong and well developed financial systems which lack significantly developing countries and therefore present implementation challenges. Another difficult aspect of implementation relates to home-host supervisory issues largely emanating from differences in implementation timetables; approaches to implementation and interpretation of Basel II, taking cognizance that a number of banks in developing countries are foreign owned. Lastly, the paper will also discuss the so called procyclicality debate, whose effect on business cycles is considered to be more pronounced in developing country economies.
The detailed discussion of these major implications and challenges will be discussed hereunder. The chapter will borrow from the results of the Quantitative Impact Studies carried out by the Financial Stability Institute on Basel II implementation on banking systems. The benefits of implementing Basel II will also be highlighted despite its associated challenges and implications on the banking system.

2.1.1. AN OVERVIEW OF BASEL I AND II

The 1988 Basel Capital Accord set minimum capital requirements at 8% of risk-adjusted assets. Risk weights depend upon asset type. For instance, exposures to all corporates attract a risk weight of 100%. This implies that risk weights are equal to the full exposure and the resultant minimum capital requirement is 8%. The 1988 Capital Accord assigned the same capital requirement to similar type of borrowers regardless of potential differences in the credit worthiness and risk that each individual borrower might pose. Eligible capital components were defined as Tier 1 comprising shareholders’ equity and Tier 2 essentially subordinated debt. Basel I was adopted by more than 150 jurisdictions worldwide. Thus, the 1988 Capital Accord can be described as a genuine step forward for most countries’ capital rules and a watershed for international cooperation among the world’s supervisors.

Basel I, however, became increasingly obsolete owing to advances in technology, risk management practices and innovation to the extent that it could not match the world’s complex organizations with a regulatory capital requirement that reflect their true risk profile (Ferguson, 2003a:2). The lack of sensitivity under Basel I encouraged banks to engage in regulatory capital arbitrage, through undertaking transactions whose main objective was to reduce capital requirements without corresponding reduction in actual risk taking. Banks were incentivized to move high quality assets off their balance sheets via securitization. The response by the BCBS was to put in place an extensive consultative process which culminated in the

Bailey (2005:5) notes that participation of developing countries in the consultation process:

“was limited to the right to respond to consultative documents and peripheral involvement via the Core Principles Liaison Group consisting of representatives from the BCBS, Bretton-Woods and 16 non-G-10 countries. All decision making responsibility remained within the G-10 and a review of responses from developing countries to the third consultative process reveals their input as largely absent from the final document”.

The overarching purpose of Basel II is to create an international standard that promotes adequate capitalization, encourages improvements in risk and capital management thereby protecting the stability of the international financial system. These capital rules imply that the greater risk to which a bank is exposed, the greater the amount of capital the bank must hold to safeguard its solvency and overall economic stability. To achieve these goals Basel II introduced “three mutually reinforcing pillars” that encourage banks to improve the quality of their control processes. The first pillar corresponds a significant strengthening of the minimum capital requirements outlined in the 1988 Accord, while the second and third pillars represent added extras to capital supervision.

“Pillar I – Minimum Capital Requirements” calculates risk weights to determine a basic minimum capital figure. Capital is calculated for three major components of risk that a bank faces: credit risk, operational risk and market risk. The minimum capital to asset ratio was maintained at 8% of risk-weighted assets. In Zimbabwe the
RBZ initially set the capital adequacy ratio at 10% and increased this to 12% effective 1 August 2012. The RBZ highlighted that the capital to asset ratio was set higher as compared to the Basel II recommendation of 8% to ensure that banks in Zimbabwe hold sufficient buffer against unexpected losses in view of “increasing banking sector risks” (RBZ Mid-Term Monetary Policy Statement of 31 July 2012:60).

Banks and supervisors can choose between three different approaches to measuring their credit risk depending on the degree and complexity of their operations. The three main approaches to setting capital charges for credit risk are the Standardized Approach; the Foundation Internal Ratings Based (FIRB) and Advanced Internal Ratings Based (AIRB) measurement approaches. Under the Standardized Approach to credit risk, banks that have simple control structures and engage in less complex forms of lending and credit underwriting may use external credit ratings to assess the credit quality of their borrowers for regulatory capital purposes. Banks that undertake more complicated risk taking and have sophisticated risk measurement systems may choose either the FIRB or AIRB, subject to approval by their supervisors. Under the IRB approaches, banks use their own internal measures of borrower credit analysis to determine capital requirements depending on availability of data, validation and operational requirements.

The Revised Framework also sets out three measurement methodologies for capital requirements for operational risk in a “continuum of increasing sophistication and risk sensitivity”. The approaches available to banks and supervisors are: the Basic Indicator Approach (BIA), the Alternative Standardized Approach (ASA) and the Advanced Measurement Approaches (AMA). The framework gives banks and supervisors the opportunity to choose an approach that reflects the quality and sophistication of their banking systems. Banks are encouraged to first adopt the simplest approaches, the Basic Indicator Approach, and then move along the
spectrum of available approaches as they develop more advanced operational risk measurement systems and practices.

Given that “Pillar I” is the focus of this study, it will be explored further in detail in this chapter. The computation of minimum capital requirements will be reviewed under the Standardized Approach and IRB approaches. The “Pillar I” framework will be used as a foundation for this commentary.

“Pillar II – Supervisory Review Process” is intended not only to ensure that banks have adequate capital to support all the risks in their business, but also to encourage banks to develop and use better risk management techniques in monitoring and managing their risks. This interaction is intended to foster an active dialogue between banks and supervisors such that when deficiencies are identified, prompt and decisive action can be taken to reduce risk or restore capital. The challenges and implications of Pillar II on the Zimbabwean banking system are not explored any further as it is outside the scope of this research study.

“Pillar III – Market Discipline” leverages the ability of market discipline to encourage prudent management by increasing the degree of transparency in banks’ public reporting. It provides a set of disclosure requirements that banks must make which allow market participants to assess their capital adequacy. The Committee believes that such disclosures will give the public sufficient understanding of banks’ risk exposures and control measures in place such that they are able to differentiate between banks and reward those that prudently manage their risks and penalize those that do not. , and hence the capital adequacy of the institution. complements the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). The challenges and implications of “Pillar III” on the Zimbabwean banking
2.2. MAIN DISCUSSION

2.2.1. COST IMPLICATIONS

Cornford (2006:15) noted that the most significant challenge affecting the pace of implementing Basel II is resources constraints and planning undertaken among supervisors and the banks themselves. These processes, planning undertaken and resources constraints, are mutually dependent in a number of ways. The planning process, for instance, will be affected by the amount of resources allocated to it and the plans themselves have to take into consideration the resources available for their implementation. Correspondingly, the banks’ state of preparedness will not only determine their capacity to implement Basel II, but also their selection of the approaches and alternatives for setting capital charges for operational and credit risk and supervisors’ validation of their plans.

Cornford further notes that the planning and resources requirements process is particularly more difficult for banks than supervisors as the Financial Stability Institute (FSI) provides guidance information for supervisors but not for banks. The FSI survey of 2006 respondents in all regions cited the formidable challenge created by Basel II in respect of upgrading skills both supervisory teams and banks. The highest priority for Basel II related training was attributed to setting of minimum capital charges for credit risk and to how the supervisors review process of assessing banks’ capital adequacy and sound techniques for risk management will be conducted. The survey also noted the need for wide-ranging planning and a significant commitment of resources by banks. The survey notes that a majority of these costs (40%-80%) are information technology related.
The challenges encountered by developing country banks are not limited to themselves but also to their regulators. Basel I was different in that it was rules based. The principal role of the regulator was to monitor compliance with the set of rules, ensuring that corrective action has been taken where necessary. Basel II, however, presents a different scenario. There is need for the supervisor to have expertise and considerable discretion, in particular with respect to Pillar 2 which requires that:

“supervisors should review and evaluate banks’ internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios” (BCBS, 2004a).

Thus, further to their responsibilities of Pillar 1 data and calculations, regulators are required to sign-off on the economic capital models, and risk management processes of banks. This represents a huge need in the responsibilities and skills of regulators. Cornford (2005) indicates that Germany, for instance, estimated that more than 500 extra supervisors will be required to implement Basel II. The problem for finding people with the right skills is further exacerbated by the fact the people with the right skills are engaged in highly paid jobs in consultancies and banks. This makes the recruitment and retention process very cumbersome for regulatory authorities. These sentiments were echoed too in the respondents to the FSI survey of 2004, where it was estimated that 25% of regulatory and supervisory staff would require training, with the training requirement rising to 70% for Africa.

Developing countries face tremendous IT challenges, yet the Basel II framework, in particular the IRB approaches is data intensive. A lot of data concerning the borrowers should be captured by banking institutions. It is about retrieving data; monitoring data; improve data quality and assurance concerning availability of reporting. Not all banks have in the required data in their database and even if they have the data, do they have the IT system in place to use such an approach? In
emerging economies and also developing countries this will be the show stopper to implement this approach, because data is not available or not being published. If the data is not available, it will become difficult for banks to use this approach and the capital gain will not be realized (Bailey, 2005).

