Demystification of Basel III Endgame

“Introduction ”

Compliance to Basel guidelines is a Journey and not a Destination

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Basel III Endgame

Notice of Proposed Rulemaking – Basel III Endgame (Expanded Risk Weight Approach)

Published on 27th July 2023 by US Fed / OCC/ FDIC

Agencies have estimated a 16% increase to CET1 capital levels and a 20% increase to RWA for large bank holding companies (with US G-SIBs and IHCs seeing the highest increases).

Impacts multiple Basel Metrics & Regulatory Reports

A banking organization’s expanded total risk-weighted assets would be phased-in starting July 1, 2025, until June 30, 2028

Data will play a central role in implementing Basel III endgame, and all banks must establish dedicated processes for discovering and obtaining data

Implementation of Basel III Endgame after receiving the final guidelines which are expected in Q1 2024

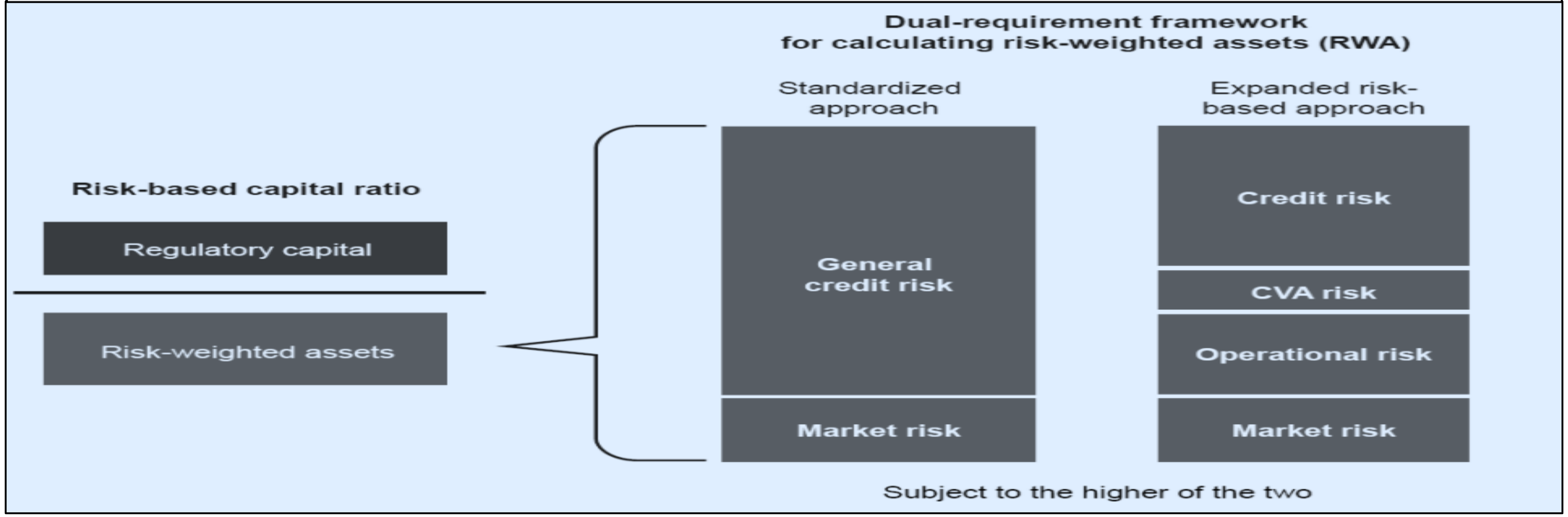
The proposed Basel III Endgame (the Expanded Risk Weight Approach), presents substantial challenges in terms of capital requirements and the tight implementation timelines. A well-defined and comprehensive data strategy is indispensable for effectively adapting to these guidelines and ensuring compliance..

