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# Banking Regulation Changes affecting Financial Risk Management - Past and Future

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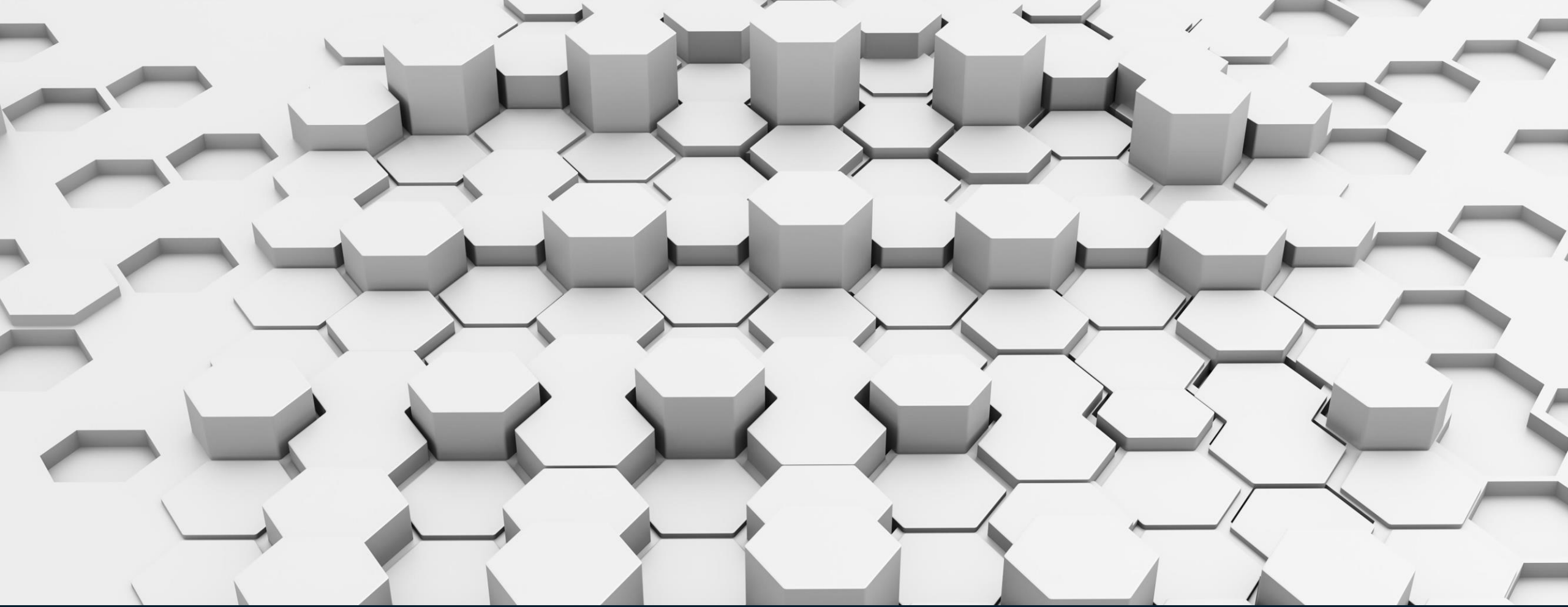
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# Introduction



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# South African Banking Legislative Landscape



01

## Basel “IV” Reforms

The Basel III post crisis reforms are Basel Committee's response to the global financial crisis provides a foundation for a resilient banking system that will help avoid the build-up of systemic vulnerabilities, placing a greater focus on going-concern loss-absorbing capital, resilience to withstand losses in times of stress, adds macroprudential elements, specifying a minimum leverage ratio, NSFR and LCR, and robust risk-sensitive capital floor

03

## Conduct Standards

The Financial Sector Conduct Authority (FSCA) commenced operations on 1 Apr 2018 in terms of the FSR Act. The COFI Bill is a key pillar in government's Twin Peaks financial sector regulatory reform process that aims to entrench better financial customer outcomes with focus on conduct standards, licencing, etc and its implementation will lead to fair treatment of customers legally enforceable as well ensuring that financial inclusion in South Africa is achieved.

06

## Benchmark Reforms

Transforming widely used interest rate benchmarks in South Africa, i.e., ZARONIA replacing JIBAR etc.

