Framing Discussion: economic and financial sector issues and challenges in the European and MENA Region since 2008

Achievements and challenges of financial reforms since the global financial crisis

Seminar – Impact of financial reforms in the Euro-Mediterranean area
Marseille, 3-4 May 2018

Olivier Prato
Head of Implementation - Basel Committee on Banking Supervision
Introduction

- What did we do and why?
- What is the - actual and likely - impact?
- What happens next?
What did we do and why?

- Ten years to establish a new regulatory framework based on multiple metrics – Basel III post-crisis reforms

- Initial phase of Basel III reforms (Dec. 2010) focused on addressing main shortcomings of the pre-crisis regulatory framework:
  - improving the quality of bank regulatory capital
  - enhancing risk capture and increasing capital requirements
  - adding macro-prudential elements
  - introducing a minimum leverage ratio requirement and a liquidity framework

- Revised standards but also further guidance for banks and supervisors

- Monitoring (QIS) and implementation (RCAP)
What did we do and why (cont’d)?

- Finalisation of Basel III (Dec. 2017):
  - Revised standardised approach for credit risk
  - Revisions to the IRB approach for credit risk
  - Revisions to the credit valuation adjustment (CVA) framework,
  - Revised standardised approach for operational risk
  - Revisions to the measurement of the leverage ratio and a buffer for G-SIBs
  - Aggregate output floor

- Overall:
  - Address excessive RWA variability and restore credibility to the capital framework
  - Improve risk-sensitivity and granularity of the standardised approach
  - Simplify rules
What did we do and why (cont’d)?

● When will the 2017 Basel III revisions come into effect?
  ▪ Jurisdictions can implement when they wish (but not later than 2022)

● Output floor transitional arrangements:
  ▪ Phase-in of the 72.5% floor from 2022-2026
  ▪ A cap on the increase in RWAs at 25% each year

● Important to emphasise:
  ▪ 2022 is the deadline for BCBS jurisdictions
  ▪ Transitional arrangements for the floor are optional (ie at national discretion)
What is the impact?

- More and higher-quality capital
- Less leverage
- Higher liquidity buffers
- Some variation across regions and banks
- See the latest Basel III monitoring report (www.bis.org/bcbs/publ/d433.htm)
  - Based on data as of 30 June 2017
  - Finalisation of Basel III reforms not yet reflected in the results - the collection of relevant data for those reforms started for the end-2017 reporting date
What is the impact? (cont’d) - Capital

Fully phased-in Basel III CET1, Tier 1 and total capital ratios

<table>
<thead>
<tr>
<th>Group 1 banks</th>
<th>Of which: G-SIBs</th>
<th>Group 2 banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per cent</td>
<td>Per cent</td>
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</table>

![Graph showing capital ratios for Group 1 banks, Of which: G-SIBs, and Group 2 banks over the years 2011 to 2017 with different capital ratios: CET1 minimum, CET1 plus conservation buffer, CET1, Tier 1 minimum, Tier 1 plus conservation buffer, Tier 1, Total minimum, Total plus conservation buffer, Total.](image)
What is the impact? (cont’d) - Leverage

Fully phased- in Basel III Tier 1 leverage ratios

<table>
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Graphs showing Leverage Ratio (lhs), Change in Tier 1 capital (rhs), and Change in exposure measure (rhs) from 2011 to 2017.
What is the impact? (cont’d) - Liquidity

LCR and change in HQLA and net outflows

Group 1 banks  Of which: G-SIBs  Group 2 banks
What is the impact? (cont’d) – Maturity transformation

NSFR and change in ASF and RSF

Group 1 banks  Of which: G-SIBs  Group 2 banks

![Graphs showing NSFR and change in ASF and RSF for different years for Group 1 banks, Of which: G-SIBs, and Group 2 banks.](image)
What is the impact (cont’d)? – Final Basel III reforms

- Regulatory certainty
- At the *aggregate* level, no significant increase in capital requirements
- Increase or decrease in requirements highly variable:
  - Depends on individual risk area, bank and jurisdiction
  - Typically, an increase in requirements is offset by decline (ie rarely is there an across-the-board increase or decrease)
- What factors will influence the impact?
  - Starting point (eg current level of capital, reliance on models)
  - Bank responses (behavioural and portfolio)
What happens next?

- BCBS agenda - Shift from policy to:
  - Implementation
  - Evaluation
  - Supervision

- Other issues:
  - Proportionality
  - Sovereign risk
What happens next (cont’d)? - Implementation

- Call for full, timely and consistent implementation of post-crisis reforms
- Regulatory Consistency Assessment Programme (RCAP)
  - Monitoring: have jurisdictions adopted the rules on a timely basis?
  - Assessment: are the national rules consistent with the global standard?
  - All BCBS members’ have been assessed for:
    - Risk-based capital framework (2012-16)
    - Liquidity coverage ratio (2014-17)
    - G-SIB/D-SIB framework (2016)
- Publication of findings and follow-up actions
- Assessments for NSFR and large exposures have started (2018-2020)
- Preliminary assessments for final Basel III reforms are considered
What happens next (cont’d)? - Evaluation

- Monitor impact of the new standards – an ongoing process
- Unintended consequences?
- Continue to monitor the effects and the effectiveness of the reforms
What happens next (cont’d)? - Supervision

- Identify emerging risks and supervisory challenges
- Develop and implement supervisory policies
- Improve supervisory tools and techniques
- Promote supervisory cooperation and coordination
- Facilitate the development of supervisory resources
- Facilitate the assessment of supervisory effectiveness
What happens next (cont’d)? – Proportionality

- BCBS mandate does not refer to proportionality
  - But standards, guidelines, and sound practices differentiate

- Basel III framework applies to internationally active banks
  - In practice adopted into law in most part of the world and often applied to a larger group of banks

- There is a wide range of banking systems across and within regions

- Proportionality is embedded in the Basel framework
  - Different approaches available for different types of risks
  - Large banks are treated differently

- Additional proportionate measures for non internationally active banks
## What happens next (cont’d)? – Proportionality

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<th>Current approaches</th>
<th>Revised approaches</th>
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<td><strong>Credit risk</strong></td>
<td>Simplified standardised approach</td>
<td>Standardised approach</td>
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<td>Standardised approach</td>
<td>Foundation internal ratings-based approach</td>
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<td><strong>Credit risk mitigation</strong></td>
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<td>Comprehensive approach: supervisory haircuts</td>
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<td>Comprehensive approach: own haircut estimates</td>
<td>Repo VaR</td>
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<td>Modelling of loss-given default for unsecured exposures</td>
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<td><strong>Counterparty credit risk</strong></td>
<td>Standardised approach for measuring counterparty credit risk</td>
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<td>Internal models method</td>
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<td><strong>Credit valuation adjustment</strong></td>
<td>Standardised CVA risk capital charge</td>
<td>Simple multiplier of counterparty credit risk requirement</td>
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<td>Advanced CVA risk capital charge</td>
<td>Basic approach</td>
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<td><strong>Securitisation framework</strong></td>
<td>Ratings-based approach</td>
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<td>Supervisory formula approach</td>
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<td>Internal assessment approach</td>
<td>Internal ratings-based approach</td>
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<td><strong>Market risk</strong></td>
<td>Standardised measurement method</td>
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<td><strong>Operational risk</strong></td>
<td>Basic indicator approach</td>
<td>Standardised approach</td>
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<td>Alternative standardised approach</td>
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<td>Advanced measurement approach</td>
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<td><strong>Leverage ratio</strong></td>
<td>Single exposure measure</td>
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<td><strong>Large exposures</strong></td>
<td>Single approach</td>
<td>Single approach</td>
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<td><strong>Liquidity coverage ratio</strong></td>
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<td>Single approach</td>
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<td><strong>Net stable funding ratio</strong></td>
<td>Single approach</td>
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<td><strong>Disclosure</strong></td>
<td>High-level description of qualitative and quantitative disclosures</td>
<td>Specific templates in fixed or flexible format</td>
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What happens next (cont’d)? – Proportionality

● Benefits from applying proportionality
  ▪ Maximising the net benefits of regulation
  ▪ Simplifying the regulatory framework
  ▪ Levelling the playing field across banks
  ▪ Enhancing supervisory efficiency

● Jurisdictional practices
  ▪ Two broad approaches (FSI, 2017) – Categorisation / Specific standard
  ▪ Often a mix and practices vary across jurisdictions
    - Implement only the standardised approaches
    - Apply variants of Basel approaches
    - Exempt of Basel approaches and use of domestic approaches
    - Different calibrations, reduced reporting requirements, etc.
What happens next (cont’d)? – Sovereign risk

● “Discussion Paper” published in December 2017 – “ideas” discussed by the Basel Committee
  ▪ Revisions to risk-weighted framework
  ▪ Mitigating concentration risk
  ▪ Other revisions considered: definition, credit risk mitigation framework, Pillar 2 guidance, Pillar 3 disclosures

● No consensus to change existing treatment

● But recognition that issues would benefit from broader discussion

● Seeking views of stakeholders to inform longer-term thinking (deadline for comments was 9 March 2018: xx comments received)
Conclusion

- Collectively, the set of Basel III reforms addresses shortcomings of the pre-crisis regulatory framework and provides a foundation for a resilient banking system.

- Finalisation of Basel III marks a shift in the Committee’s agenda from policy to implementation, evaluation and supervision.

- Proportionality is an increasingly relevant policy issue, under review in several jurisdictions and an area for future work by the Committee.

- BCBS jurisdictions should yield to the temptation to dilute, delay or deviate from the globally agreed-upon framework.
THANK YOU!

Questions and discussion

www.bis.org/bcbs/