The South African Reserve Bank set January 1, 2008 as its Basel II implementation date. A consulting firm Accenture approximated that South African internationally active banks would require up to ZAR1 billion (one billion) to enable them become Basle II compliant. The Chairman of ABSA, quoted by Bridge (2004:1) estimated the cost of complying with Basel II at ZAR250 million and indicated that other large commercial banks in South Africa may be looking at similar costs. Basel II compliance implies significant costs to banks. Richardson, Accenture’s banking expert in risk and regulation quoted by Bridge (2004:1) warned that delays in implementing Basel II would add an extra cost of about 10% of compliance. These extra costs will result from the need to hire more people and continued use of manual work in bank risk management systems to attain compliance. The total global cost of compliance with Basel II was estimated by Richardson at US$185 billion.

A global survey sponsored by Mercer Oliver Wyman, Accenture and SAP (Scott, 2004:1) noted that there is considerable uncertainty over the costs involved. About 31% of the respondents indicated that they do not have a cost estimate for Basel II compliance. Banks that provided estimates, those with assets of below US$100 billion expect a cost of €50 million or less whilst other large banks projected a cost of more than that. According to a research published by Towergroup Massachusetts based technology consultants, expenditure on operational risk technology systems is expected to rise to US$8.2 billion by 2007 from the current level of US$5.2 billion (Anon 3. 2004:1).
2.2.2. IMPLICATION ON CAPITAL REQUIREMENTS

An analysis of the likely effects of Basel II on capital requirements was undertaken by the BCBS in October 2002, dubbed the third Quantitative Impact Study (QIS3). The study included a range of banks across 43 countries (Basel Committee on Banking Supervision, 2003a:1). The study involved 188 banks from the 13 G10 countries and 177 banks from 30 other countries (emerging markets and developing countries). All the 15 European Union (EU) member countries took part in the study. Banks participating in the study were divided into two groups: Group 1 consisted of banks that were considered large, diversified and internationally active, with Tier 1 capital exceeding €3 billion. Group 2 banks comprised smaller, specialized entities.

It is worth mentioning that South Africa participated in the study and was included in the “other” country grouping (Basel Committee on Banking Supervision, 2003a:1). A total of eight South African banks participated in the study among them, FirstRand, Absa, Nedcor, African Bank Investments, Investec, Marriott Merchant Bank, Standard Bank and Gensec Bank. According to Davidson (2003a:8), four South African banks provided returns based on the advanced IRB approach, while three banks gave returns for the foundation IRB approach, with one bank giving information based on the standardized approach to credit risk.

Banks were requested to conduct the exercise using the three main options to setting capital charges for credit risk as well as the standardized approach for operational risk. The three main approaches to setting capital charges for credit risk are the standardized approach; the foundation internal ratings based (IRB) and advanced IRB measurement approaches. The table below indicates the overall percentage change in capital requirements.
The results indicate that capital requirements increased for banks in both country groupings using the standardized approach compared with current capital levels under Basel I. Most of the increase in capital requirements was however attributed to the new capital charge for operational risk. Using the foundation IRB approach, the study revealed substantial capital reductions for Group 2 banks in the G-10 countries and EU Group 2 banks. The reason behind the substantial reduction in capital for EU Group 2 and G-10 Group 2 banks was attributed to the fact that these banks on average are more retail oriented. Under the Basel II framework, retail exposures attract lower capital requirements compared to the current levels in the Basel I framework. Small capital rises were recorded for Group 1 banks in the G-10 countries and for banks in other countries under the foundation IRB approach. Capital reductions were also reported by Group 1 banks in the EU and G-10 countries under the advanced IRB approach relative to those under Basel I.

This indicates that Basel II encourages large internationally active banks to implement the more complicated advanced IRB approaches which results in significant capital requirements benefits. As depicted in the table above, capital requirements would be lowered substantially for banks using the IRB approaches compared to banks adopting the standardized approach. On the other hand, capital requirements could lower significantly for smaller, domestically oriented banks.

Table 2.1: Results on Overall Percentage Change in Capital Requirements

<table>
<thead>
<tr>
<th></th>
<th>Standardized</th>
<th>Foundation IRB</th>
<th>Advanced IRB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other Groups 1 &amp; 2</td>
<td>12%</td>
<td>4%</td>
<td>-</td>
</tr>
<tr>
<td>EU Group 1</td>
<td>6%</td>
<td>-4%</td>
<td>-6%</td>
</tr>
<tr>
<td>EU Group 2</td>
<td>1%</td>
<td>-20%</td>
<td>-</td>
</tr>
<tr>
<td>G10 Group 1</td>
<td>11%</td>
<td>3%</td>
<td>-2%</td>
</tr>
<tr>
<td>G10 Group 2</td>
<td>3%</td>
<td>-19%</td>
<td>-</td>
</tr>
</tbody>
</table>

Adapted from Basel Committee on Banking Supervision (2003a), QIS3, page 3
largely due to the generally lower risk perceived in this portfolio. The impact study also revealed that the new capital charge for operational risk more than outweighs any reduction in new credit risk capital requirements under Basel II. As such, some banks will have to reconsider whether they still want to offer some of their operational services to clients, and if so, at what price.

Thus the implication is that developing country banks which are characterized by lending to more risky counterparties and are more likely to use the standardized approach are likely to experience increases in capital requirements. On the other hand larger developed banks are more likely to witness a decrease in capital requirements.

2.2.3. MERGERS AND ACQUISITIONS

Bailey (2005:4) notes local banks in developing countries will find themselves increasingly capital constrained making them vulnerable to acquisition by advanced international banks able to offer them fresh capital injection and expertise sought by regulators. Notwithstanding such developments, many developing countries feel obliged to adopt Basel II, as without it developed country regulators may refuse their banks market access.

2.2.4. IMPLICATIONS ON BANK CUSTOMER RELATIONSHIPS

Kemp (2004:50) argues that the importance of external ratings in generating capital requirements will increase with the adoption of Basel II. Borrowers who are poorly rated are likely to attract high loan rates as lenders will need to allocate additional capital to mitigate against potential risks. Roberts (2003:26) supports this argument and adds that such developments will ultimately affect the bank customer
relationship and may accelerate towards disintermediation. He argues that the bank customer relationship is likely to be strengthened for companies with higher ratings. Banks will assign better ratings to companies they trust and know thereby giving prominence to preferred banking relationships. This is likely to be more pronounced to banks that use their own internal ratings than those that use external credit rating agencies (Stewart, 2004a:1).

The researcher notes that a number of markets in Africa, except South Africa, do not have credit rating agencies, which imply that banks would need to internally rate their borrowers. This ideally should result in a strengthened bank customer relationship as banks will compensate absence of external credit ratings by developing internal credit rating systems. However, as Neville (2003:29) indicates, a significant portion of lending in many African countries is public sector borrowing, which may result in prudent rating of parastatals very difficult. The researcher agrees with the foregoing because in Zimbabwe there are no credit rating agencies, which resulted in the RBZ developing a Modified Standardized Approach for calculating minimum requirements for credit risk. The RBZ encouraged banks to develop their own internal ratings, subject to the central bank’s approval. Taking cognizance that most of bank lending in Zimbabwe is indeed public sector borrowing, this makes it difficult for banks to practically rate such borrowers. As such, the expected improvement in the bank customer relationship may not be readily realized in Zimbabwe and other developing countries owing to dominance of public sector borrowing.

Cornford provides a differing view to the above notion on credit analysis in developing countries and indicates that:

"Basel II incorporates underlying assumptions about the nature of the relationship between a bank and its counterparties which, although increasingly accepted as the model to be followed, are not universally
applied. In Basel II this relationship is managed at arm’s-length, and decisions about lending and the provision of other banking services are based on reasoned analysis of the counterparty’s capacity to meet interest obligations and of other dimensions of creditworthiness. Where banking practices follow a different model, implementation of Basel II is likely to be slowed to allow for the required changes in such practices to be adopted or to provide time for regulatory reconciliation of the Basel II model with alternative principles” (Conford, 2006:25).

Conford gives the example of Islamic banking practices which do not allow interest and are based on different principles regarding the sharing of risk between the sources and users of bank finance. In such cases, credit risk analysis plays little or no role and the relationship is less arm’s length and more like an equity investment. Conford also noted the Asian banking practices where collateral takes priority over borrower credit worthiness, in what he described as pawn shop or collateral based lending. The same views were shared by Caprio and Honohan (2004) where they indicated that Basel II is fundamentally incompatible with lending practices in developing countries. They argue that Basel II does not recognize close ties between banks, the state and industry. Lending practices which go by names, state-led, directed or policy lending; name or relationship lending; related party or connected lending; and collateral based lending remain significant in many developing countries today. Consequently, in most instances credit is extended, not on the basis of sound credit worthiness, but either on relationships or policy lending.

Hai et al. (2006) in their paper investigated the issues, challenges and implications of Basel II implementation of the developing economies with focus on Pakistan. They argued that, especially for developing counties, striking a right balance between regulation, supervision and market discipline is a difficult task. It requires the banks to develop internal risk models and advance risk management system.
Taking into account the concerns that may arise during the Basel II implementation, it may be necessary for regulators to adopt a flexible approach for implementation. For the implementation of this data intensive, technology driven Capital Accord, Pakistan were to direct more resources to ensure that banking supervision in the 21st century is more dynamic, more preventive, more inclusive and more transparent (Caruana, 2006).

The researcher strongly agrees with such different banking practice in developing countries, in particular Zimbabwe, as evidenced by the RBZ directing banks to lend to certain sectors of the economy (policy or directed lending) which does not confirm to Basel II standards. More specifically, the RBZ directed lending as follows:

"... banking institutions are required to reorient their portfolios such that loans to the SME sector should constitute at least 30% of the total loan book. The Reserve Bank will conduct monthly assessments to monitor compliance and any institution found wanting, will face severe penalties. Given the current banking sector loans of $3.5 billion as at 31 December 2012, an allocation of 30% to the SME sector will translate to loans of $1.05 billion. Assuming $40,000 is granted to each SME borrower, a total of between 25,000-30,000 clients would benefit thus creating or sustaining more than half a million jobs per annum. As the loans grow each year, we envisage corresponding increases in the number of jobs created or people empowered by the banking sector" (RBZ Monetary Policy Statement, January 2013:43).

Previously, the RBZ had, through a Press Statement dated 6 November 2009, directed banking institutions to orient their lending portfolios to achieve sectoral credit levels of 30% to Agriculture, 25% to Manufacturing, 25% to Mining while all the other sectors will account for 20% of all credit. Thus, whilst banks are being encouraged to adopt sound credit risk assessment in line with the Revised
Framework, they are caught between a “rock and hard place” as the same authorities are directing alternative models of lending practices i.e. policy or directed lending which are contrary to Basel II standards.

2.2.5. CREDIT RISK MITIGATION

Under the Basel II framework, commercial real estate is not recognized as eligible instrument for collateral based lending, preferring instead financial collateral such as cash and securities. Yet commercial real estate is the most recognized collateral in most developing countries (Gabarretta, 2003). Singapore and Hong Kong argued for a more fair treatment of eligible collateral under Pillar 1, however, because they are non-G10 member countries, a few concessions were granted. Indeed, in Zimbabwe most banks accept commercial real estate as collateral. The Basel II framework, by not recognizing commercial real estate as eligible collateral results in banks allocating more capital on their exposure i.e. 100% risk weighting. The results will be the same as those under Basel I framework.

2.2.6. HOME – HOST SUPERVISORY ISSUES

Basel II is built on the premise of consolidated supervision. The concept of consolidated supervision may present difficulties for home and host supervisors and even slow the pace of implementation if the supervisors apply different rules. This challenge is likely more to affect developing countries as the concept of consolidated supervision is not fully embraced, or is still in its infancy (Cornford, 2006). Home-host supervisors are more concerned with regulatory arbitrage in banking operations across jurisdictions. The key home-host considerations are:

- different approaches to implementation
- different implementation time tables
- different interpretation of Basel II etc.
This could happen, for instance, if the supervisor of an international bank in its parent country applies different rules from that of its subsidiary in a host country. The parent supervisor may approve the international bank’s adoption of an IRB approach, whilst the host supervisor may require all banks subject to its supervision to use the Standardized approach due to limitations in its supervisory capacity. The host supervisor may not entrust the parent supervisor to assess capital adequacy of the foreign subsidiary. If the host supervisor insists on the subsidiary to use the Standardized approach, whilst the parent bank is using the IRB approach, then there will be additional costs imposed on the parent bank and burden on the parent supervisor when integrating the subsidiary’s use of different approaches into financial reporting of its operations.

Cornford argues that these differences between national supervisors are capable of complicating the implementation of Basel II as well as increasing its cost, in particular, in developing countries where a number of banks are foreign owned. Cornford indicated that it will be difficult to predict how important these differences would be. In the European Union, the principles of home country control and mutual recognition accord primary authority to the parent supervisor in the case of branches. The application of the new capital rules and the authorization of the different approaches is carried out by the “consolidating supervisor” i.e. the supervisor with primary responsibility for supervising the cross border banking group. Cornford however asserts that though the capital rules may not be a source of difficulty in the EU, this does not mean that they will be easy to apply.

There is bound to be regulatory arbitrage in banking operations across jurisdictions. Daoud (2003) adds that the home-host issue will probably be one of the most difficult for emerging market and developing country regulators to navigate. If a subsidiary of a foreign bank is a relatively large bank for a host country, but small
compared to a bank's global operations, home and host supervisory priorities may differ.

Powell (2004) agrees with the argument put forward but argues that home-host regulatory and supervisory issues are already present under Basel I, but they are accentuated under Basel II because there is greater scope for multiple regulatory treatments and because a number of cross-border issues remain unresolved. Related to the cross border implementation challenge is the issue that in many developing countries, only banks are required to implement Basel II. Other financial services providers such as securities firms and insurance companies are not mentioned yet the Revised Framework presupposes consolidated supervision for banking groups. As such this presents problems to a banking group in integrating management and accounting frameworks as the new capital rules are only specific to banks, yet its insurance arm and securities firm maybe subject to different rules.

2.2.7. TECHNICALITY OF BASEL II

The Consultative Paper 1 of 2001 conducted by the Financial Stability Institute initially set the deadline for implementation for Basel II as 2004 for BCBS member countries. However, this timetable was proven to be too demanding due to the technicality of the data requirements. Resultantly, Consultative Paper 2 of April 2003 conducted by the FSI set a new deadline of 2006. Different countries’ supervisory priorities, coupled with diverse problems confronting national supervisors led to the relaxation of the implementation date. There was explicit acknowledgement that the implementation of the New Accord was just not a one-off act of signing up to the adoption of the accord, but a process that requires considerable time and resources. The BCBS recognized that the implementation process required additional impact assessments and large scale legal and regulatory changes with respect to capital and risk management. About nine countries from the BCBS member countries
including US and Germany, in 2006, indicated that there was need for the national economies to make additional impact assessments prior to full adoption of Basel II. Even the BCBS itself announced the need to carry out a follow-up impact assessment to its own Quantitative Impact Study 3 (QIS3), widely known as Quantitative Impact Study 4 (QIS4).

According to Cornford (2006), the US regulators, following a preliminary review of the QIS4 announced that they will delay issuing rules implementing Basel II as they intended to make further analysis on the impact of the rules on their national economy. Regulators in the US, made up of the Federal Reserve System, Federal Deposit Protection Corporation, Office of the Comptroller of Currency and Office of Thrift Supervision, were concerned of the results of QIS4 which showed major reductions in regulatory capital and the dispersion of changes among banks and among portfolio types. Taking cognizance of these hurdles, the BCBS proposed that the implementation of the advanced approaches should be continued beyond 2006 until the end of 2008. Thus implementation of Basel II is marred with shifting deadlines as authorities will still require time to assess impact and also due to the technicality of the subject.

According to Vladimir Gamza, (Chairman of the Risk Management and Basel Accord Implementation Committee appointed by the Association of Russian Banks), quoted in the Global Risk Regulator (Newsletter of February 2007), the Central Bank of Russia (CBR) initially intended to implement Basel II by 2007, then 2008. Gamza added that implementation of Basel II by 2010 by the CBR was highly unlikely as the central bank had not done anything to prepare Russia’s 1,100 banks for Basel II. He noted that implementation of the new standard was slowed down by language barriers and inertia. A draft translation of the revised framework was only put on the CBR website in January 2007. The Association of Russian Banks (ARB) was spearheading the implementation process. The Risk Management and Basel Accord
Committee will organize training and official recognition conferences to educate the required experts; arrange translation of key Basel II documents; put together suitable scientific materials and methodology; ensure a wide-ranging use of international experience; and create a web-based system of efficient cooperation among the committee members.

The Global Risk Regulator further notes that another reason that could be resulting CBR laxity from implementing Basel II is the fact they have more pressing issues. Russians have little confidence in banks, in particular, private sector banks. Whilst large banks have embraced the concept of risk management and had in place fairly detailed credit risk management practices the majority of Russian banks were still at a very early stage of development according to Gamza. Operational risk management systems were reported by Gamza to be still “in a kind of embryonic state” at most banks. The researcher supports the view and adds that Zimbabweans too have little confidence in the banking system owing to high bank charges and a number of banks’, promulgation of economic empowerment regulations and varied views over its implementation have further dented confidence in the banking sector.

“The freezing of Zim-dollar deposits eroded the transacting public’s confidence in the banking system. Accordingly, there is an unusually strong preference to hold and transact in cash instead of making use of the banking system... The exorbitant banks charges currently levied by banks as well as negligible interest rates offered on deposits have also conspired to severely dent the confidence of the banking public.” (RBZ Mid-Term Monetary Policy Statement, July 2011:44).

2.2.8. ASSET QUALITY

In 2007, China highlighted that it was still fully implementing the 1988 Accord and noted that it will not rush to implement Basel II, arguing that shifting to new rules
soon after implementation of the Revised Framework would pose considerable constraints on both the supervisors and the banks (Cornford, 2006:9). Cornford further indicates that China highlighted that implementation of Basel II was considered to be too complex for banks in China as their balance sheets were characterized with high levels of non-performing loans. Chinese authorities had to find a solution to such poor asset quality which would result in either increased provisioning or a fall in credit to certain sectors or firms.

The researcher supports the foregoing mainly because Zimbabwean banks have a high prevalence of non-performing loans, with a number of banks being placed under curatorship having high ratios on non-performing loans of above 15% against a recommended benchmark of 5%. The RBZ noted:

“the gradual deterioration in asset quality as reflected by the level of non-performing loans which is now trending towards the watch list category (above 15%). Asset quality challenges can potentially heighten liquidity risks given the current operating environment where credit is largely financed by volatile short term deposits. In this regard, it is imperative that banking institutions enhance their credit risk management systems with special emphasis on credit assessment, origination, administration, monitoring and control standards” (RBZ Monetary Policy Statement, January 2012:24).

The RBZ added that the high levels of non-performing loans are mainly characterized by loans to insiders and connected parties. The RBZ increased provisioning levels under the Basel II framework in a bid to encourage banks to strengthen their credit risk assessment processes. The table below provides a comparison between the provisioning levels under Basel I and the proposed provisioning under Basel II currently being used for the parallel run:
Table 2.2: Provisioning under the Basel II Framework

<table>
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<tr>
<th>Grade</th>
<th>Provisioning Percentage (of Exposure)</th>
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<tbody>
<tr>
<td></td>
<td>Basel II Framework</td>
</tr>
<tr>
<td>1 to 2</td>
<td>1%</td>
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<tr>
<td>3</td>
<td>2%</td>
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<td>4</td>
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<tr>
<td>9</td>
<td>50%</td>
</tr>
<tr>
<td>10</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Adapted from RBZ Monetary Policy Statement of 31 July 2012, page 62

2.2.9. DATA AVAILABILITY

Non-availability of high quality data and its usability is likely to pose a number of problems for developing countries as they try to make use of advanced approaches to Basel II implementation (Bailey, 2005:28). For a bank to qualify for using the IRB approach, it must have been using a rating system largely in line with the requirements of the Basel II framework for at least three years. On the other hand, the data used for the estimation of Probability of Default (PD) must have been observed by the bank for a period of at least five years. The length of the period of observation for data used to estimate Exposure at Default (EAD) and Loss given Default (LGD) must be at least seven years. Banks are likely to face challenges in calculating the capital charge for say credit risk, as components of the formula to estimate risk-weighted assets may not be available for IRB approaches. This is further compounded by the absence of a clear definition of default and inconsistent rules for valuing collateral to reliably estimate LGD. Cornford argues that requirements of the formula to estimate risk-weighted assets may not be met if insolvency regimes are favorable to debtors as is most evident in developing countries. He also argues that lack of relevant experience also amplifies the challenges of internally estimating EAD.
The researcher agrees that lack of sufficient data negatively impacts on calibration and benchmarking of models. Such lack of data seems to be more pronounced in Zimbabwe. When Zimbabwe adopted the multi-currency system in February 2009, data denominated in Zimbabwe dollar currency was lost, so banks are still working on building such databases. The problem is further compounded by the absence of rating agencies to rate issuers. Ideally banks should have relied on internal models to circumvent the problem of unrated counterparties, but absence of such data presents yet another problem. Even if banks were to use their internal estimates, Waller (2003) argues that supervisors in developing countries would face practical challenges in implementing Pillar 2 (Supervisory Review Process), relating to the approval and validation of internal capital allocation models for banks. Lack of data warehouses and a general paucity of data on historical default rates is a major issue in developing countries. In addition, a number of banks do not have a rating system in place to rate borrowers. For those banks that have the rating system in place the worry is does it comply with the requirements determined by the Basel Committee (Powell, 2004).

2.2.10. BASEL II AND PROCYCLICALITY

There have been studies on the impact of Basel II on capital flows to developing countries, some of which is surveyed in Daoud (2003). This growing literature points to the negative effects of adopting the new risk weights and what this could have on international capital flows to developing countries.

Griffith-Jones, Spratt, and Segoviano (2002) and Weder and Wedow (2002) echoed the same sentiments and argue that Basel II could lead to an international credit crunch for developing countries and emerging markets, due to a combination of reduced volumes of credit and the increase in the pricing of
loans, as regulatory capital requirements may feed through international lending rates.

Griffith-Jones et al (2002) have argued, it is very important to allow international banks’ subsidiaries in developing countries to continue to use the Standardized Approach on a permanent basis and not be compelled to move to the IRB approach. They argue that this would diminish uncertainty about the capital requirements such banks would face, and remove the possibility of a large proportion of the banking system in poorer countries having an incentive to concentrate their lending on higher-rated borrowers.

Researchers have also studied the pro–cyclicality debate of Basel II implementation. While Basel II purportedly intends to improve financial stability by depending on banks’ internal rating systems that are better aligned to actual risks, this would only prove to have the contrary systemic impact because of the increased propensity towards pro-cyclicality. Kashyap and Stein (2004) argued that the operation of the new Capital Accord will lead to more pronounced business cycles. The arguments suggest that in times of recession when a bank’s capital base is eroded by loan losses, its existing (non-defaulted) borrowers will be downgraded by the relevant credit-risk models, forcing the bank to hold more capital against its current loan portfolio. To the extent that it is difficult or costly for the bank to raise fresh external capital in bad times, it will be forced to cut back on its lending activity, thereby contributing to a worsening of the initial downturn. In comparison Basel I works as a kind of an automatic stabilizer, the risk weight remains stable over time, in recessions it makes loans cheaper that they would be under individual risk assessment conditions, in booms loans would be more expensive.
Kashayap and Stein (2004), emphasize the cyclicality aspect of Basel II capital regulations by using simulations. Their results suggest that the new Basel II capital requirements have the potential to create an amount of additional cyclicality in capital charges that is, at a minimum, economically significant, and that may be – depending on a bank’s customer mix and the credit risk models that it uses – quite large. However, Morgan and Rohatgi (2000), bring a new dimension to the argument when they argue that it is not clear that the new Accord will necessarily exacerbate this pro-cyclicality. They suggest that Business cycle fluctuations can have a major impact on credit portfolio loss distributions. Carey (2002), using re-sampling techniques, shows that mean losses during a recession are about the same as losses during an expansion.

Bangia et al. (2002), using a regime switching approach, find that capital held by banks over a one-year horizon needs to be 25-30% higher in a recession that in an expansion. To be sure, it is not clear how to detect pro-cyclicality, even if it were to exist. Are losses higher in a recession because of a bad draw from the loss distribution or because cyclical factors affecting the loss distribution have shifted? Rojas-Suarez (2002) argues that the lateness and the cyclical determination of credit rating agencies’ ratings means that ratings improve and capital charges decline during booms, while credit ratings are lowered during the bust, implying higher capital requirements during a recession. So far, the major credit rating agencies have had a rather poor record in forecasting crises, and there have been widespread instances where ratings downgrades coincided with or even followed deteriorations in creditworthiness which were sometimes associated with crises. Thus, the Standardized Approach’s reliance on credit rating agencies for the assessment of credit risk and for the setting of risk weights does give rise to potential pro-cyclicality.
Tunner (2002) proposed a number of possible counter-cyclical measures to address the pro-cyclical concern. Of the options available the one that has attracted the most support, and even some degree of consensus, is for regulators to encourage or better, require - higher general provisions to be made for possible loan losses to cover normal cyclical risks. The BCBS recognized the cyclical concern, but argues that the benefits outweigh the costs. However, the trade-offs in terms of costs and benefits are viewed in terms of their impact on the major banks. The developing world will most probably feel the costs disproportionately (reduced lending coupled with increased scale of crises) while simultaneously attracting few, if any, of the benefits. Also, it may be that the Committee is more broadly underestimating the likely impact upon the business cycle and thus the financial system’s propensities for crises, these systemic considerations have significant implications for the developed and developing worlds alike.

2.2.11. BUSINESS IMPACT

Ischenko & Samuels (2001:9) indicates that the introduction of Basel II will significantly impact mortgage and corporate lending. Under the Basel I framework, corporate and mortgage lending attracted high risk weightings compared to exposures to sovereigns and banks, which enjoyed very low risk weightings. As such capital requirements for these two classes of assets were very high. On the other hand, bank investors penalized banks for holding high levels of exposure in mortgage and corporate lending as margins were thin and opportunities for cross selling limited. Basel II reverses this thought process as mortgage and corporate lending now have favourable risk weightings.

Neville (2003:29) highlights that for banks that carry out specialized lending such as asset finance, commercial real estate and project finance will be significantly
disadvantaged under Basel II as the risk weights for such business would lead to high capital requirements. Neville suggests that banks with small divisions undertaking specialist finance would consider exiting which would open doors for non-bank financial institutions which are not formally subject to Basel II to carry out leasing, asset finance and similar businesses.