04

## Digital Reforms

Intergovernmental Fintech Working Group (IFWG) and South African financial sector regulators focus area on digital regulations, innovation, regulatory sandbox experiments on new products, AI, Crypto Currency, etc.

05

## ESG

ESG stands for environmental, social and governance. These are called pillars in ESG frameworks and represent the 3 main topic areas that companies are expected to report in. The goal of ESG is to capture all the non-financial risks and opportunities inherent to a company's day to day activities.

02

## Resolution Framework and CODI

CODI was established as part of the financial safety net, designed to protect vulnerable bank depositors by ensuring that they will have timeous access to their savings should a bank fail. It will also alleviate the burden on Government to bail out banks and compensate depositors using taxpayers' money.

07

## Umoja Programme

This is multiyear PA target operating model transformation programme similar to ECB's supervisory financial reporting data points (SFDP XBRL) Package. This allows for uniform technical standard for data collection, defining the data items, business concepts, relations, visualisations and validation rules making use data point models, taxonomies, etc

08

## AML/CFT

Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) strengthen the fight against corruption, fraud and terrorism, and assist South Africa in meeting the international standards on AML/CFT, noncompliance results to grey listing by the Financial Action Task Force (FATF). The PA applies a risk-based supervisory framework based on risk profile of an accountable institution.

# Background



The fundamental basis of the Basel Capital Accords has always been that banks that are exposed to more risk should hold more capital. What has developed over the last 30+ years since the implementation of the first Basel Capital Accord is the range of risks covered by the Accords, and the sophistication of the assessment of riskiness and allocation of capital.

Since its inception in the Basel accord of 1988, the Basel framework on capital regulation has come to be established as the core assessment of soundness and stability of the banking system. The framework continues to evolve with various revisions in response to the changing circumstance. Basel 3, and Basel 3.1 (often referred to as Basel IV) aim to address a number of short-comings in the pre-crisis regulatory framework, and to provide the foundation for a resilient banking system.

Basel 3 sets out requirements for higher and better-quality capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk-based requirement, measures to promote the build-up of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards. Basel 3.1 aims to address the loss of faith in the internal models used by banks, through constraints on internally modelled approaches and introduction of the standardised output floor.

