What is going on in Basel?

Nigel Jenkinson
Monetary and Capital Markets Department, IMF

2018 Seminar for Senior Bank Supervisors from Emerging Economies

A lot has been accomplished

The sweeping reform agenda produced significant success

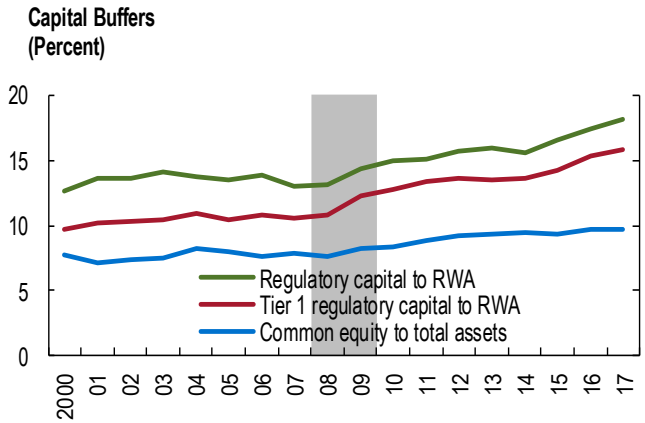
"A decade on, this [reform] programme has largely been achieved. The financial system is safer, simpler, and fairer"

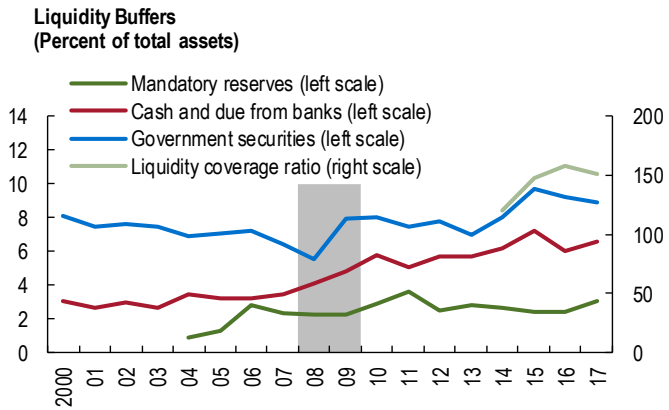
-Mark Carney
Chair, Financial Stability Board

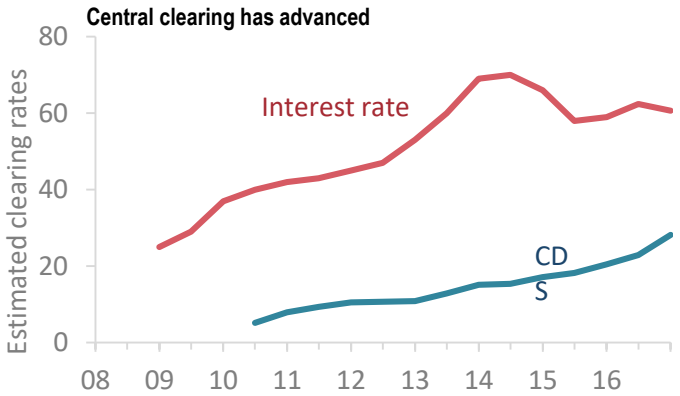
April 20 2017

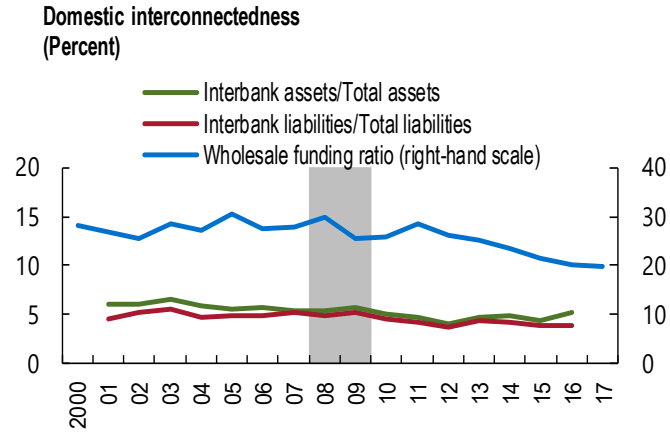
The financial system is stronger

Substantial progress on G20 policy objectives: cf. GFSR special chapter ten years on









Where are we in the regulatory process?

Agenda

Finalizing Basel III

Implementation & other recent activities

Challenges and risks

Finalization of banks reforms

A long awaited agreement

- Addressing RWA inconsistencies
- New credit risk framework
- New operational risk framework
- Leverage ratio buffer

Changing landscape

Basel II completely overhauled

Pillar 1 Charges	Internal Models	Standardized
Credit risk	FIRB AIRB **Revised** Dec 2017	Credit Standardized **Revised** Dec 2017
Market risk	IMM **Under review** Mar 2018	Market Standardized **Under review** Mar 2018
Operational risk	AMA **Eliminated** Jan 2016	BIA TSA / ASA **New Approach** Dec 2017

Finalization of Basel III

Focus on risk weight assets

Basel III (2010)