Himmelberger et al (2004:5) notes that a survey carried out in 2004 involving bank senior executives across the world reinforced the changes expected through the QIS3 survey. The survey revealed consensus towards increased competition on lending to the retail sector which comprises the small to medium enterprises. Specialized lending and corporate lending will be biased towards less risky customers contributing to selective lending. There is a view that Basel II might penalize smaller customers of banks because all the capital savings would be concentrated in other areas of the business. Blaauw (2003:2) disputes this argument arguing that banks cross-subsidize. He argues that banks are aware that certain market segments may be less profitable but growing. Banks will cross-subsidize because they want capital savings in some markets allowed by Basel II whilst at the same time they would want to be competitive in other market segments. Thus, at the end of the day, Basel II will not leave out some sectors of the economy.

Garside & Pedersen (2002:103), however, seem opposed to Blaauw’s argument, indicating that super monoclines are likely to emerge as banks take advantage of reductions in capital requirements in large corporate or retail portfolios. This will create more uniform portfolios which will make it easier to employ advanced IRB approaches. As such, Garside & Pedersen (2002) are of the view that only the most sophisticated banks are more likely to manage broad portfolios and compete successfully on this basis.
2.3. BENEFITS OF IMPLEMENTING BASEL II

Basel II encourages ongoing improvements in risk measurement, assessment and mitigation. Thus, over time, it presents banks with an opportunity to gain competitive advantage by allocating capital to those processes, segments, and markets that demonstrate a strong risk/return ratio. Developing a better understanding of the risk/reward trade-off for capital supporting specific businesses, customers, products, and processes is one of the most important potential business benefits banks may derive from Basel II, as envisioned by the Basel Committee.

Basel II should produce pricing that is better aligned with risk, since the ability to quantify risk more precisely is crucial to being able to price adequately to cover that risk. Basel II will also help lenders explain to borrowers why costs are rising for weaker credits and falling for stronger credits (BCBS, 2004b).

Basel II promotes decision making and encourages both banks and supervisors to efficiently and effectively use limited resources (Grenadier and Hall, 2006). Banks will have to choose methodologies that fit their abilities, business mix and strategies. A haphazard approach may constrain technical infrastructures and exhaust the budget without achieving desired results. Grenadier and Hall (2006) suggested a number of actions that may be considered to promote successful implementation of Basel II as follows:

a) Board and senior management buy-in;
b) Embedding a culture of risk management across all business lines;
c) Integrating Basel II into existing risk processes and other risk initiatives;
d) Team work across product, business, and customer lines;
e) Creating incentives for compliance; and
f) Building flexibility into all initiatives.
Delisle (2004) shares the same view with Grenadier and Hall and affirms that the board and senior management must give more than lip-service by demonstrating to all employees that Basel II and better risk practices are a priority. Lack of management buy-in seriously impedes Basel II implementation process. As such, the tone must be set at the top to ensure accomplishment of Basel II objectives and commitment of resources. Delisle postulates that naming a Chief Risk Officer, who reports directly to the Chief Executive Officer and a designated Board Risk Management Committee, facilitates implementation of Basel II requirements.

The researcher agrees very much with the foregoing in that commitment by the top management of bank is a necessary ingredient in the implementation of Basel II. Investors and the public are likely to benefit from greater transparency when banks implement Basel II. More extensive disclosure of risk exposures and methodologies under Basel II should improve the perceptions of customers, employees and investors about banks with better risk profiles (Carey and Hrycay, 2001).

2.4. CHAPTER SUMMARY

The chapter discussed the implications, issues and challenges of Basel II implementation, in particular in developing countries and provided differing views by authors on the subject. Benefits of adopting the Revised Framework were also explained. The next chapter discusses the methodology that was used to collect data.
3. CHAPTER THREE - RESEARCH METHODOLOGY

3.1. INTRODUCTION

This chapter describes the steps followed in carrying out the study and also provides a brief justification of the methods used to collect and evaluate data. The main focus of this study is to establish the challenges and implications of Basel II implementation on the Zimbabwean banking system.

3.2. RESEARCH DESIGN

The study was quantitative in nature. According to Dane (2004) the approach to be used should be chosen after deciding on the data to be collected and depending on the circumstances surrounding the exercise. A quantitative method was used in this research so the data collected would be correct and relevant. Quantitative methods involve the use of numerical measurements and statistical analyses of measurements to examine social phenomena (Saunders, Lewis & Thornhill, 2003). In terms of this approach, questionnaires were designed and a sample of the employees was requested to complete them in order to assist in ascertaining their perceptions of the impact of implementing Basel II on the banking system in Zimbabwe.

According to Ahuja (2005: 23) quantitative methods include reviewing a substantial amount of literature in order to provide direction for the research questions. In quantitative studies, questions, objectives and hypotheses represent specific restatements of the purpose of the study. These are used deductively as a basis for advancing research questions and to describe related literature in a separate section in order to compare with the findings of a quantitative study plan. Quantitative research is based on attempts to apply the methods of natural science to the human
sciences. Its strengths are that it provides data that are easily quantifiable and based on reasonably objective evidence that lends itself to rigorous analysis. On the other hand, according to Sekaran (2003), quantitative research fails to distinguish people and social institutions from the world of nature. In addition, the reliance on instruments and procedures hinders the connection between research and everyday life.

3.3. RESEARCH STRATEGY

A sample of employees from Zimbabwean banks was selected to participate in the study, as employees have information about the impact of implementing Basel II to the banking system. In order to accomplish the research aims and objectives, the researcher used the survey approach. The survey approach is carried out on a sample of respondents from a selected population through administration of a questionnaire. Surveys are normally used where large volumes of data are involved with quantitative methods of analysis. In this study a sample of a hundred questionnaires, which is considered a large amount of data, was used.

3.4. POPULATION AND SAMPLING TECHNIQUES

3.4.1. POPULATION

Polit and Hungler (1999:37) define population as the totality or aggregate of all the subjects, objects or members that conform to a set of specifications. In this study, the population is confined to the banking sector and the regulatory and supervisory authority responsible for bank supervision. As at 31 December 2012, the banking sector comprised 22 operating institutions, which include 16 commercial banks, three (3) building societies, two (2) merchant banks and one (1) savings bank. The
Reserve Bank of Zimbabwe regulates and supervises banking institutions through its division namely, Bank Licensing, Supervision and Surveillance.

The research was centred in Harare taking cognizant that the target population has head offices situated in Harare and information to solve the problem at hand was readily accessible. The Risk Management Department is largely responsible for spearheading the Basel II implementation process. All the banking institutions have their Risk Management Departments housed at head office. The Bank Licensing, Supervision and Surveillance Department of the Reserve Bank of Zimbabwe is also housed at the central bank head office in Harare. The employees, who are the staff and management in the Risk Management Department and bank examiners at RBZ who are in the Bank Licensing, Supervision and Surveillance Department, are the target population. This group of people was selected because it is considered to be in a better position to have knowledge about Basel II and an appreciation of the implementation process.

3.4.2. SAMPLING STRATEGY

In order to avoid bias, a simple random sampling strategy was used. The aim of the sample size was to have an appropriate number of respondents to participate in the study. Random sampling was used in the study because it allows every member in the population to have equal chance of being selected to participate (Saunders et al., 2010).

3.5. DATA COLLECTION METHODS

This section is going to look at collection of both primary data collection and secondary data sources.
3.5.1. PRIMARY DATA COLLECTION INSTRUMENTS

QUESTIONNAIRES

Data were collected using questionnaires. Questionnaires are data collection instruments that enable the researcher to pose questions to subjects in his/her research in order to obtain answers to the research questions. Questionnaires were used because it eliminates interviewer bias and guarantees anonymity of respondents as most respondents in the research preferred to remain anonymous.

The questionnaires covered a broad array of issues concerning the implications and challenges as regards Basel II implementation on the Zimbabwean banking system. Questions were specifically designed to obtain relevant information from the sampling unit pertaining to the following:

a) Relevance of Basel II to the Zimbabwean banking sector
b) Challenges faced in adopting the new capital adequacy framework
c) Zimbabwean banking sectors’ level of preparedness to implement Basel II

The design of a questionnaire is critical to ensure that the correct research questions are addressed and that accurate and appropriate data for statistical analysis is collected. The questionnaires were designed in three sections, the administrative, classification and the information sought sections. The administrative section is used to record the identity of the researcher and the respondent. The classification section describes the respondent by a number of demographic characteristics which include class in which the respondent’s banking institution is in, years of experience in risk management and highest qualification in risk management attained.

The questionnaire offers a number of advantages. Firstly, it does not require trained interviewers. This was very handy to a student who has not studied any course in human psychology. Respondents were given the opportunity to answer the questions while the researcher was not present (except where they willingly wanted
to do so during her presence). Also, no question asked respondents’ personal names, this gave them anonymity and freedom which can generate more reliable and valid information. The other advantage stemming from the above facts is that if a follow-up is made, a very high response rate will be obtained.

