What is going on in Basel?

by

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Outline

I. You need to know: standards, guidelines and sound practices

II. Zooming in: new standards

III. Zooming out: implementation, ongoing work and looking forward
I. What’s new from Basel?

You need to know: new standards, guidelines and sound practices
Latest standards (2015-2016): a lot!

2015
• Revised Pillar 3 disclosure requirements
• Margin requirements for non-centrally cleared derivatives
• NSFR disclosure standards
• FAQs Basel III Leverage Ratio Framework
• FAQs Standardized approaches for measuring counterparty credit risk exposures
• FAQs on Basel III Countercyclical Capital Buffer

2016
• Minimum capital requirements for Market risk
• Interest rate risk in the banking book
• Revisions to the securitization framework (simple, transparent and comparable)
• More FAQs on leverage ratio, NSFR, large exposures
Guidelines and sound practices (2015-2016)

- Developments in credit risk management across sectors: current practices and recommendations (Jun 2015)
- Supervisory guidelines for identifying and dealing with weak banks (Jul 2015)
- Criteria for identifying simple, transparent and comparable securitizations (Jul 2015)
- Report on impact and accountability of banking supervision (Jul 2015)
- Corporate governance principles for banks (Jul 2015)
- Credit risk and accounting for expected credit losses (Dec 2015)
- General guide to account opening
- Application of the BCP to institutions relevant to financial inclusion (Sept 2016)
Monitoring, implementation (2015-2016)

- The interplay of accounting and regulation and its impact on bank behavior (Jan 2015)
- Range of practice in the regulation and supervision of institutions relevant to financial inclusion (Jan 2015)
- Macroprudential stress tests: liquidity and solvency interactions (Nov 2015)
- Progress in adopting principles for effective risk data aggregation and risk reporting (Dec 2015)
- Basel III monitoring and implementation reports (Sept 2016 – latest)
- RWA for credit risk in the banking book (Apr 2016)
- FAQ on revised Pillar 3 (Aug 2016)
- Statement on capital arbitrage transactions (Jun 2016)
- RCAP reports: 18 completed and published for capital standards, 9 for LCR, 5 for G-SIB/D-SIB.
II. Zooming in
## Basel I – III Synopsis

<table>
<thead>
<tr>
<th>Basel I</th>
<th>Basel II</th>
<th>Basel III</th>
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<tbody>
<tr>
<td>Basel Accord 1988, first international agreement</td>
<td>Published in 2004</td>
<td>Published in 2010</td>
</tr>
<tr>
<td>Definition of capital</td>
<td>Introduced 3 Pillars</td>
<td>Implementation 2013-2019</td>
</tr>
<tr>
<td>Focus on sufficiency of capital vis-à-vis credit risk</td>
<td>✓ Menu of more risk-sensitive approaches</td>
<td>Better definition of capital, enhanced risk coverage, new and higher ratios</td>
</tr>
<tr>
<td>✓ Fixed risk weights</td>
<td>✓ Sup review process</td>
<td>Leverage Ratio</td>
</tr>
<tr>
<td>Amended in 1996 to include a parallel capital requirement for market risk</td>
<td>✓ Disclosure</td>
<td>Mitigating pro-cyclicality</td>
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<tr>
<td></td>
<td></td>
<td>✓ Capital Conservation and Counter-Cyclical Buffers</td>
</tr>
<tr>
<td></td>
<td>Broader coverage of risks</td>
<td>Two new Liquidity Standards</td>
</tr>
<tr>
<td></td>
<td>✓ Credit risk</td>
<td>Focus on Global Systemically Important Institutions</td>
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<tr>
<td></td>
<td>✓ Market Risk</td>
<td>✓ G-SIB surcharge</td>
</tr>
<tr>
<td></td>
<td>✓ Operational Risk</td>
<td>Enhanced disclosure</td>
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</table>

| | | |
| | | ✓ Securitization, off-balance sheet vehicles, components of capital |
Basel III reforms target

Bank-level, or **microprudential**, regulation, which will help raise the resilience of individual banking institutions to periods of stress.

System-wide, or **macroprudential**, risks that can build up across the banking sector as well as the procyclical amplification of these risks over time.
Last year’s slide – finishing Basel III

Leverage ratio

Liquidity framework

Pillar III
Last year’s slide – finishing Basel III

Leverage ratio

Liquidity framework

Pillar III
Leverage Ratio: The backstop to supplement risk-based capital

**Capital to total on and off balance sheet assets**

- **Assets**
  - On balance sheet
  - Off balance sheet

- **Capital**
  - Tier 1
  - Other Tier 1
  - Tier 2

**Simple, transparent, non-risk based measure**

**Numerator**
- Key issues – netting and off-balance sheet items
- Conversion factors (CCF) – as Basel II, with 10% floor
- 100% CCF for committed lines

**Denominator**
- 3% proposal
- To be tested during parallel run period of 2013-2016
Last year’s slide – finishing Basel III