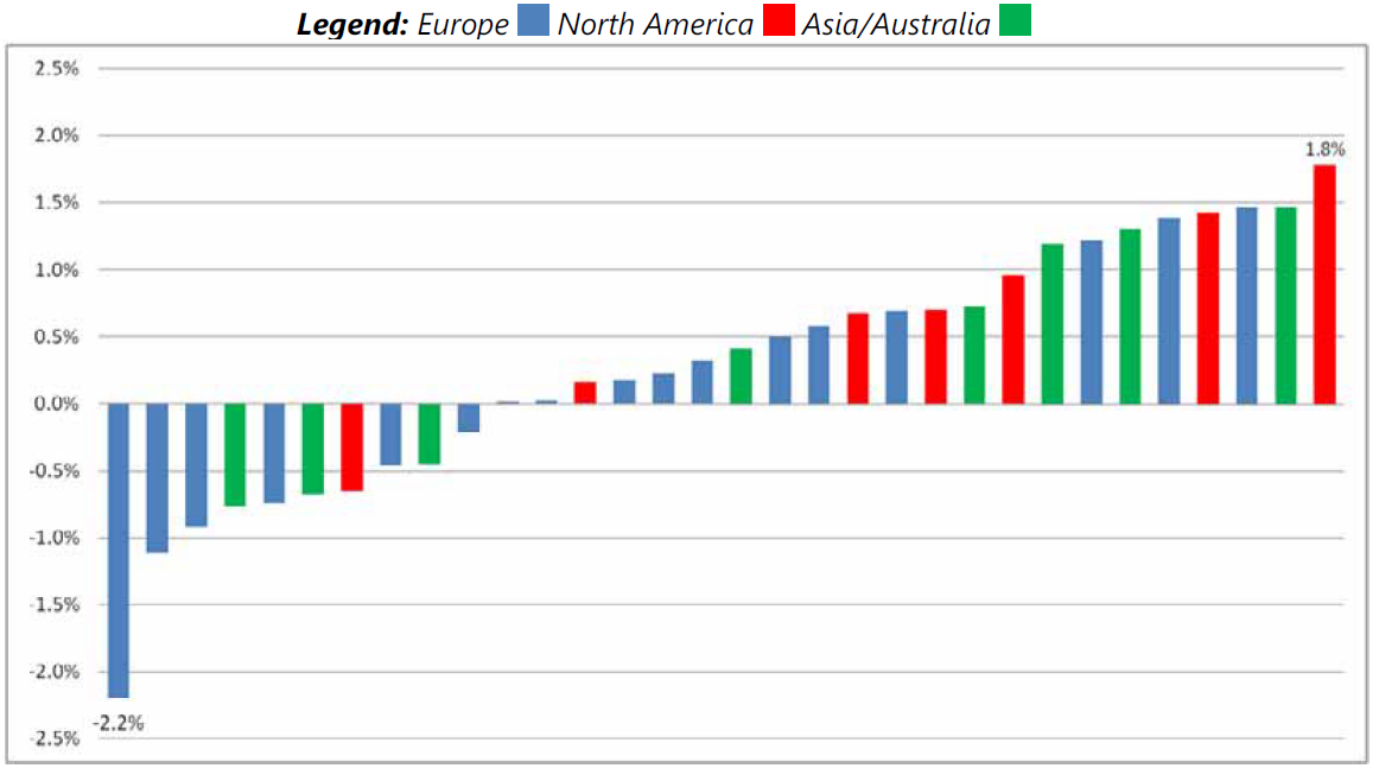
$$CAR = \frac{K}{RWA}$$

Basel III (2017)

Excessive risk weight variation

Undermine trust on capital ratios

Chart 1: Impact of Risk Weight variation on capital ratios

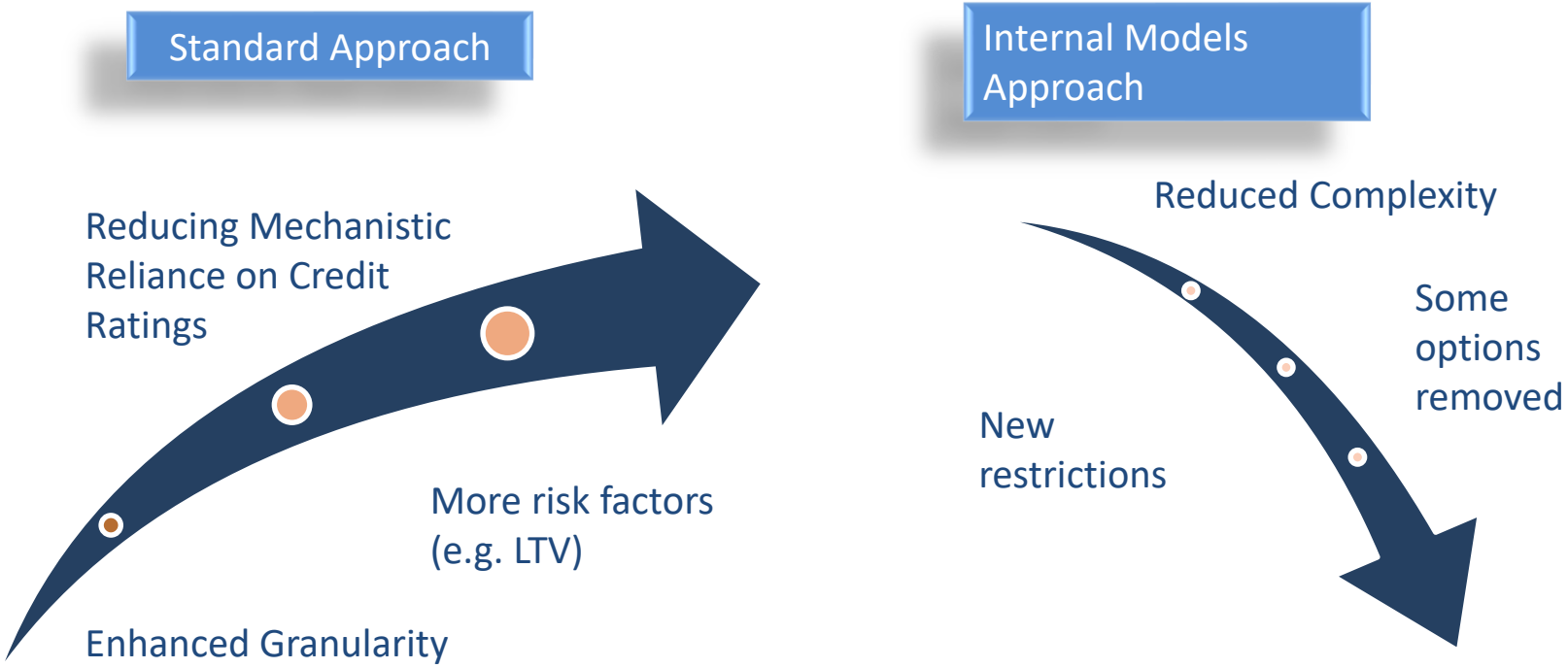


Change from 10% capital ratio if individual bank risk weights from the HPE are adjusted to the median from the sample. Each bar represents one bank. The chart is based on the assumption that variations observed at each bank for the hypothetical portfolios are representative for the entire sovereign, bank, and corporate portfolios of the bank and are adjusted accordingly. No other adjustments are made to RWA or capital.

Source: BCBS 2016 – Analysis of risk weighted assets for credit risk in the banking book

Credit risk

Credit risk review



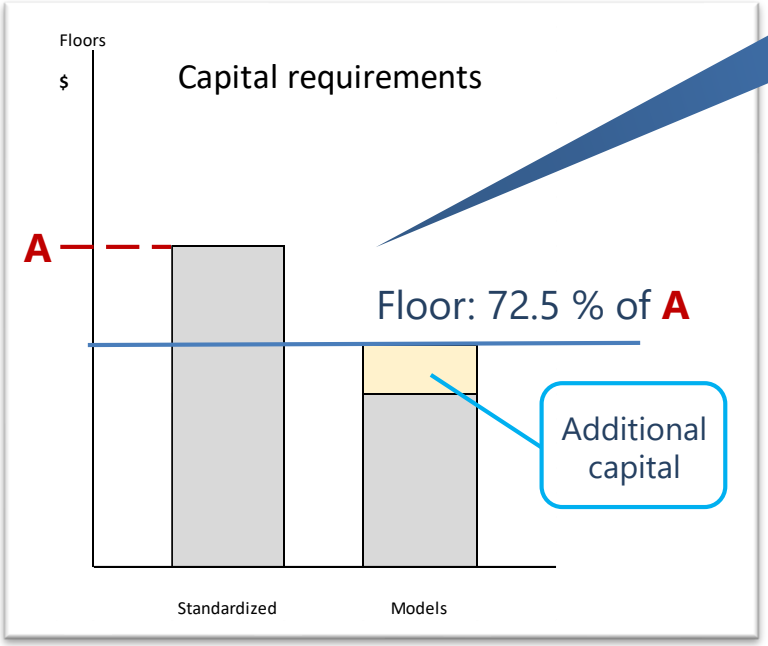
New Credit Risk Standardized Framework

- Residential mortgages: risk weight depend on the loan-to value
- SMEs: New risk weight (85%)
- Banks and Corporates: more granular treatment for unrated exposures.
- Retail exposures: distinction between revolving facilities and transactors)
- Off-balance sheet items: CCFs more granular and conservative
- Currency mismatches: 1.5 multiplier for retail and mortgages exposures