| Basel 1                                                                                                                                                        | Basel 2                                                                                                                                                                        | Basel 2.5                                                                                                                                                      | Basel 3                                                                                                                                                                                                                    | Basel 3.1 (final reforms)                                                                                                                                                                                                                     |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1988                                                                                                                                                           | Jun 2006                                                                                                                                                                       | Nov 2009/Dec 2010                                                                                                                                              | 2010                                                                                                                                                                                                                       | 2017                                                                                                                                                                                                                                          |
| <ul style="list-style-type: none"> <li>Simple in application</li> <li>Easy to achieve significant capital reduction with little or no risk transfer</li> </ul> | <ul style="list-style-type: none"> <li>Much more complex and risk sensitive</li> <li>Three pillar approach</li> <li>Differentiates between both exposures and banks</li> </ul> | <ul style="list-style-type: none"> <li>Further market risk requirements</li> <li>New securitisation framework</li> <li>New remuneration constraints</li> </ul> | <ul style="list-style-type: none"> <li>Increased regulatory capital for all banks</li> <li>Enhanced quality of capital</li> <li>Additional capital buffers</li> <li>Leverage ratio</li> <li>Liquidity framework</li> </ul> | <ul style="list-style-type: none"> <li>Reduced use of internal modelling for RWA calculations</li> <li>More sophisticated standardised approaches for RWA calculations</li> <li>New resolvability measures</li> <li>Capital floors</li> </ul> |
| Eligible capital                                                                                                                                               | Eligible capital                                                                                                                                                               | Eligible capital                                                                                                                                               | Eligible capital                                                                                                                                                                                                           | Eligible capital                                                                                                                                                                                                                              |
| Minimum capital requirement                                                                                                                                    | Minimum capital requirement                                                                                                                                                    | Minimum capital requirement                                                                                                                                    | Minimum capital requirement                                                                                                                                                                                                | Minimum capital requirement                                                                                                                                                                                                                   |
| Credit risk; standardised risk weightings                                                                                                                      | Credit risk                                                                                                                                                                    | Credit risk                                                                                                                                                    | Credit risk                                                                                                                                                                                                                | Credit risk                                                                                                                                                                                                                                   |
|                                                                                                                                                                | Counterparty credit risk                                                                                                                                                       | Counterparty credit risk                                                                                                                                       | Counterparty credit risk                                                                                                                                                                                                   | Counterparty credit risk                                                                                                                                                                                                                      |
|                                                                                                                                                                | Securitisation                                                                                                                                                                 | Securitisation                                                                                                                                                 | Securitisation                                                                                                                                                                                                             | Securitisation                                                                                                                                                                                                                                |
|                                                                                                                                                                | Market risk                                                                                                                                                                    | Market risk                                                                                                                                                    | Market risk                                                                                                                                                                                                                | Market risk                                                                                                                                                                                                                                   |
|                                                                                                                                                                | Operational risk                                                                                                                                                               | Operational risk                                                                                                                                               | Operational risk                                                                                                                                                                                                           | Operational risk                                                                                                                                                                                                                              |
|                                                                                                                                                                | Pillar 2: regulatory review                                                                                                                                                    | Pillar 2: regulatory review                                                                                                                                    | Pillar 2: regulatory review                                                                                                                                                                                                | Pillar 2: regulatory review                                                                                                                                                                                                                   |
|                                                                                                                                                                | Pillar 3: market disclosure                                                                                                                                                    | Pillar 3: market disclosure                                                                                                                                    | Pillar 3: market disclosure                                                                                                                                                                                                | Pillar 3: market disclosure                                                                                                                                                                                                                   |
|                                                                                                                                                                |                                                                                                                                                                                | Remuneration                                                                                                                                                   | Remuneration                                                                                                                                                                                                               | Remuneration                                                                                                                                                                                                                                  |
|                                                                                                                                                                |                                                                                                                                                                                |                                                                                                                                                                | Leverage ratio                                                                                                                                                                                                             | Leverage ratio                                                                                                                                                                                                                                |
|                                                                                                                                                                |                                                                                                                                                                                |                                                                                                                                                                | Liquidity framework                                                                                                                                                                                                        | Liquidity framework                                                                                                                                                                                                                           |
|                                                                                                                                                                |                                                                                                                                                                                |                                                                                                                                                                |                                                                                                                                                                                                                            | Capital framework                                                                                                                                                                                                                             |

New Requirement
 Changing requirement with increasing capital requirements
 Changing requirement with decreasing capital requirements
 No change/minimal impact



- The current bank capital framework is an amalgamation of rules developed before the GFC (Basel 2) and rules put in place as an immediate response to the GFC (Basel 2.5 and Basel 3).
- **The rules that have been implemented so far address many of the most important failings of the pre-crisis bank capital framework.**
- This was achieved by raising the **quality and quantity of capital** that banks hold, **revising areas of the risk-weighted capital framework that had proved to be acutely mis-calibrated during the GFC** (including market risk, counterparty credit risk and securitisation), introducing **global liquidity standards**, specifying a **minimum leverage ratio requirement** and **addressing gaps in the framework** (such as CVA risk).
- However, reforms that address the loss of confidence in banks' reported risk weighted capital ratios, and address the variability in banks' risk weighted assets, were not part of the initial phase of the post-crisis reform agenda. Those fundamental issues are addressed by Basel 3.1 (Basel 'IV'), which has not yet been implemented.

## **Key theme: the use of internal models**

- *Under the existing framework, banks are able to use internally modelled approaches to calculate their capital requirements for most risks.*
- *While some scope for use of internal models will remain under the future framework (with constraints), in areas such as operational risk and CVA risk only standardised or basic approaches will be available.*
- *Internally modelled approaches use more inputs than standardised approaches, and require more granular data. The benefit for banks is that the capital charges generated by internal models tend to be lower than under the standardised approach.*
- *The use of internal models requires supervisory approval, and is accompanied by greater supervisory scrutiny.*

# Key Features of the finalised Basel III Reform



The Basel III Reform addresses weaknesses that were revealed by the 2007/08 global financial crisis.

## Enhance capital buffer

Increase the quantity and quality of capital and introduce macro-prudential buffers

## Constrain excessive leverage

Introduce leverage ratio to constrain excessive leverage in banking system

## Strengthen liquidity levels

Introduce LCR and NSFR to strengthen liquidity and funding profiles of banks

## Enhance the robustness and risk sensitivity of Standardised Approach

Streamline the Standardised Approach to improve the comparability of banks' capital ratios

## Constrain the use of internally-modelled approaches

Place limits on certain inputs used to calculate capital requirements under the internal ratings-based (IRB) approach for credit risk and remove the use of the internal model approaches for CVA risk and for operational risk

## Reduce excessive RWA variability

Improve risk capture and risk sensitivity of Standardised Approach while reducing excessive RWA variation across banks by constrained use of internal models

### Revision to credit risk Standardised Approach

- Recalibration of risk-weights for exposure to risk classes for jurisdictions in which ratings approach is not permitted and for any unrated exposures;
- Introduced a loan-to-value component, real estate asset class and customer type (i.e. transactor and revolver) to calculate capital charges for real estate exposures;
- Banks are required to conduct sufficient due diligence on an annual basis to avoid reliance on external ratings.

### Revised operational risk Standardised Approach

- Introduced business indicator component (BIC) which depends on a financial-statement-based proxy for operational risk and a set of regulatory determined marginal coefficients;
- Considered Internal Loss Multiplier (ILM), which is a scaling factor that is based on a bank's average historical losses and the BIC.

### Constraints on the use of IRB approach for credit risk

- Eliminated the use of the A-IRB approach for calculation of exposure to large corporates, banks and other financial institutions, for which banks should use more supervisory-estimated values, such as LGD, EAD, and maturity.

### Revised market risk framework

- Trading desks with supervisory approval to use Internal Models Approach (IMA) must perform P&L attribution tests on a quarterly basis;
- Additionally, banks using IMA are required to calculate capital charge for risk factors which cannot be modelled.

### New output floor requirements

- Banks using internal models will need to calculate a separate capital charge using the Standardised Approaches, multiplied by 50% initially, from which the percentage will be incrementally increased each year, to 72.5%. The higher of the two amounts will be taken as the capital charge.

# Minimum Capital Requirements



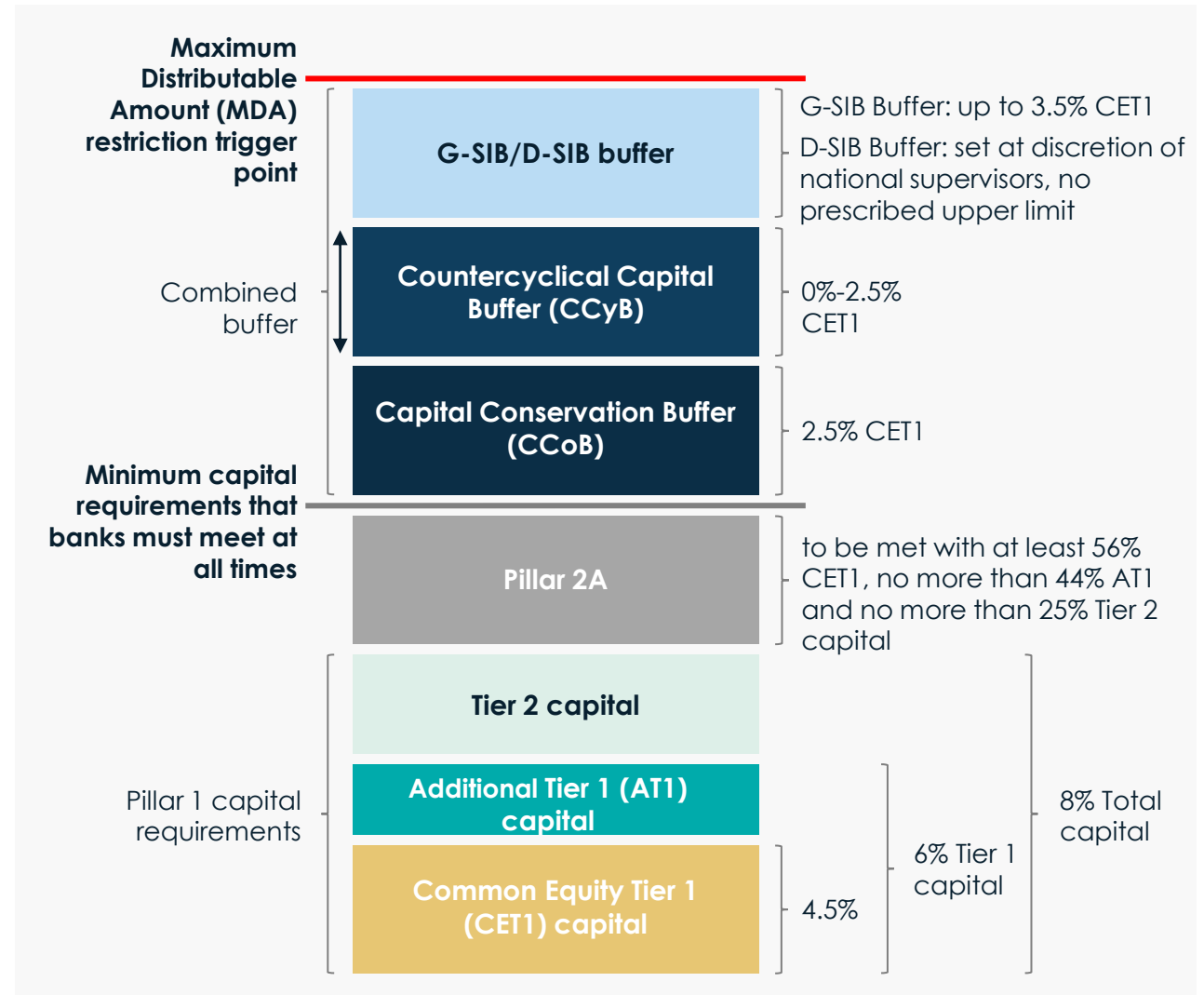
**Basel 3 imposed significantly higher capital requirements on banks, as well as a requirement that a significantly higher proportion of capital is held in the form of shares and retained earnings (Common Equity Tier 1 or CET1), as these are regarded as the most loss-absorbing forms of capital.**