Leverage ratio

Liquidity framework

Pillar III
Last year’s slide – finishing Basel III

Leverage ratio

Liquidity framework

Pillar III
Pillar 3

• Issued January 2015, start on end 2016
• Main elements
  a) Transparency of the internal model-based approaches
  b) Comparability: use of templates for quantitative disclosure accompanied with definitions, some of them with a fixed format.
• Consultation on enhancements! 2016
  a) Additional dashboard of key metrics
  b) More granularity
  c) Ongoing reforms (TLAC, operational risk, market risk...)
III. Looking ahead

AH! SO THERE YOU ARE!
Main themes

- Policy development
- Balance between Simplicity, Comparability and Risk Sensitivity
- Implementation: monitoring and assessing
- Improving effectiveness of supervision
Balance between Simplicity, Comparability and Risk Sensitivity

- Restore confidence in risk-weighted capital ratios
- Consolidate regulatory capital and liquidity standards
- Strategic capital review (including models and AMA)
- Greater constraints on risk model parameters
- Likely to continue to be based on multiple metrics: internal models, standardized approaches, leverage ratio

Basel ... IV?!
Changing Landscape

Pillar 1
Charges

Credit risk
Market risk
Operational risk

Internal Models
Consultation Mar 2016
AIRB

Standardized
Consultation Dec 2015
Cred.

Consultation Jan 2016
New Approach
Market Standardized

Consultation Jan 2016
New Approach

Eliminated Jan 2016

BIA
Consultation
Mar 2016

ISA / ASA
Work-in-progress

Review of the standardized approaches

• Credit, market and operational risks

Capital Floors

• Consultation documents released on both aggregate floors based on Standardized approaches (2014) and on exposure-level, model-parameter floors to ensure a minimum level of conservatism for portfolios “where the IRB approaches remain available “(2016)
• Floors based on 1988 Accord not meaningful anymore: need to mitigate model risk
• Comparability of capital outcomes across banks
• This affects risk/simplicity balance
What about Sovereign risk

Basel: standardized approach allows a zero risk weight to be applied to AAA and AA-rated sovereigns (both foreign and local currency denominated).

National discretion: lower RW for debt issued and funded in domestic currency

IRB: banks to assess the credit risk of individual sovereigns using granular rating scale, accounting for all relevant measured differences in risk with a bespoke risk weight per sovereign

EU: 0% RW for all EU members...

And permanent IRB carve out...

Why? Government can print themselves out of the debt.

Although these countries do not issue their own currency!

Basel ... V?!
September 2016:

- The GHOS endorsed the broad direction of the Committee's reforms. The GHOS discussed the Basel Committee's ongoing cumulative impact assessment and reaffirmed that, as a result of this assessment, the Committee should focus on not significantly increasing overall capital requirements.

- "Finalising the Committee's post-crisis reforms will complete Basel III and help restore confidence in banks' risk-weighted capital ratios,"
Improving effectiveness of supervision: several projects

- Dealing with weak banks, corporate governance, expected credit losses
- Exchange views on Pillar 2 approaches
- Colleges
- Impact and accountability
- Prudential treatment of assets
Some reforms with large effect on EMDEs are not Basel III

- AML/CFT
- TLAC and Resolution requirements on G-SIB
- moving OTCs to trading platforms
- Country-specific structural reforms

Effects of implementation

- Implementation by the EMDEs
- Implementation by home supervisors of foreign banks
- Intended vs unintended
Consolidated application of requirements

- QIS do not separate effects on subs
- Sovereign RWs in foreign subs
- Minority interest issued by holding companies in host jurisdiction
- Liquidity reserves at parent level vs ring fencing liquidity

Constraints for implementation

- Limited diversification of HQLA, Level 1 mostly sovereign debt, little availability of level 2 (corporate debt)
- Appropriate run-off ratios
- Difficulty in determining credit cycles
- Where is the reliable data?

Growing pains of intended consequences

- More capital requirements = more cost
- Liquidity requirements = business models adjustments
- Combination of reforms = is lower profitability the new normal
- Is the balance simplicity/risk sensitivity right?
Thanks!
Additional slides