Internal models review

New floors based on standardized approaches

Banks will no longer be able to "turn off" the systems that produce the standardised data



Operational risk

Operational risk weaknesses

Substantial flaws being addressed

Standardized

- Low risk sensitivity
- Counterintuitive results

AMA

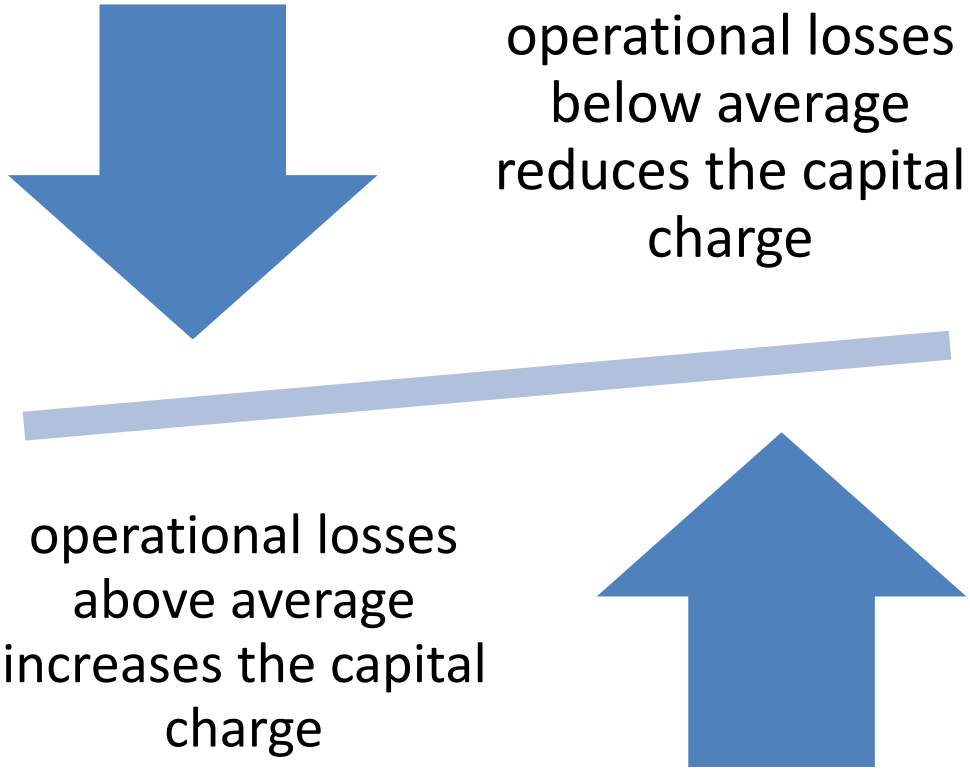
- Too complex
- No common practice

New Approach

- Incorporates internal data in a simple and standard way

Operational risk weaknesses

Substantial flaws being addressed

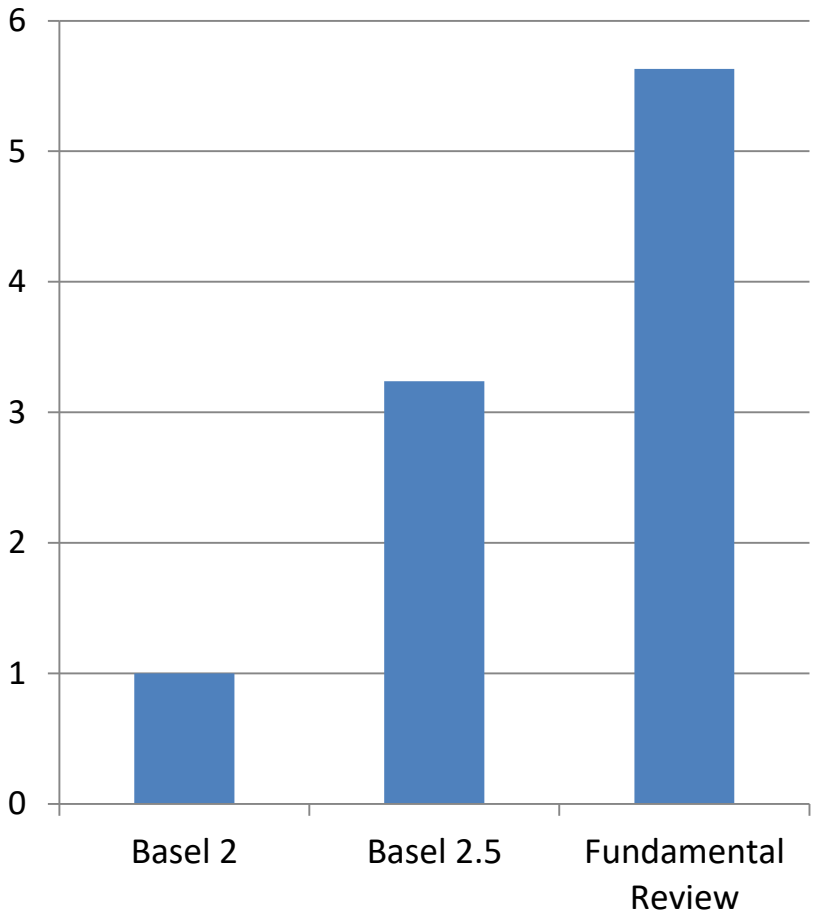


Market risk

Market risk review

Fine tuning underway

- Fundamental review of the trading book
  - Substantial increase in capital requirements
  - Address boundary issue (avoid arbitrage)
  - Better capture risks
  - More complex



Market risk review

Fine tuning under way

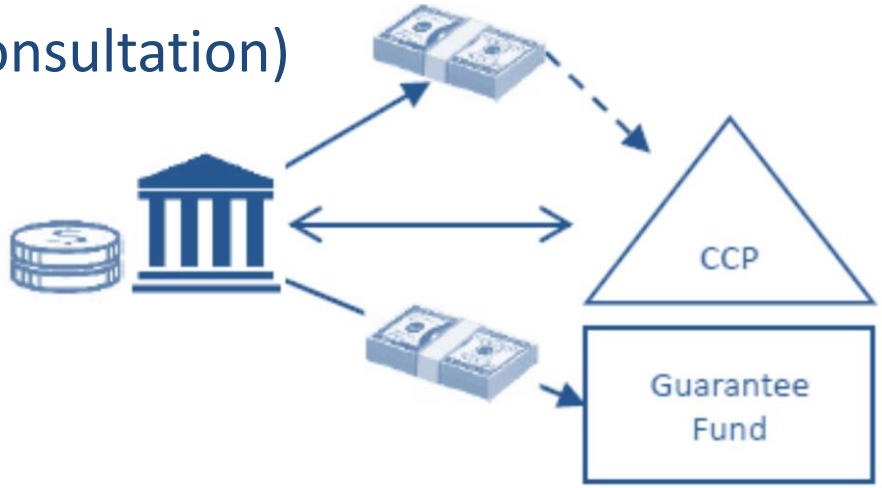
- New standardized framework became more complex
  - Sensitivity based method, which requires sound pricing models
  - Basel Committee developing simplified alternative
    - Public consultation published in March /2018
    - Based on a recalibration of Basel II
    - Proposed scaling factors vary between 1.25 and 3.5
  - Expects to finalize revisions around the end of the year