Basel III Endgame – Brief Note

On July 27th, the Federal Reserve (Fed), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) unveiled a highly anticipated proposal (Notice of Proposed Rulemaking-NPR) aimed at putting the finishing touches on the Basel III agreement. This initiative, often referred to as the **"Basel III endgame,"** outlines crucial regulatory measures.

Additionally, the Fed presented proposed changes to how the capital surcharge is calculated for G-SIBs. Furthermore, the proposal includes substantial amendments to the Systemic Risk Report (FR Y-15) and expecting changes to capital adequacy related FFIEC reports

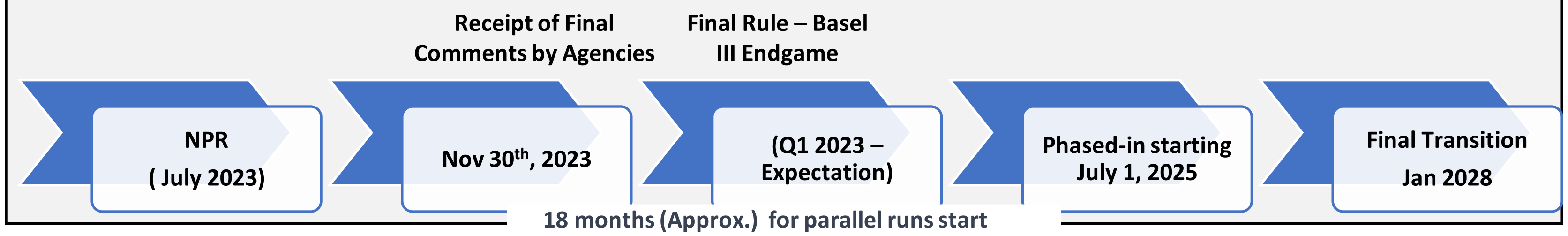
large banking organization would be required to calculate its risk-based capital ratios under both the **new expanded risk-based approach** and the **current standardized approach** (including market risk, as applicable), and use the lower of each risk-based capital ratio. All capital buffer requirements, including the stress capital buffer requirement, would apply regardless of whether the expanded risk-based approach or the existing standardized approach produces the lower ratio.



Impact Assessment

Agencies have estimated that the Basel III endgame proposal would result in a 16% increase to CET1 capital levels and a 20% increase to RWA for large bank holding companies (with US G-SIBs and IHCs seeing the highest increases).

A banking organization's expanded total risk-weighted assets would be phased-in starting July 1, 2025, until June 30, 2028



Basel III Endgame – Key Changes

Key Change	Description
Improve consistency of risk measurement in the capital rule for large banking organizations	The proposal introduces an "**expanded risk-based approach"** to replace current internal-models-based capital requirements for credit and operational risk. This approach applies to all banking organizations with assets exceeding $100 billion (Category 1-IV)
Apply the capital standards for large banking organizations to a broader set of large banking organizations	**Consistent Regulatory Capital Calculation:** The proposal mandates that all banking organizations with assets exceeding $100 billion must calculate regulatory capital consistently. This includes accounting for unrealized gains and losses on available-for-sale securities to better represent their actual loss-absorbing capacity. **Supplementary Leverage Ratio and Countercyclical Capital Buffer:** Additionally, it requires all banking organizations with assets exceeding $100 billion to meet the supplementary leverage ratio requirement and apply the countercyclical capital buffer, if activated.
Maintain stricter standards for the largest, most systemic banking organizations.	In the proposal, U.S. GSIBs will still face a risk-based capital surcharge, and Category I banking organizations will maintain the enhanced supplementary leverage ratio requirement.
Increase transparency of capital requirements across large banking organizations	The proposal uses standardized methods and better public disclosures to make it easier to compare and understand the capital requirements of large banks.
Maintain two methodologies to determine risk-based requirements	The proposal keeps a "**dual requirement system"**, where large banks calculate their risk-weighted assets using both the **current standard method** and the **new expanded approach**. They must meet the stricter of the two, ensuring their capital requirements are at least as strict as those for smaller banks.
Provide a transition period	The Basel III NPR allows banks a transition period of three years, starting July 1, 2025, with a fully phased-in date of July 1, 2028