Also, a questionnaire is a standard instrument i.e. the same questions are asked to different respondents. This standardization allows data obtained from different respondents to be interpreted comparatively, and to be generalized to other situations. The other advantage of a questionnaire is that it is relatively inexpensive compared to other instruments. This was very desirable because the researcher was operating within the confines of a very tight budget.

The questionnaires had their drawbacks. Basel II is a technically challenging topic. The major challenge the researcher faced was in trying to construct simple questions in a way that can be understood by any of the sampling unit. In addition, the technique did not allow for further probing and observation of non-verbal communication. The researcher used closed questions to ensure easy data analysis, and save the respondent’s time to complete the questionnaires.

**QUESTIONNAIRE DISTRIBUTION STRATEGY**

There are three major means of distributing questionnaires; direct mail, personal distribution and e-mail. Direct mail involves sending questionnaires to the respondents by mail. Personal distribution entails delivering the questionnaires by hand to the respondents and leaving them to go through the questionnaires and provide feedback. The e-mailing technique involves sending questions using e-mail and responses will also be expected to be received using the same technique.
Considering that the target population is based in Harare where the researcher is also based, the researcher made use of the personal distribution and e-mail techniques. Direct mail and e-mail distribution techniques were avoided because the questionnaires take time to be delivered to the recipients.

3.5.2. SECONDARY DATA COLLECTION METHODS

Ghauri and Gronhaug (2002) define secondary data as “information collected by others for purposes that can be different from ours.” Secondary data clarifies and redefines the problem and aids in primary research design, background information and foster creativity.

The most important reason for applying secondary research is to accumulate further information which might have been unobserved during primary research. The use of secondary data is less time consuming as well as less expensive since databases and library research will be applicable to locate the information.

As a part of secondary research, the researcher used many documents in the evaluation of secondary data available from the British Council Library. Documentary evidence was used in the form of published reports by the Bank of International Settlements, Basel Committee on Banking Supervision, RBZ and IMF and other documents and information in the public domain. Throughout, quantitative methods were applied in collecting and processing data for the research.

The researcher benefited from the use of documentary review as information was readily available. In addition, various sources of information were used to give the researcher wide scope. It was a cost effective method of data gathering in terms of time and finance. However, locating suitable documents was a challenge as some
libraries did not file the records in a user friendly manner. In addition, issues to do with the following also arose:

a) **Access block** – some information was deemed highly confidential therefore the researcher was denied access.

b) **Reporting bias** – most documents have almost in-built proneness to subjectivity because human beings tend to report more favorably about themselves.

Research carried out from various websites on the internet is listed under the bibliography section. The internet was considered of immense help as information was readily available, various sources could be accessed in a short space of time. In addition, the process was time and cost effective and enabled the researcher easier and fast access to documents by experts on the subject under study. However, the use of the internet posed some disadvantages. Searching through the various links was time consuming, whilst the credibility of some data sources may be questionable since they may not have been easily verified.

3.6. **RESEARCH PROCEDURE**

The researcher personally collected the completed questionnaires in respect of those that were hand delivered to respondents. In a number of cases where the respondents willingly completed the questionnaires during the researcher’s presence, informal discussions were held and these were particularly brainstorming. A total of 40 questionnaires were collected. When the questionnaires were gathered they were coded and cleaned. Data was entered using Epi-info. It was then exported to statistical package of social scientists (SPSS).
3.7. RESEARCH LIMITATIONS

The researcher found it difficult to access all the requisite information for the research. The main challenge was with respect to access of recent empirical research on the impact of Basel II in developing countries.

3.8. CHAPTER SUMMARY

Chapter three discussed the methods used to collect and evaluate data. It outlined the research design, research method, the population under study, the sampling procedure and the method that was used to collect data. The chapter provided the advantages and disadvantages of research instruments used as well as ethical considerations relating to the research.
4. CHAPTER FOUR - RESEARCH PRESENTATION, ANALYSIS AND DISCUSSION

4.1. INTRODUCTION

This chapter presents the findings of the study and discussions on the findings. The purpose of this study as defined in the problem statement was to establish the challenges and implications of Basel II implementation on the Zimbabwean banking system. The study was brought about by the announcement by the RBZ for banks to continue with the parallel run of Basel I and Basel II through 2013, yet the RBZ had initially set 1 January 2013 as the date of full implementation with Basel II, where Basel I will no longer be used in Zimbabwe. In January 2013, the RBZ indicated that banks were at various stages of implementing Basel II and any identified weaknesses were being addressed.

The study sought to establish these weaknesses, or rather challenges the banking system in Zimbabwe was facing and the implications on banking business as far as Basel II adoption is concerned. The major findings of this study, presentation and discussion thereof are presented in this chapter.

4.2. RESPONSE RATE

A total of 100 questionnaires were sent to banking institutions operating in Zimbabwe. For these 100 questionnaires, 40 were successfully completed and returned giving a response rate of 40% which warrants validity and reliability of the study findings.
4.3. DEMOGRAPHICS INFORMATION

This section provides an analysis of the demographic information which is the nature of banking institutions, area of responsibility and length of service of the respondents.

CLASS OF BANKING INSTITUTIONS

Figure 4.1 below shows that 85% of the respondents were from the commercial banking sector, 2.5% were from the building society, 7.5% were from merchant banks and 5% were from the savings bank. This is in line with the size of the target population of the banking industry in Zimbabwe where the majority are from the commercial banking sector.
Figure 4.1: Class of Banking Institutions

Figure 4.2 below shows that 82.50% of the respondents were in risk management, 7.5% were from information and communication technology, 5% were from operations and 5% were from finance department. This implies that the researcher was biased towards risk management personnel as compared to other professions because the risk management personnel appreciate Basel II.
Figure 4.2: Area of Responsibility in the Organisation

The researcher sought to establish the period respondents have been working in their areas of responsibilities within their banks. The results for this analysis are shown in Figure 4.3 below.

The results show that 50% of the respondents had between 5 and 10 years in their areas of professionalism, 32.5% had between 3 and 5 years, 15% had 1 to 3 years and 2.5% had between 10 and 15 years. These results show that respondents were adequately experienced in their area of profession and have the possibility to have knowledge of Basel II.
4.4. CHALLENGES FACED BY THE BANKING SYSTEM IN IMPLEMENTING BASEL II IN ZIMBABWE

This section provides an analysis on the challenges which are being faced by the Zimbabwean banking system in implementing the Revised Framework. The challenges include lack of familiarity, skills unavailability, lack of buy-in from senior of management and unavailability of funds to fund critical IT infrastructure and skills upgrading. Generally, the analysis on challenges revealed that challenges on implementation are around governance, technology, expertise, financial and database issues.
SKILLS AVAILABILITY

The research went on to find out if there are skills available for the implementing Basel II. Figure 4.4 indicate the results.

Figure 4.4: Skills Availability

The analysis above shows that respondents agreed that there is lack of human skills, supervisors’ capacity to provide technical assistance and that it is very expensive to get trained on Basel II related subjects to ensure successful implementation and understanding of the concepts. On skills issues the researcher also establish if the banks conducted a gap analysis on Basel II implementation based on the minimum requirements set out by the RBZ during the last 12 months.
The analysis shows that 95% of the respondents argued that their banks conducted gap analysis over the last 12 months. Therefore the issue is not on the implementation of the gap analysis but it is the ability to do the gap analysis the right way since on figure 4.4 they argued that there are no skills to monitor and to implement the system. This is in line with Shleifer and Vishny (2002) who shared a similar view to the Basel Committee on Banking Supervision as well as Warner (2003), who warned that Banks in emerging markets would face serious implementation challenges due to lack of adequate technical skills, under development of financial markets, structural rigidities and less robust legal systems.

**FINANCIAL AVAILABILITY**

This section provides analysis on the adequacy of the budget and lack of financial resources to implement Basel II in the banking sector of Zimbabwe.
The analysis above shows that the mean response on the issues to do with financial factors was approximately 2. This implies that respondents agreed that inadequate budget and lack of financial resources are impacting negatively to the implementation of Basel II in the banking sector of Zimbabwe. This is supported by Mayor (2005) who cited lack of financial resources as the major challenge likely to be faced by developing countries in implementing Basel II. Banks are required to make relevant budgets for Basel II implementation and this should cover IT requirements and all the training requirements.
DATABASE

This section provides an analysis on the need to build long and reliable database the accessibility of the data in formats easily understandable to the users of the system.

The analysis revealed that the mean response was about 2 which we agree on the questionnaire lirket scale. This is skewed towards strongly agree which implies that there is need to maintain a long and reliable database and that the unavailability of required data of least three years in an easily accessible or comprehensive format is

Figure 4.6: Database
challenging the implementation of Basel II. This coincides with Bailey (2005) who indicated non-availability of high quality data as a challenge likely to be faced by developing countries as they try to make use of advanced approaches to Basel II implementation. The researcher agrees with the need for data as lack of sufficient data negatively impacts on calibration and benchmarking of models. This view is also supported by Waller (2003) that lack of data warehouses and a general paucity of data on historical default rates is a major issue in developing countries.