Leverage ratio

Leverage ratio

Fine tuning under discussion

- Ensure incentives for central clearing
  - Ongoing debate if exposures represented by initial margin and default funds' contributions might curb access of clients to central clearing (to be put to consultation)



Transitional arrangements

Implementation further extended to 2027

Revision	Implementation Date
Revised Standardised Approach Credit Risk	1 January 2022
Revised IRB framework	1 January 2022
Revised Operational Risk Framework	1 January 2022
Revised Market Risk Framework	1 January 2022
Leverage Ratio	Existing exposure definition: 1 January 2018 Revised exposure definition: 1 January 2022 GSIB buffer: 1 January 2022
Output Floor	1 January 2022 50% 1 January 2023 55% 1 January 2024 60% 1 January 2025 65% 1 January 2026 70% 1 January 2027 72.5%

Basel Committee is changing its focus

Progress allows the Basel Committee to focus on supervision and implementation of reforms

- Implementation monitoring
- Supervision guidance
- Fine tuning Basel III
- Finalizing the reforms
- In the pipeline

Basel Committee implementation reports (2017-2018)

Focus on implementation growing

27 Sep 2018	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel NSFR regulations - Kingdom of Saudi Arabia
27 Sep 2018	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel large exposures framework - Kingdom of Saudi Arabia
21 Jun 2018	Progress in adopting the "Principles for effective risk data aggregation and risk reporting"
23 Apr 2018	Fourteenth progress report on adoption of the Basel regulatory framework
12 Mar 2018	Regulatory Consistency Assessment Programme (RCAP) - Handbook for Jurisdictional Assessments
21 Dec 2017	Progress report on the implementation of principles for effective supervisory colleges
18 Oct 2017	Thirteenth progress report on adoption of the Basel regulatory framework
18 Oct 2017	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III LCR regulations - Australia
18 Oct 2017	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III LCR regulations - Brazil
18 Oct 2017	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III LCR regulations - Canada
18 Oct 2017	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III LCR regulations - Switzerland
04 Jul 2017	Implementation of Basel standards
03 Jul 2017	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III LCR regulations - China
03 Jul 2017	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III LCR regulations - European Union
03 Jul 2017	Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III LCR regulations - United States of America
22 Jun 2017	Range of practices in implementing the countercyclical capital buffer policy
25 Apr 2017	Twelfth progress report on adoption of the Basel regulatory framework
28 Mar 2017	Progress in adopting the "Principles for effective risk data aggregation and risk reporting"

Basel Committee FAQs (2017-2018)

Providing clarifications on standards

22 Mar 2018	Frequently asked questions on the Basel III standardised approach for measuring counterparty credit risk exposures
22 Mar 2018	Frequently asked questions on market risk capital requirements
19 Sep 2017	Basel III definition of capital - Frequently asked questions
08 Jun 2017	Basel III - The Liquidity Coverage Ratio: frequently asked questions
06 Apr 2017	Frequently asked questions on changes to lease accounting
24 Feb 2017	Basel III - The Net Stable Funding Ratio: frequently asked questions
26 Jan 2017	Frequently asked questions on market risk capital requirements

Basel Committee sound practices and guidelines (2017-2018)

Important supervision guidance have been developed

17 Oct 2018	**Stress testing** principles
14 May 2018	Criteria for identifying simple, transparent and comparable short-term securitisations
19 Feb 2018	Sound Practices: implications of **fintech** developments for banks and bank supervisors
20 Dec 2017	Supervisory and bank **stress testing**: range of practices
25 Oct 2017	Identification and management of **step-in risk**
07 Jun 2017	Sound management of risks related to **money laundering** and financing of terrorism: revisions to correspondent banking annex
04 Apr 2017	Prudential **treatment of problem assets** - definitions of non-performing exposures and forbearance

Basel Committee standards (2017-2018)

Basel III finally completed -other adjustments

30 Aug 2018	**Pillar 3 disclosure requirements - regulatory treatment of accounting provisions**
05 Jul 2018	Global systemically important banks: revised assessment methodology and the higher loss absorbency requirement
29 Jun 2018	Treatment of extraordinary monetary policy operations in the Net Stable Funding Ratio
14 May 2018	Capital treatment for simple, transparent and comparable short-term securitisations
07 Dec 2017	Basel III: Finalizing post-crisis reforms
10 Oct 2017	Risk weight for Asian Infrastructure Investment Bank
06 Oct 2017	Implementation of net stable funding ratio and treatment of derivative liabilities
29 Mar 2017	Regulatory treatment of accounting provisions - interim approach and transitional arrangements
29 Mar 2017	Pillar 3 disclosure requirements - consolidated and enhanced framework

Basel Committee selected consultative documents

Topics in the pipeline

07 Aug 2018	Incentives to **centrally clear over-the-counter (OTC) derivatives** - A post-implementation evaluation of the effects of the G20 financial regulatory reforms
22 Mar 2018	Revisions to the minimum **capital requirements for market risk**
27 Feb 2018	**Pillar 3** disclosure requirements - updated framework

Challenges and risks

No time for complacency

- Implementation delays and risk of rollback
- Risk landscape
- Sovereign – bank nexus
- Proportionality
- FSAP Findings – supervision weaknesses
- Conglomerates supervision
- Fintech
- Cyber risk
- Regulatory arbitrage

Regulatory Reform Agenda

Reform challenges and remaining gaps

Not all elements of reform agenda finalized yet

Implementation challenges

… roll-back pressures are increasing

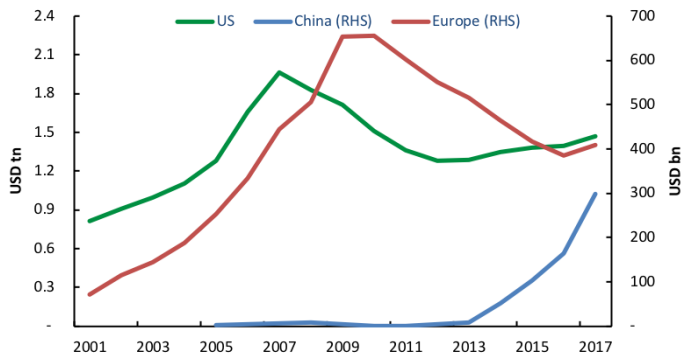
In addition some gaps remain:

- Sovereign risk; lack of consensus
- Proportionality framework
- Accounting; no convergence of IFRS and US GAAP