Basel III Endgame – Proposed Changes to the Framework

Basel IIII Endgame – Capital Adequacy Requirements			Category I (G SIBs)	Category II >= 700 b Total assets	Category III >= 250 b Total assets	Category IV 100 b - 250 b Total assets
Capital	Capital Buffers	G SIB Surcharge	Revised	NA	NA	NA
		FR Y 15 : Systemic Risk Report	Revised	Revised	Revised	NA
		Countercyclical capital Buffer	No change	No change	No change	Newly introduced
		Stress Capital Buffer (SCB)	Revised	Revised	Revised	Revised
	Current Standardized Approach	Credit Risk	No change	No change	No change	No change
		SA-CCR (Derivatives)	No change	No change	Newly introduced	Newly introduced
		Market Risk	Revised	Revised	Revised	Revised
	Expanded Risk Based Approach (Replaces current advance approaches)	Credit Risk	Newly proposed	Newly proposed	Newly proposed	Newly proposed
		Market Risk	Newly proposed	Newly proposed	Newly proposed	Newly proposed
		Operational Risk	Newly proposed	Newly proposed	Newly proposed	Newly proposed
		CVA	Newly proposed	Newly proposed	Newly proposed	Newly proposed
	Leverage Capital	Supplementary Leverage Ratio	Revised	No change	No change	Newly proposed
SCCL	SCCL	SCCL (SA-CCR for derivatives)	Revised	Revised	Revised	No change

Market Risk : The proposal introduces a new risk sensitivity-based SA for RWA and replaces value at risk (VaR) measures with an expected shortfall (ES) measure in the IMA to better capture tail losses
any banking organization with aggregate trading assets and trading liabilities that, as of the most recent calendar quarter, equal to $1 billion or more, or 10 percent or more of the banking organization’s total consolidated assets, is required to calculate market risk capital requirements

Basel III Endgame – Data Requirements

Data will play a central role in implementing Basel III endgame, and all banks must establish dedicated processes for discovering and obtaining data. If new data sources are necessary, banks should assess whether they provide adequate support for regulatory reporting and create improvement plans as necessary

Data currently being used

- **Data Assessment:** Begin by thoroughly assessing the data currently in use to ensure its accuracy, completeness, and relevance to Basel III requirements.
- **Data Validation:** Implement robust data validation processes to verify the accuracy and integrity of the data being used for regulatory reporting.
- **Documentation:** Maintain comprehensive documentation of data sources, transformations, and calculations to ensure transparency and regulatory compliance.
- **Data Governance:** Establish strong data governance practices to oversee the quality and consistency of data used for Basel III endgame .

New Data - available in different systems

- **Data Integration:** Develop a strategy for integrating new data from various systems into a unified data platform.
- **Data Mapping:** Create clear data mapping and transformation procedures to ensure the consistency and reliability of newly integrated data.
- **Data Quality Checks:** Implement data quality checks and validation processes specific to the new data sources to identify and rectify any issues.
- **Reporting Alignment:** Ensure that the newly integrated data aligns with the reporting requirements specified under Basel III

New Data - not available in any system

- **Data Identification:** Identify the specific data elements that are currently missing from any existing systems but are required for NPR
- **Data Sourcing:** Explore options for sourcing these missing data elements, which may involve collecting data from external sources or creating new data capture processes.
- **Data Storage:** Determine where and how to store these new data elements securely, keeping in mind data protection and privacy regulations.
- **Data Validation:** Develop validation procedures and controls for the newly acquired data to ensure its accuracy and reliability.
- **Integration Planning:** If applicable, plan for the integration of the new data into existing systems or reporting processes.
- **Regulatory Alignment:** Ensure that the newly acquired data aligns with Basel III endgame requirements and can be used effectively for compliance

Reference Document	**Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity**
URL	https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant