



Finalising Basel III

EFTA Working Group on Financial Services

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Objectives of our work

- Finalise Basel III around year-end
- Outstanding work to a large extent relates to reducing excessive variability in risk-weighted assets
- Aim is not to **significantly** increase **overall** capital requirements
- Maintain risk-sensitive framework

A bit of history

- Work started in 2008
- First set of documents published at end-2010
 - Resulted in
 - Significantly higher requirements for loss absorption
 - More emphasis on higher-quality capital
- Extensive consultations have taken place
- Comprehensive assessment of the impact of the Committee's policy reforms

Post-crisis regulatory reforms

- Pre-crisis: one regulatory constraint: risk-weighted ratio
- Post crisis: a framework with multiple constraints/metrics
 - Risk-weighted ratio (with more capital of higher quality)
 - Capital conservation buffer and countercyclical buffer
 - Leverage ratio
 - Large exposures regime
 - Additional requirements for systemically important banks
 - Liquidity coverage ratio
 - Net stable funding ratio

What remains to be done?

- A package of elements
 - Standardised approach for credit risk
 - Operational risk
 - Internal ratings-based approach
 - Potential output floor and overall calibration
 - Leverage ratio surcharge for systemically important banks
- Comprehensive cumulative impact study crucial element

Credit risk – standardised approach

- Has gained in importance, mainly due to potential of output floors
- Aim: improve the standard's risk sensitivity
- However, this is likely to increase complexity
- For some portfolios, two approaches suggested
 - For jurisdictions that (i) allow or (ii) do not allow external ratings

Credit risk – standardised approach

- Issues raised during consultation
 - Exposures to unrated banks
 - Covered bonds
 - Treatment of SMEs (and other corporates)
 - Residential real estate

Credit risk – internal ratings-based approach

- Concern expressed about banks' modelling practices and degree of freedom in estimating risk components
- Proposal in CP:
 - Remove option to use IRB and require standardised approach for
 - Banks and financial institutions, large corporates, equities
- Responses strongly requested to maintain IRB

Operational risk

- Key element of revised approach
- Under consideration to
 - Combine simple accounting proxy for operational risk with a bank's internal loss data
 - Discontinue with Advanced Measurement Approaches

Output floor

- Current floor for IRB and AMA based on Basel I
- Floor introduced to mitigate model risk and measurement error
- Places a limit on the benefit a bank derives from using its internal models for estimating required capital

Next steps

- BCBS meeting on 28-29 November 2016
- Basel III ultimately to be endorsed by Governors and Heads of Supervision (governing body of BCBS)
- Transitional arrangements
- Implementation (due date)
- Treatment of sovereign exposures
- Assessment of implementation
- More work on supervision