Risks to Financial Sector Health

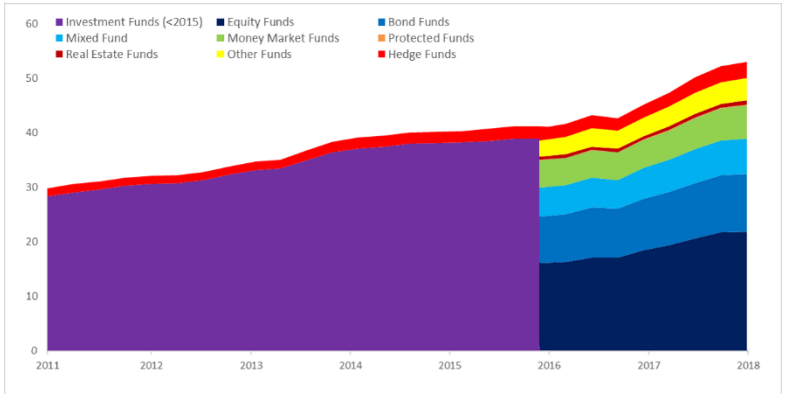
Increasing leverage and changing financial landscape

ABS market: Outstanding volume ($ tn/bn)

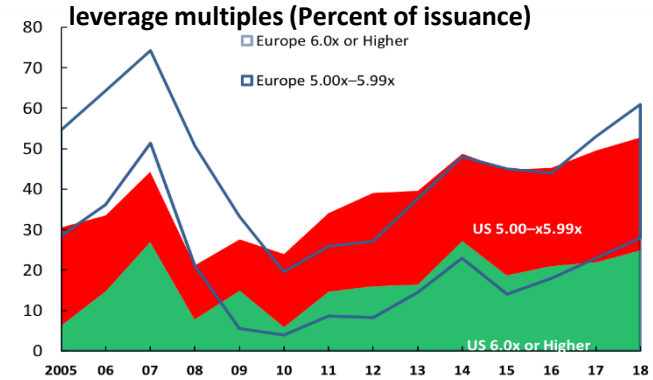


Sources: SIFMA, China Securitization Analytics

Global fund industry size ($ tn)

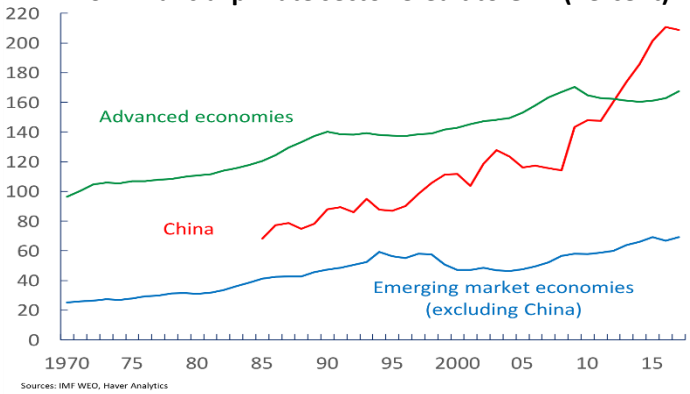


US and European Leveraged Loan issuance by leverage multiples (Percent of issuance)



Source: S&P Leveraged Commentary and Data

Non-financial private sector Credit to GDP (Percent)



Sources: IMF WEO, Haver Analytics

Sovereign – Bank nexus

Banks hold large exposures to sovereigns

Banks sovereign exposures in percent of total assets

	Mean exposure			Median exposure		
	All	AEs	EMDEs	All	AEs	EMDEs
1999	8.1	6.4	17.7	4.8	4.2	15.7
2000	7.7	5.9	18.4	4.5	3.9	15.3
2001	8.2	6.2	19.6	4.8	4.3	18.5
2002	8.2	6.0	20.9	4.7	3.9	19.2
2003	8.5	6.6	20.0	5.3	4.7	18.1
2004	8.8	7.0	19.2	5.8	4.9	17.2
2005	9.0	7.5	18.0	6.3	5.4	17.3
2006	8.7	7.3	16.7	6.0	5.0	15.1
2007	8.1	6.8	15.7	5.3	4.5	14.8
2008	7.8	6.4	15.6	5.0	4.4	15.6
2009	8.9	7.4	17.5	6.1	5.3	16.7
2010	9.1	7.7	17.6	6.4	5.6	16.9
2011	9.3	8.1	16.6	6.7	5.9	18.1
2012	9.8	8.6	16.7	7.0	6.1	18.2
2013	10.0	8.8	17.0	7.4	6.7	17.9
2014	10.2	9.1	17.1	7.6	6.8	16.8
2005-14	**9.1**	**7.8**	**16.8**	**6.3**	**5.5**	**16.7**

Sovereign – Bank nexus

Global standards do not address risks

Nexus operate through multiple channels

Sovereign debt

Safety net

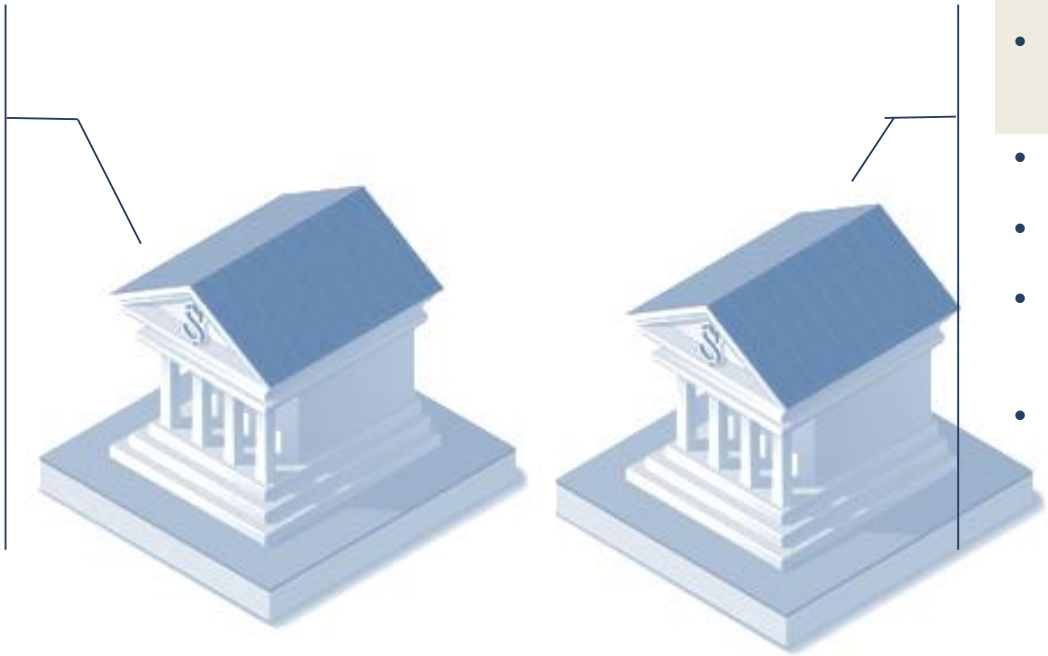
Macroeconomic

IMF Departmental paper: Managing the sovereign – bank nexus

Proportionality

How EMDEs can benefit the most from international standards?