Under the prior regime, banks had to hold 8% of RWAs as capital, although only half of that capital was required to be Tier 1 – shares and long dated highly subordinated debt – and only half of the Tier 1 capital had to be in the form of shares and retained earnings.

Under the new regime, banks will have to hold significantly more capital in total – typically in excess of 10.5% - and significantly more of this will have to be CET1 – from 7% up.

In addition to the higher base requirements, there are a number of capital buffers which will vary from firm to firm and which must be met with CET1 capital:

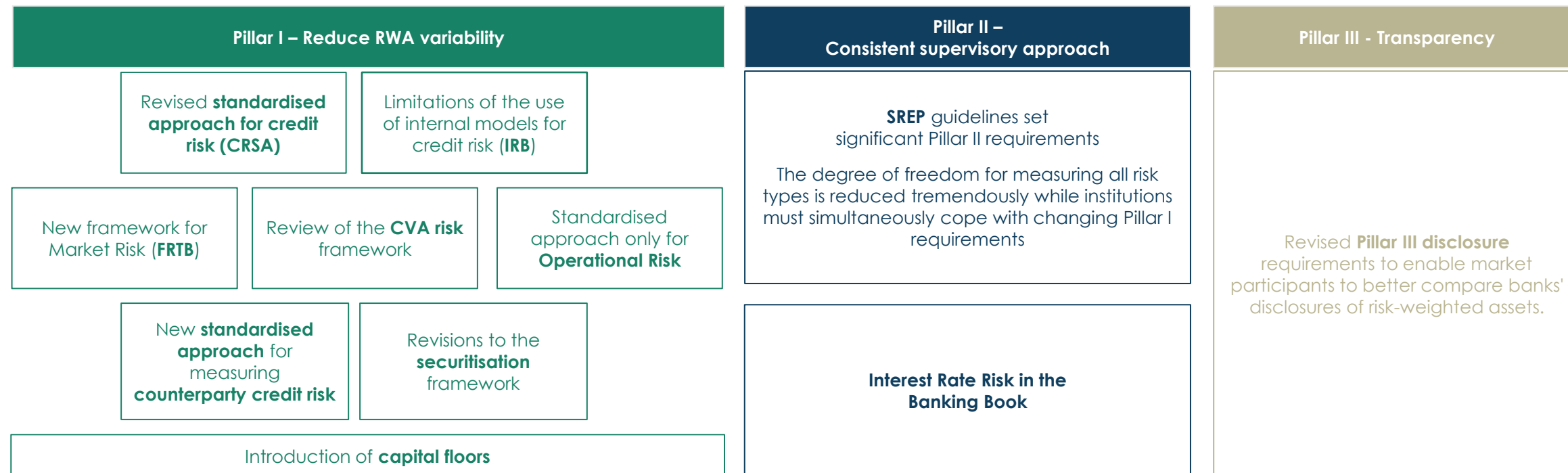
- 1) Capital Conservation Buffer – designed to ensure that firms do not jeopardise their financial strength by making payments (dividends and bonuses) that take them into financial difficulty. If the Capital Conservation Buffer is used, restrictions on distributions come into force.
- 2) Countercyclical buffer – designed to provide a tool to manage macro-economic conditions, e.g. Housing bubble. Can be precisely targeted at institutions, sectors or asset types, to increase capital requirements on commercial real estate, for example.
- 3) G-SIB or D-SIB buffer – additional capital requirements to cover the increased risk posed by systemically important banks.