The researcher went on to establish the adequacy of the ICT infrastructure to support the implementation of Basel II. The analysis shows that 75% of the respondents argued that the IT systems of banks are not capable of producing, and on timely basis, the information of reports required for disclosure. This is in line with a similar assessment made by Powell (2006) who further warns that trying to adopt Basel II before a nation is really ready could be putting the cart before the horse in a way that could be dangerous for the overall financial system.

“Some developing countries have fairly basic banking markets and Basel II looks like trying to crack a nut with a technically complex and potentially expensive machine” (Powell, 2006:12).

In particular, he notes, some of the more advanced methodologies in Pillar I presume a level of sophistication not yet reached in many developing markets.

4.5. STATE OF READINESS

This section provides an analysis on the readiness of the both the banking system and the supervisory authority to implement Basel II by January 2013.
The analysis above shows that 55% of the respondents argued that the supervisor does not have adequate legal and regulatory authority to enforce compliance with Basel II standards. Generally this implies that the supervisor does have adequate intervention powers to enforce compliance with Basel II. This has affected the preparedness of the supervisory authority and there was no adequate legal framework to enforce compliance with established capital ratios. According to the BCBS (2004) implementation of Basel II requires a substantial resource commitment on the part of both banks and supervisors. The Committee argued that an adequately trained staff is central to a robust supervisory infrastructure and the successful implementation of Basel II. There is need to retain both bank and supervisory personnel with the quantitative expertise and skills to understand banks’

Figure 4.7 Legal and Regulatory Authority of Supervisor
rating systems, models and capital assessment strategies in advance of Basel II implementation. The researcher went on to find out when the last onsite was done by the RBZ on banking institutions. Figure 4.8 indicates the results.

![Figure 4.8: Last Onsite Examination](image)

Figure 4.8 above shows that, although 32% said it was last done in 2012, RBZ has not done its onsite visitation recently for most of the banks. About 30% of the respondents noted that onsite inspections were last carried out prior to 2009, before the country adopted the multi-currency system. This signifies lack of resources on the part of the supervisor to continuously monitor the adequacy of risk and capital management initiatives of banks which are the reinforcing pillars of Basel II.

The research went on to establish whether the Modified Standardized Approach developed by the RBZ closely mirrors the standards of external credit rating
agencies, such as Standards & Poor’s, Moody’s or Fitch. The results are shown in the Figure 4.9 below:

![Figure 4.9: Modified Standardised Approach for Credit Risk](image)

Figure 4.9 above shows that 62.5% of the respondents argued that the modified standardised approach for credit risk does not reach those developed by the standards of rating agencies such as Moody’s and Fitch. This aligns to the sentiments shared by Powell (2004) who argued that even if banks in developing countries were allowed to use their own internal ratings, the question that arises is whether the internal rating system meets the requirements of the Basel II framework.

The researcher also sorts to establish if the supervisor provided adequate technical support for banks to implement Basel II. The analysis showed that 97.5% of the respondents argued that the supervisor did not provide the adequate technical
support for banks to implement Basel II. This implies that RBZ has not been providing the banks with technical support for banks to implement Basel II. This is in line with the view put forward in the Global Risk Regulator (2007) where Gamza was quoted indicating the implementation of Basel II in Russia was slowed by language barriers and inertia and that the central bank of Russia had not done anything to prepare Russia’s 1,100 banks. Gamza indicated that the Central Bank of Russia initially had set Basel II date implementation of January 2007, then 2008, then 2010, but he indicated that possibility to implement by 2010 was also highly unlikely as quoted in the Global Risk Regulator. The Basel II document is highly technical in nature and therefore requires intensive training and explanation of concepts to ensure uniform interpretation across the board.

4.6. RELEVANCE AND APPROPRIATENESS OF BASEL II

The researcher also seeks to establish the relevance to and appropriateness of Basel II standards in the Zimbabwean economy. About 80% of the respondents indicated that Basel II standards are relevant for the Zimbabwean banking sector. The Basel Committee on Banking Supervision (2004) share the same sentiments but argue that supervisors in countries with scarce resources will need to find the appropriate balance between implementation of Basel II and other supervisory priorities. This approach recognizes that the objectives of Basel II are not to simply enforce compliance with a new set of capital rules. Rather, they are to build upon a solid infrastructure, and to enhance risk management, capital adequacy, market discipline and financial stability.

A follow up analysis was done to seek if banks that implement Basel II will improve their competitiveness. The analysis showed that 62.5% agreed that banks which have implemented Basel II will be more competitive than those which do not. This implies a positive relationship between competitiveness and the implementation of
Basel II. Griffith et al notes that competitiveness will be brought by promoting consolidated and cross border supervision, promoting confidence in the banking system, improving risk and capital management, enhances efficiency and effectiveness of banking operations, integrated data management and providing more information to bankers, supervisors, and other market participants.

4.7. CHAPTER SUMMARY

The present chapter has presented findings on the implementation of Basel II approach by the banks in Zimbabwe. These findings were discussed by linking with the literature reviewed by the study. The research found that banks face challenges to implement Basel II. It was also found in this chapter that there is no preparedness of implementing Basel II by the banks and the supervisor (RBZ). Although banks are facing financial and skills challenge it is crucial to implement Basel II for it is a way for banks to be competitive. These findings will make conclusions of this research. The next chapter presents the major conclusions and recommendations of the study.
5. CHAPTER FIVE - CONCLUSIONS AND RECOMMENDATIONS

5.1. INTRODUCTION

This chapter presents the conclusions and recommendations made by the study. The conclusions were made from the findings of the study. The study will recommend on the best way of implementing Basel II in Zimbabwe. Area of further study is also presented in this chapter.

5.2. CONCLUSIONS

The study made the following conclusions:

**CHALLENGES FACED BY THE BANKING SYSTEM IN IMPLEMENTING BASEL II IN ZIMBABWE**

The study concluded that Zimbabwean banks are facing a number of challenges in implementing Basel II. These challenges are lack of human skills. Human skill is a major challenge where there is no skilled or trained staff to implement Basel II. It is very expensive to get trained on Basel II related subjects to which Zimbabwean banks are failing to afford owing to liquidity challenges.

The supervisor who is the Reserve Bank of Bank (RBZ) has limited capacity to provide technical assistance. RBZ is not providing banks with the technical assistance to understand and then appropriately implement the requirements of Basel II. Banks are left at their own discretion and as such there may not be uniform interpretation of the concepts laid down in the Basel II framework in the entire banking sector, which factor is also exacerbated by lack of skills and expertise on
Basel II. In addition, the RBZ is not adequately monitoring banks through conducting onsite inspections, which may also be resulting from inadequate resources on the part of the supervisor.

Zimbabwean banks also suffer from inadequate budget and lack of financial resources, which is impacting negatively to the implementation of Basel II. In addition, banks in Zimbabwe do not have that the required data of at least three years in an easily accessible or comprehensive format. This has implications on using the internal rating based approaches, which is data intensive and yet there are no external credit rating agencies in Zimbabwe implementation of Basel II. The IT systems of the banks are not capable of producing, and on timely basis the database that is needed when implementing Basel II.

STATE OF READINESS

It seems that both the supervisor and banks were not sufficiently ready to implement Basel II by 1 January 2013. This has been evidenced by lack of adequately cooperation among the four regulators of the financial system in Zimbabwe namely; the RBZ, IPEC, the SEC and the DPC. Only recently, in 2012, did the RBZ announce that a Memorandum of Understanding had been signed amongst all the supervisors for mutual cooperation. However, the enabling regulations are still being discussed in Parliament in the Draft Amendment Bill to the Banking Act. Generally this implies that the supervisor does not have the legal and regulatory authority to enforce compliance.

In addition, the supervisor (RBZ) lacks adequate resources to conduct ongoing monitoring of banks as evidenced by 30% of the respondents indicating they were last supervised in 2008. This undermines the supervisory review process. In
addition, the lack by the RBZ to provide the much needed technical support to bank indicates that the supervisory authority itself requires capacity building to enable it to discharge its mandate. Again the overwhelming response that the Modified Standardised Approach for credit risk developed by the RBZ does not meet the criteria of those developed by external credit rating implies that, in general the supervisor was not ready to implement Basel II by 1 January 2013.

**RELEVANCE AND APPROPRIATENESS OF BASEL II**

The research concluded that Basel II standards are relevant to Zimbabwean banks despite the challenges that are being faced. The reason being that there is positive relationship between competitiveness and the implementation of Basel II as concluded in the research.

**5.3. TESTING THE PROPOSITION**

The proposition that the Zimbabwean banking system is facing challenges in implementing Basel II is true based on the findings of the study.