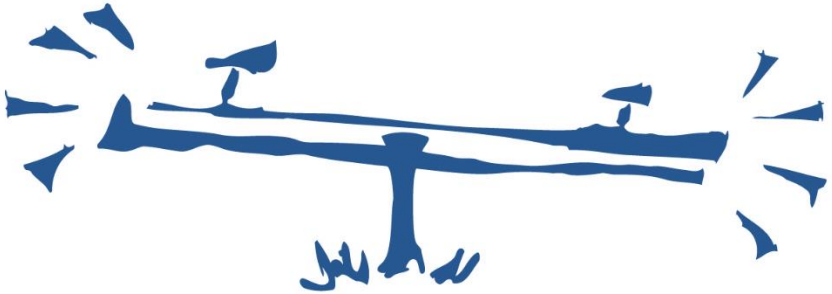
- Basel III
- TLAC
- …



- Risks to financial stability?
- Areas for simplification?
- How to avoid arbitrage?
- Appropriate threshold for differentiation?
- National consideration or international guidelines?

Proportionality

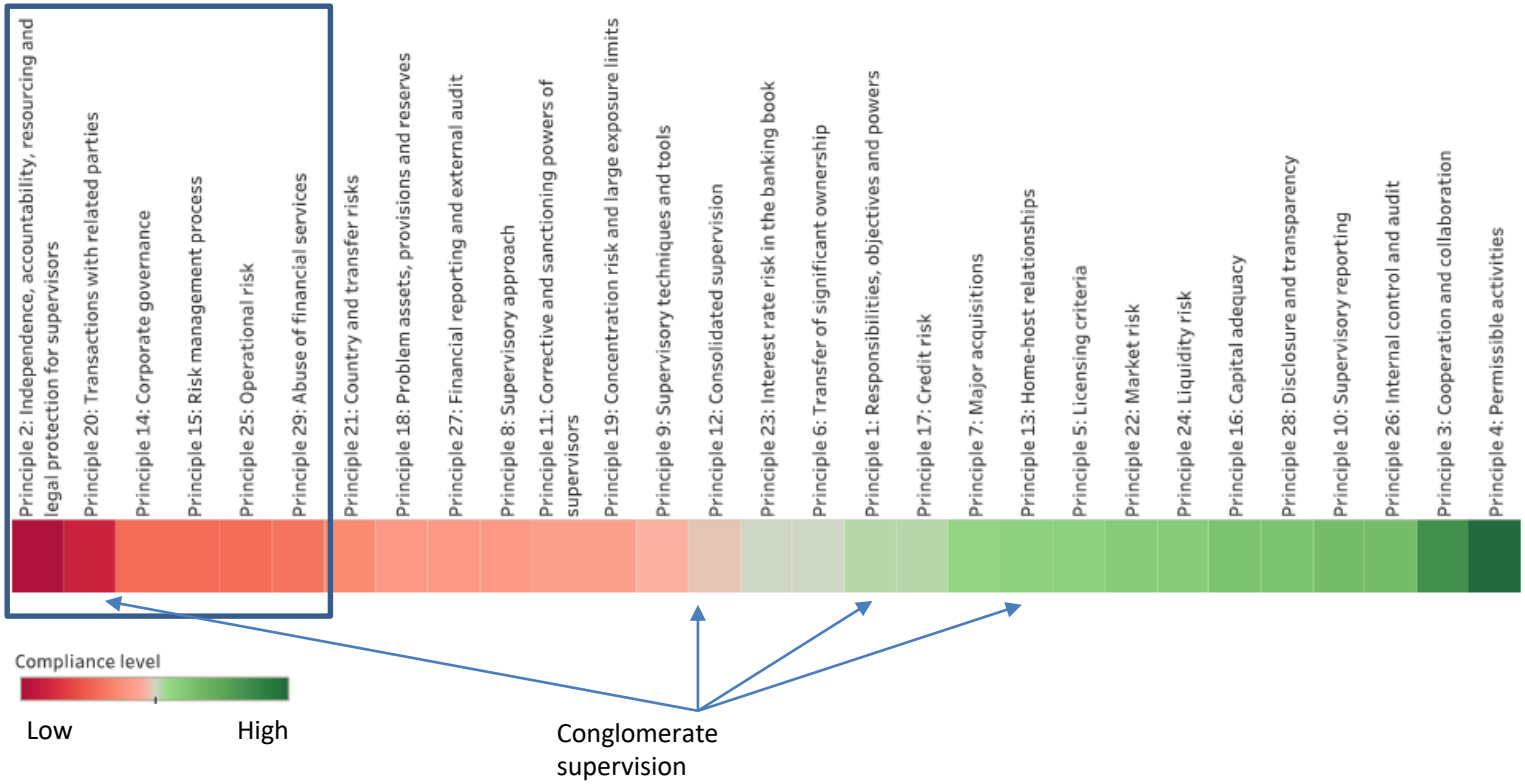
How EMDEs can benefit the most from international standards?



- Adjustments for size, complexity, market development, supervisory capacity,…
- Not about a new standard
- Not less conservative
- Allow convergence to international standards as market/ institutions evolve

FSAP Findings – Banking Supervision

Basel Core Principles Assessments 2013-2017 (37 assessments)



Banking supervision: Independence and resourcing

The main issue across sectors

Independence

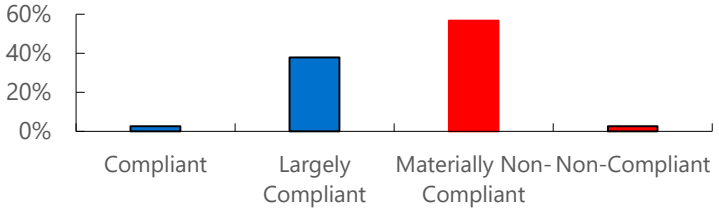
- Operational
- Budget

Legal protection of staff

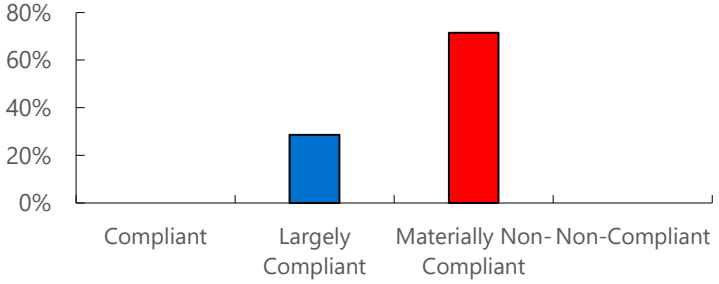
Resources

- Number of staff
- Qualifications of staff

Principle 2: Independence, accountability, resourcing, and legal protection for supervisors
(All BCP assessments since 2012)



Published BCP assessments in 2016-2017



Banking Supervision: Governance and conduct

Framework improved but challenges (across sectors) remain

Regulatory framework

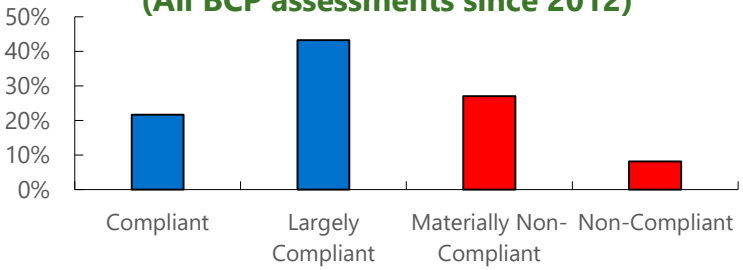
- Governance (incl. remuneration), risk management and conduct regulations