# Changes in the Basel framework



Substantial changes to Basel framework in all pillars

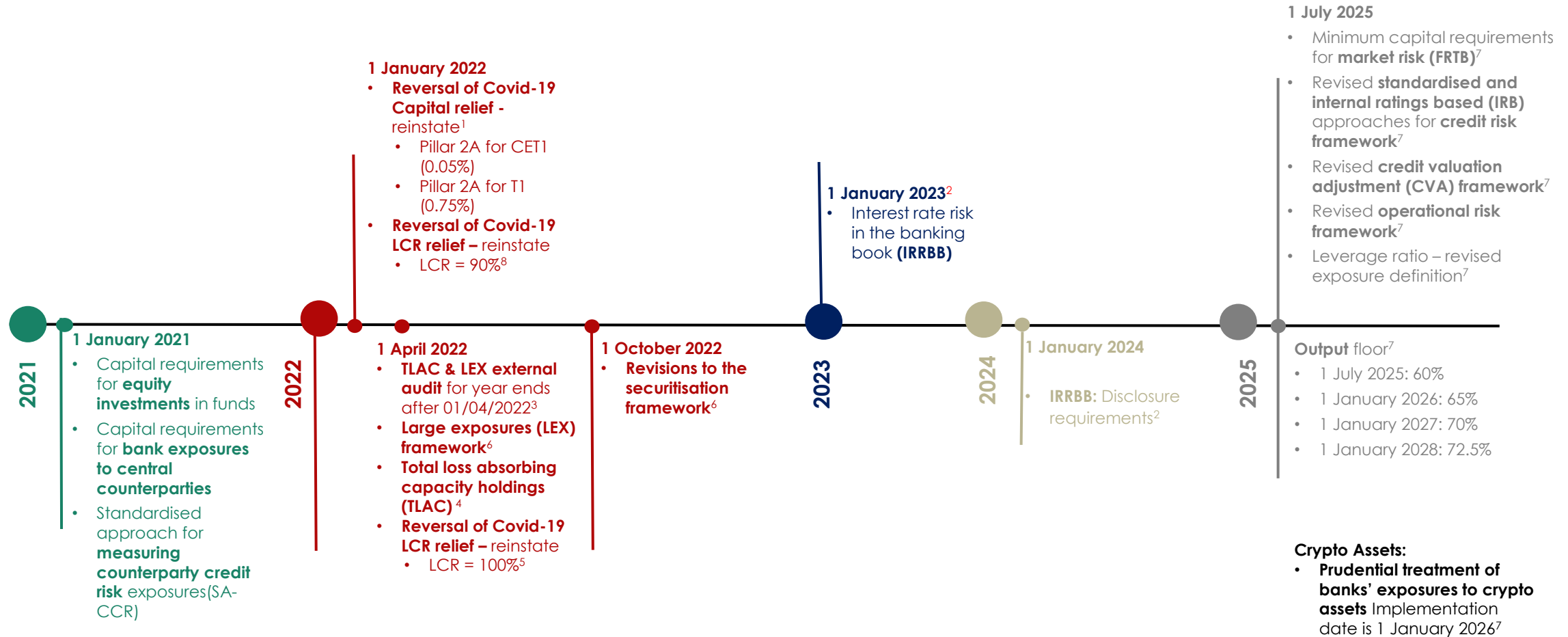


## Impact on: Capital Planning, Business Model and Profitability Management

### Themes

- Removal of internal model approach in certain instances (Operational Risk, Securitisations, CVA)
- Stricter rules and controls on internal model approaches (Credit Risk, Market Risk, CVA)
- Compulsory standardised approach implementation for capital floor and fallback purposes
- Internal models more standardised, standardised approaches more risk sensitive
- Penalties for poor models and data

