The issue of procyclicality arose long before the introduction of Basel II (cf. [Turner, 2000]). However only after the crisis 2007-2009 it has come to fore, when banking systems of different countries experienced huge undercapitalization. One of the reasons for such a situation was the procyclical nature of capital regulation. More on drawback of Basel II (e.g. reduced credit levels to developing economies, discouraged lending to SME and etc.) for developing countries see [Griffith-Jones, 2007].

The contribution of credit and market risks has procyclical nature.

2. Literature Overview

The financial system plays an important role for the development of the whole economy. However, it may also be a major source of intensifying business cycles (cf. The CRR II includes the EU implementation of the fundamental review of the trading book. In terms of methodologies for the own funds calculation approaches, CRR II broadly follows the Basel framework and adopts the revised approach proposed by the BCBS. The proposal introduces the new more risk sensitive standardised approach (SBA) and variations to the internal model approach (IMA). The new SBA includes the calculation of delta, vega and curvature risk. During a three year phase-in period, the European Banking Authority will review and report to the European Commission on the appropriateness of methodologies for the own funds calculation approaches.

1 Introduction

2. The standardised approach to credit risk in Basel II and review of the literature.

3 Rating data and methodology.

4 Results.

Several studies indeed show that smaller credit rating agencies, whose assessments will also be used in Basel II, tend to assign more favourable credit ratings than those issued by Moody’s, S&P and Fitch. Some developing countries like China and India have already announced that they will not adopt the Basel II framework (The Economist, 2003). ECB Working Paper Series No. 517. August 2005.

The minimum capital requirements for credit risk in Basel I and Basel II are set according to the following formulas:

\[ n = \sum \text{Credit Risk Measurement Under Basel II : An Overview and Implementation Issues for Developing Countries} \]

The illustration of a credit risk modeling refers to data driven risk models which calculates the chances of a borrower defaults on loan (or credit card). If a borrower fails to repay loan, how much amount he/she owes at the time of default and how much lender would lose from the outstanding amount.