Independence and quality of oversight functions

Supervisory intensity and focus

Principle 14: Corporate governance

(All BCP assessments since 2012)



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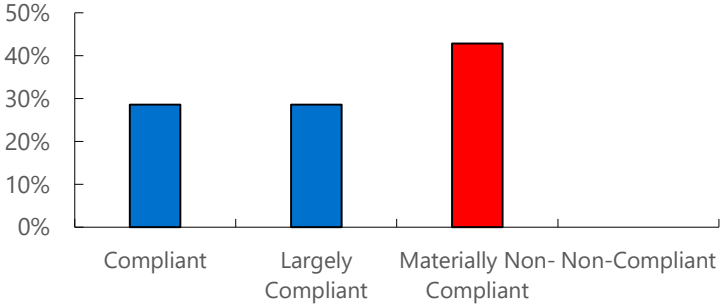
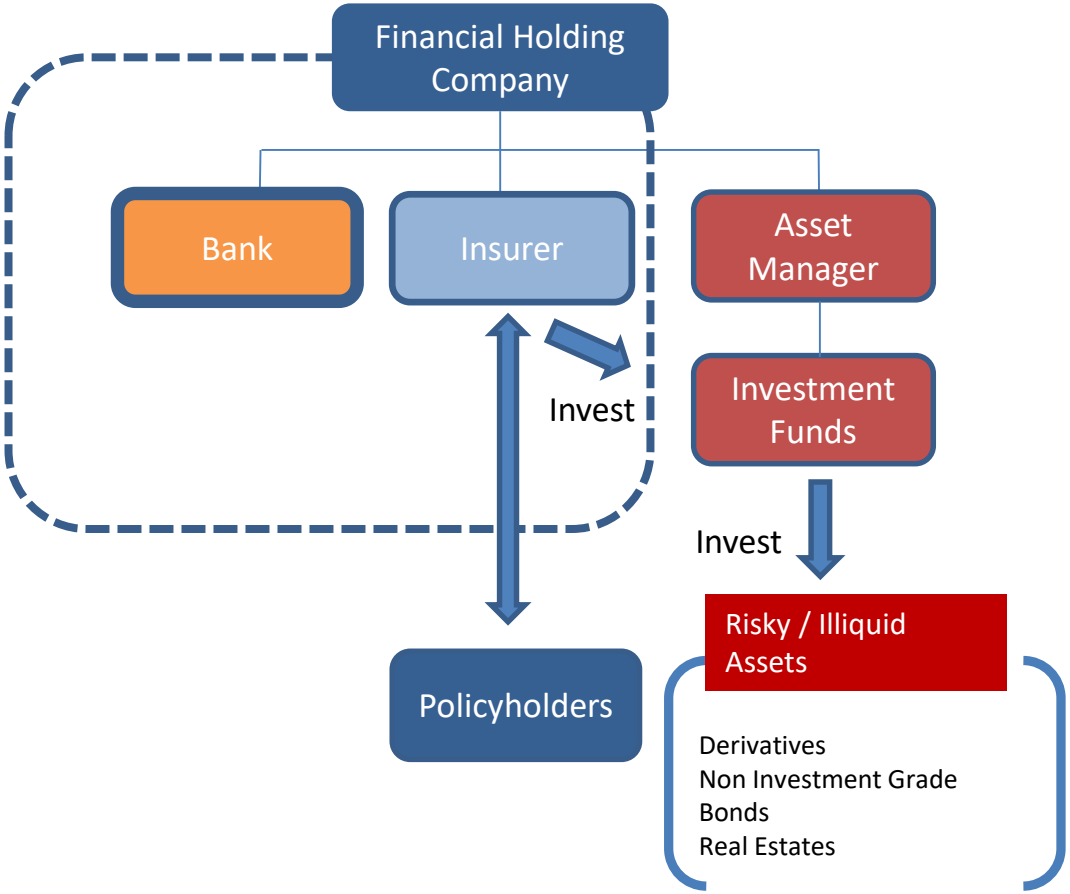


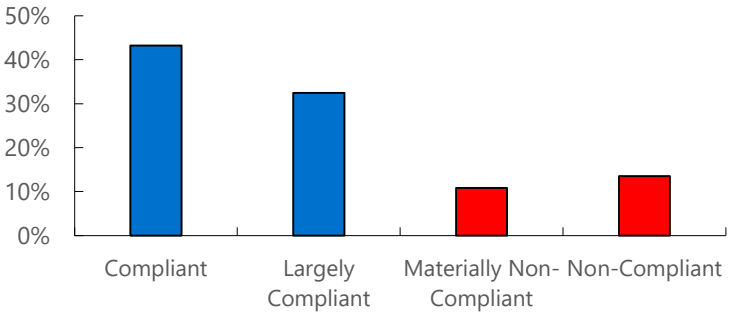
Conglomerates

Framework needs strengthening



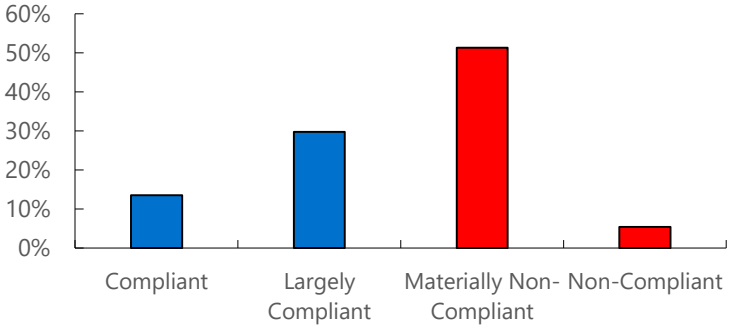
Principle 12: Consolidated supervision

(All BCP assessments since 2012)