## Phase-in Arrangements

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<tbody>
<tr>
<td>Leverage Ratio</td>
<td>Migration to Pillar 1</td>
<td>Disclosure starts 1 Jan 2015</td>
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<tr>
<td>Minimum Common Equity Capital Ratio</td>
<td>3.50%</td>
<td>4.00%</td>
<td>4.50%</td>
<td>4.5%</td>
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<tr>
<td>Capital Conservation Buffer</td>
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<td>0.63%</td>
<td>1.25%</td>
<td>1.88%</td>
<td>2.5%</td>
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<tr>
<td>Minimum common equity plus capital conservation buffer</td>
<td>3.50%</td>
<td>4.00%</td>
<td>4.50%</td>
<td>5.13%</td>
<td>5.75%</td>
<td>6.38%</td>
<td>7.0%</td>
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<td>Phase-in of deductions from CET1*</td>
<td></td>
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<td>20%</td>
<td>40%</td>
<td>60%</td>
<td>80%</td>
<td>100%</td>
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<tr>
<td>Minimum Tier 1 Capital</td>
<td>4.50%</td>
<td>5.50%</td>
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<td>6.00%</td>
<td>6.0%</td>
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<tr>
<td>Minimum Total Capital</td>
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<td>8.00%</td>
<td>8.0%</td>
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<tr>
<td>Minimum Total Capital plus conservation buffer</td>
<td>8.00%</td>
<td>8.63%</td>
<td>9.25%</td>
<td>9.88%</td>
<td>10.5%</td>
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<tr>
<td>Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital</td>
<td>Phased out over 10 year horizon beginning 2013</td>
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<table>
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<th>Liquidity</th>
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<tbody>
<tr>
<td>Liquidity coverage ratio – minimum requirement</td>
<td>60%</td>
<td>70%</td>
<td>80%</td>
<td>90%</td>
<td>100%</td>
<td></td>
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<tr>
<td>Net stable funding ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Introduction minimum standard</td>
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* Including amounts exceeding the limit for deferred tax assets (DTAs), mortgage servicing rights (MSRs) and financials.

- transition periods
Liquidity risk: the new metrics

Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)

Two complementary metrics with different time horizons

<table>
<thead>
<tr>
<th>Stock of High Quality Liquid Assets</th>
<th>Available Amount of Stable Funding</th>
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<tbody>
<tr>
<td>Net Cash Out over 30 days under stress</td>
<td>Required Amount of Stable Funding</td>
</tr>
<tr>
<td>&gt; 100%</td>
<td>&gt; 100%</td>
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**LCR: short-term** - ensure that a bank maintains an adequate level of unencumbered, high quality assets that can be converted into cash to meet its liquidity needs for a **30-day time horizon** under an acute liquidity stress

**NSFR: medium to long-term** - full balance-sheet metric that compares, under more prolonged but less acute stress than in the LCR, estimates of reliable funding sources and required stable funding over the **1 year horizon**.


NSFR: Finalized Oct 2014, Disclosure Jun 2015; to become minimum stnd by Jan 2018

2014

• Leverage ratio and disclosure requirements
• Liquidity coverage ratio disclosure standards
• LCR and restricted use committed liquidity facilities
• Standardized approaches for measuring counterparty credit risk exposures
• Capital requirements for bank exposures to central counterparties
• Supervisory framework for measuring and controlling large exposures
• FAQs LCR
• FAQ leverage ratio
• Net Stable Funding ratio
• G-SIB assessment methodology
• Revisions to the securitization framework

2015

• Revised Pillar 3 disclosure requirements
• Margin requirements for non-centrally cleared derivatives
• NSFR disclosure standards
• FAQs Basel III Leverage Ratio Framework
• FAQs Standardized approaches for measuring counterparty credit risk exposures

- Guidance for supervisors on market-based indicators of liquidity (Jan 2014)
- Sound management of risks related to money laundering and financing of terrorism (Jan 2014)
- A sound capital planning process: fundamental elements (Jan 2014)
- Range of practice in the regulation and supervision of institutions relevant to financial inclusion (Jan 2015)
- External audits of banks (Mar 2014)
- Principles for effective supervisory colleges (Jun 2014)
- Review of the principles for sound management of operational risk (Oct 2014)
- Developments in credit risk management across sectors: current practices and recommendations (Jun 2015)
- Supervisory guidelines for identifying and dealing with weak banks (Jul 2015)
- Criteria for identifying simple, transparent and comparable securitisations (Jul 2015)
- Report on impact and accountability of banking supervision (Jul 2015)
- Corporate governance principles for banks (Jul 2015)

Important consultative guidance doc:
- Guidance on accounting for expected credit losses

- Point of sale disclosure in the insurance, banking and securities sector (Apr 2014)
- Supervisory colleges for financial conglomerates (Apr 2014)
- Trading book hypothetical portfolio exercise (Sept 2014)
- Reducing excessive variability in banks regulatory capital ratios (Nov 2014)
- Impact and implementation challenges of Basel framework for emerging market developing and small economies (Nov 2014)
- The interplay of accounting and regulation and its impact on bank behavior (Jan 2015)
- Range of practice in the regulation and supervision of institutions relevant to financial inclusion (Jan 2015)
- Basel III monitoring and implementation reports (September 2015 – latest)
- RCAP reports: 14 completed and published, since 2015 including LCR (latest South Africa, Saudi Arabia and India)
- Progress in adopting principles for effective risk data aggregation and risk reporting (Jan 2015)
- Basel capital framework national discretions (Nov 2014) – and in April 2015, elimination of some low hanging fruit (press release)