**5.4. RECOMMENDATIONS**

The study recommends that for the implementation of Basel II to be successful in Zimbabwe, there is need for a lot of training and awareness. Policy stability by RBZ and a budget is needed for the importation of skills for the appropriateness of the implementation of Basel II in the Zimbabwean banking systems.
The research recommends that board and senior management buy-in of the Basel II implementation process is a first priority for banks. The Chief Executive Officer must commit resources and funds to ensure compliance, otherwise nothing will be achieved. In order for to reduce challenges faced in the adoption of Basel II approach, Zimbabwean banks need to make substantial investments just to gather and store the right data. Banks have to develop or buy robust models and information technology (IT) systems and hire skilled staff and train them. Banks must combat cultural resistance to new risk procedures and avoid needless spending that might arise as banks navigate a thicket of new rules.

5.5. AREAS OF FURTHER STUDY

A further study is recommended to investigate the actual impact of Basel II implementation on the banking system in Zimbabwe after it has been fully implemented. Another area will be an investigation of the extent of competitiveness in the financial sector following full adoption of Basel II.
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7. APPENDICES

QUESTIONNAIRE

LETTER OF INTRODUCTION

25 Ashdown Drive
Ashdown Park
Harare

26 June 2013

Dear Respondent

RE: QUESTIONNAIRE ON BASEL II IMPLEMENTATION – CHALLENGES AND IMPLICATIONS FOR THE ZIMBABWEAN BANKING SYSTEM

1. Reference is made to the above subject.

2. I am a final year student at the University of Zimbabwe, Graduate School of Management, studying towards attaining a degree of Master of Business Administration.

3. As part of the requirements of the Master of Business Administration degree program, I am carrying out a research on the topic: Basel II Implementation – Challenges and Implications for the Zimbabwean Banking System.

4. Please find attached a copy of the research questionnaire which I am kindly requesting you to complete to the best of your knowledge. All the information you are going provide shall be treated with utmost confidentiality and used for academic purposes only.

5. For any clarification, please do not hesitate to contact the researcher on 0773 263632.
Your views and contributions will be greatly appreciated.

Yours faithfully

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Patience Chinomona (RO88253F)
QUESTIONNAIRE

INSTRUCTIONS

Please complete this questionnaire by filling in the spaces provided or ticking in the appropriate boxes. You are not required to provide your name.

A. DEMOGRAPHIC QUESTIONS

1. What is the class of your banking institution? (please tick the appropriate box)
   Commercial Bank [ ]
   Merchant Bank [ ]
   Building Society [ ]
   Savings Bank [ ]

2. Please tick your area of responsibility in the organisation.
   Risk Management [ ]
   Information and Communication Technology [ ]
   Finance [ ]
   Operations [ ]
   Other specify……………………………………

3. For how long have you been working in your area of responsibility in the bank?
   Less than a year [ ]
   1 – 3 years [ ]
   3 – 5 years [ ]
   5- 10 years [ ]
   10 – 15 years [ ]
   Above 15 years [ ]
B. PRACTICAL CHALLENGES FACED BY THE BANKING SYSTEM IN IMPLEMENTING BASEL II STANDARDS IN ZIMBABWE

4. Indicate your level of familiarity with the Basel II implementation process at your institution.
   - Very familiar [ ]
   - Fairly familiar [ ]
   - Heard of only [ ]
   - Never heard [ ]

5. How do you rate your institution’s implementation of Basel II standards as at 31 March 2013 in line with RBZ guidelines?
   a. Meets the criterion [ ]
   b. Some gaps remain; however, these are not critical [ ]
   c. Significant gaps in meeting the criterion [ ]

6. Below are some of the challenges of implementing Basel II. Do you agree?
   a. Lack of human skills and expertise
      - Strongly Agree [ ]
      - Agree [ ]
      - Not sure [ ]
      - Disagree [ ]
      - Strongly Disagree [ ]
   b. Lack of financial resources
      - Strongly Agree [ ]
      - Agree [ ]
      - Not sure [ ]
      - Disagree [ ]
      - Strongly Disagree [ ]
   c. No sufficient capacity to validate models
      - Strongly Agree [ ]
      - Agree [ ]
      - Not sure [ ]
      - Disagree [ ]
      - Strongly disagree [ ]
d. Supervisors’ capacity to provide technical assistance

Strongly Agree [ ] Agree [ ] Not sure [ ] Disagree [ ]
Strongly disagree [ ]

7. What challenges exist in securing an appropriate IT infrastructure to secure Basel II compliance?

a. Lack of board and senior management buy-in

Strongly Agree [ ] Agree [ ] Not sure [ ]
Disagree [ ] Strongly disagree [ ]

b. Inadequate budget

Strongly Agree [ ] Agree [ ] Not sure [ ]
Disagree [ ] Strongly disagree [ ]

c. Skills shortage

Strongly Agree [ ] Agree [ ] Not sure [ ]
Disagree [ ] Strongly disagree [ ]

d. Need to build long and reliable data base

Strongly Agree [ ] Agree [ ] Not sure [ ]
Disagree [ ] Strongly disagree [ ]

8. Are the IT systems capable of producing, and on a timely basis, the information or reports required for disclosure?

Yes [ ] No [ ] Not sure [ ]

9. Has your bank conducted a gap analysis on Basel II implementation based on the minimum requirements set out by the RBZ during the last 12 months?

Yes [ ] No [ ] Not sure [ ]
10. If yes, what are the critical gaps that have been identified?

- Governance [ ]
- Technological [ ]
- Expertise (human resources) [ ]
- Financial [ ]
- Data Collection and Management [ ]
- Data Validation and documentation [ ]
- Other Specify…………………………………………

11. Does your bank have a committee responsible for reviewing and assessing the gap analysis on an ongoing basis?

- Yes [ ]
- No [ ]
- Not sure [ ]

12. Unavailability of required at least three year data in an easily accessible or comprehensive format is challenging the implementation of Basel II

- Strongly Agree [ ]
- Agree [ ]
- Not sure [ ]
- Disagree [ ]
- Strongly Disagree [ ]

13. There is dearth of skilled professionals in my organization

- Strongly Agree [ ]
- Agree [ ]
- Not sure [ ]
- Disagree [ ]
- Strongly Disagree [ ]

14. It is very expensive to get training Basel II related subjects

- Strongly Agree [ ]
- Agree [ ]
- Not sure [ ]
- Disagree [ ]
- Strongly disagree [ ]
C. STATE OF READINESS FOR BOTH THE BANKS AND THE SUPERVISORY AUTHORITY TO IMPLEMENT BASEL II BY 1 JANUARY 2013

15. Does the supervisor have the legal and regulatory authority to enforce compliance with Basel II standards?
   Yes [ ] No [ ] Not Sure [ ]

16. Is there on-going dialogue between your bank and the supervisory teams?
   Yes [ ] No [ ] Not sure [ ]

17. When was the last onsite examination conducted for your bank by the Reserve Bank of Zimbabwe?

18. Do you think the Modified Standardized Approach for Credit Risk developed by the meets the standards of rating agencies such as Standards & Poor’s, Fitch, and Moody’s?
   Yes [ ] No [ ] Not sure [ ]

19. The process of implementing Basel II stretches scarce supervisory resources.
   Strongly Agree [ ] Agree [ ] Not sure [ ]
   Disagree [ ] Strongly disagree [ ]

20. Has the regulator provided adequate technical support for banks to implement Basel II?
   Yes [ ] No [ ] Not sure [ ]

21. How does the upward review of minimum capital requirements by the Reserve Bank of Zimbabwe affect your banking institution in the following areas:
   Liquidity:  Strongly affected [ ]
   Moderately affected [ ]
   Slightly affected [ ]
   Competitiveness (profitability): Yes [ ]
   No [ ]
D. THE RELEVANCE TO AND APPROPRIATENESS OF BASEL II STANDARDS IN ZIMBABWE

22. Basel II standards are irrelevant given the nature of the Zimbabwean banking sector?
   Strongly Agree [    ] Agree [    ] Not sure [    ] Disagree [    ] Strongly Disagree [    ]

23. Would banks that adopt the Basel II approach have competitive advantage over other banks?
   Yes [    ] No [    ] Not sure [    ]

24. The following are the benefits of adopting Basel II. Please rank the benefits from the most important to least important by ticking the appropriate number. 1=most important; 2=important; 3=moderately important; 4= least important
   a. Promotes consolidated and cross border supervision 1 2 3 4
   b. Promotes confidence in the banking system 1 2 3 4
   c. Improves risk and capital management 1 2 3 4
d. Enhances efficiency & effectiveness in bank operations 1 2 3 4
e. Integrated data management 1 2 3 4
f. Provides more information to bankers, supervisors and other market participants 1 2 3 4

25. Do you think minimum capital requirements are effective in regulating banking institutions in Zimbabwe?
   Strongly Agree [    ] Agree [    ] Not sure [    ] Disagree [    ] Strongly Disagree [    ]
26. Do you think the application of Basel II banking regulations will reduce the risk of bank failures in Zimbabwe?

- Strongly Agree [    ]
- Agree [    ]
- Not sure [    ]
- Disagree [    ]
- Strongly Disagree [    ]

27. Non-compliance with Basel II standards will reduce banking competitiveness

- Strongly Agree [    ]
- Agree [    ]
- Not sure [    ]
- Disagree [    ]
- Strongly Disagree [    ]

END OF QUESTIONNAIRE