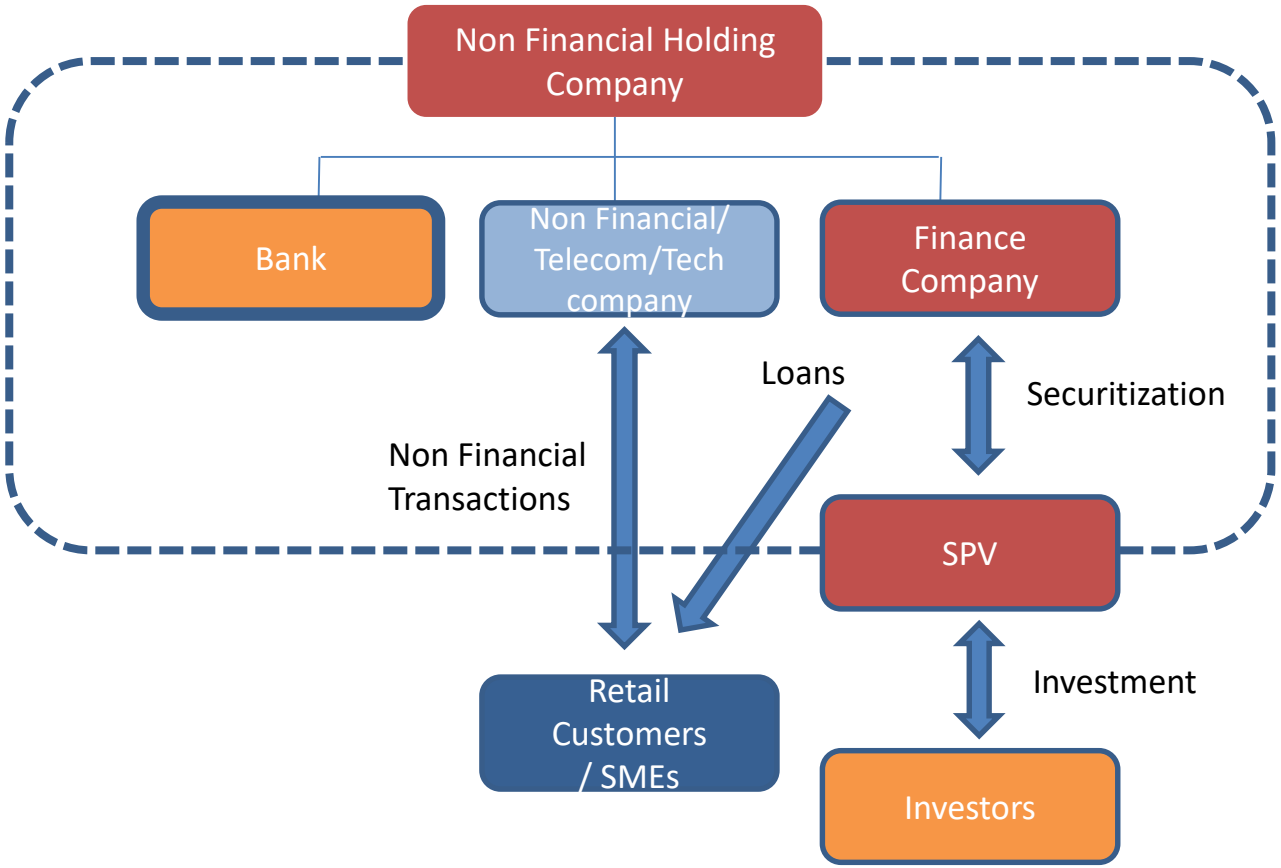
Principle 20: Related parties

(All BCP assessments since 2012)



Fintech

Changing the financial landscape



Changing landscape

- New players
- New products
- Changing business models of incumbents
- Cross-border nature
- Artificial Intelligence
- Machine learning
- Data security
- Operational resilience

⇒ Challenging for regulators

⇒ Need for agile and proactive approach

What is the appropriate framework to best foster the possibilities provided by fintech?

INTERNATIONAL MONETARY FUND

WORLD BANK GROUP

THE BALI FINTECH AGENDA—CHAPEAU PAPER

October 3, 2018

EXECUTIVE SUMMARY

Rapid advances in financial technology are transforming the economic and financial landscape, offering wide-ranging opportunities while raising potential risks. Fintech can support potential growth and poverty reduction by strengthening financial development, inclusion, and efficiency—but it may pose risks to consumers and investors and, more broadly, to financial stability and integrity.

National authorities are keen to foster fintech's potential benefits and to mitigate its possible risks. Many international and regional groupings are now examining various aspects of fintech, in line with their respective mandates. There have been calls for greater international cooperation and guidance about how to address emerging issues, with some also cautioning against premature policy responses.

In response to these calls from member countries, the IMF and the World Bank staff have developed the Bali Fintech Agenda, summarized in Annex I of this paper. The Agenda brings together and advances key issues for policymakers and the international community to consider as individual countries formulate their policy approaches. It distills these considerations into 12 elements arising from the experiences of member countries.[1]

https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/10/11/pp101118-bali-fintech-agenda

Bali Agenda -Some Key Considerations

Promise of Fintech	• Reaping the benefits (financial inclusion, efficiency etc.) requires preparation (institutional capacity, outreach to stakeholders, cross agency cooperation)
Competition	• Open, free and contestable markets for level playing field. Foster standardization, interoperability and access to key infrastructures.
Monitoring	• Improvements and extension in the reach of monitoring framework, including ongoing dialogue with stakeholders.
Regulation	• For orderly development. Modification of perimeter (arbitrage risks). Proportional and holistic response. Legal frameworks. Safeguard financial integrity.
Infrastructure	• Robust data and financial infrastructure. Resilient to cyber attacks and other disruptions.
International Cooperation	• Essential to ensure effective policy responses and limit risks. Share experience and best practices.

Cyber risks

Ensuring resilience to a rising trend

Ever-evolving and growing risk

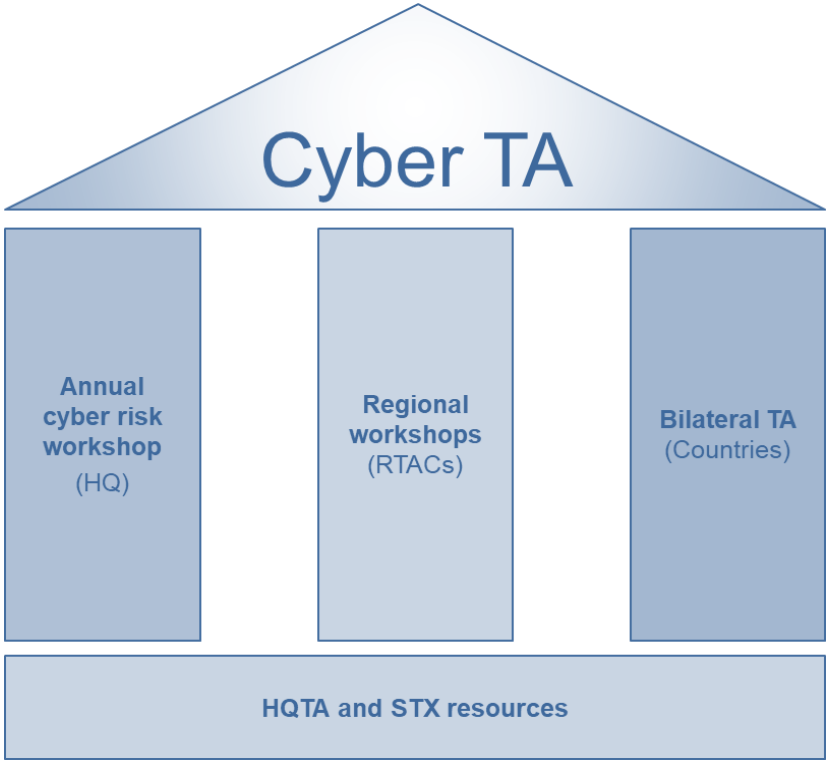
- Assume breach concept
- Focus on detection, response, and recovery

Effective supervision is key

- International harmonization and cooperation needed

Cyber risk TA framework

- Based on evolving international standards and frameworks



Looking forward

CONTINUING CHALLENGES
Independence and resources
Governance and conduct
Conglomerate supervision
Sovereign-bank nexus
Proportionality

INTERNATIONAL HARMONIZATION AND COORDINATION
Emerging risks are cross border
Decrease regulatory arbitrage opportunities

AREAS IMPROVING
Bank capital and liquidity
Derivatives clearing

NEW CHALLENGES
Fintech
Cyber-risk
Financial innovation and regulatory arbitrage

Thank you!