# South African timelines – Basel 3.1 / “IV”



<sup>1</sup> Per Directive 5/2021

<sup>2</sup> Per proposed Directive 08/08/2022 & G4/2022

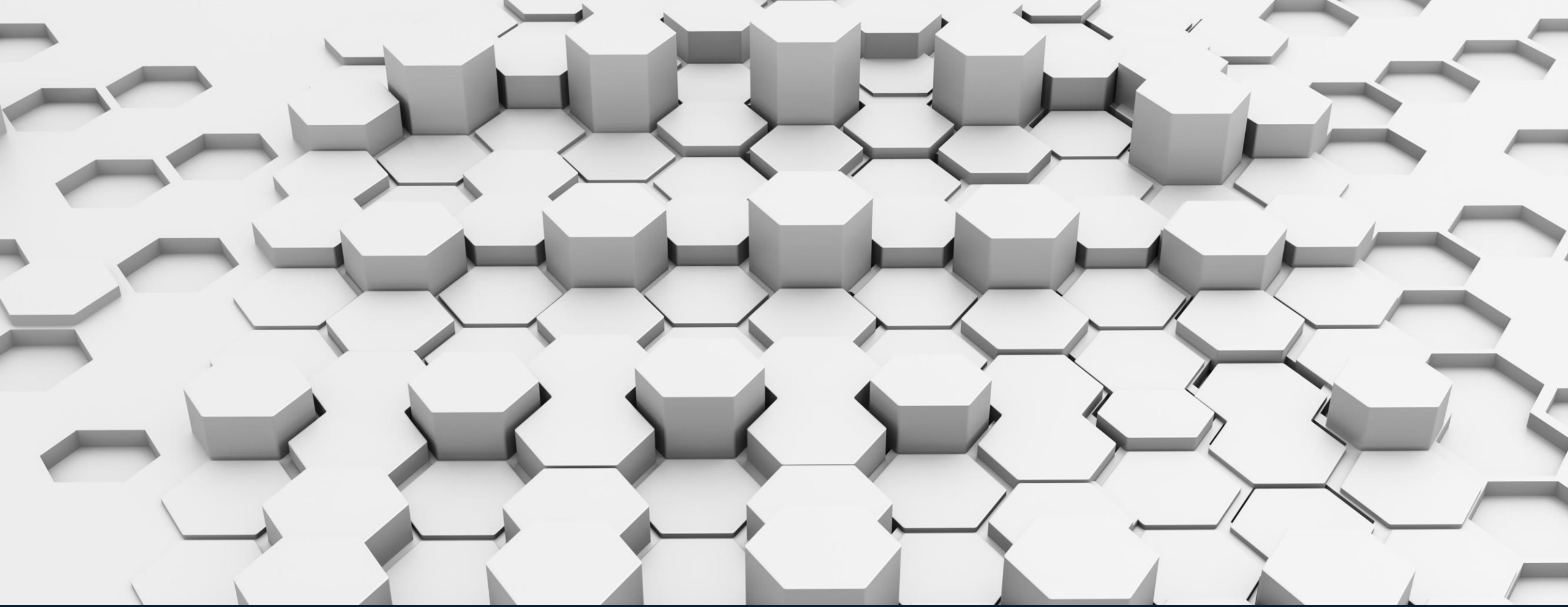
<sup>3</sup> Per proposed Directive 20/06/2022

<sup>4</sup> Per Prudential Communication 2/2022

<sup>5</sup> Per Directive 8/2021

<sup>6</sup> Per Guidance Note G4/2022

<sup>7</sup> Per Guidance Note 3/2023



# Credit Risk: Internal Ratings-Based (IRB) Approach

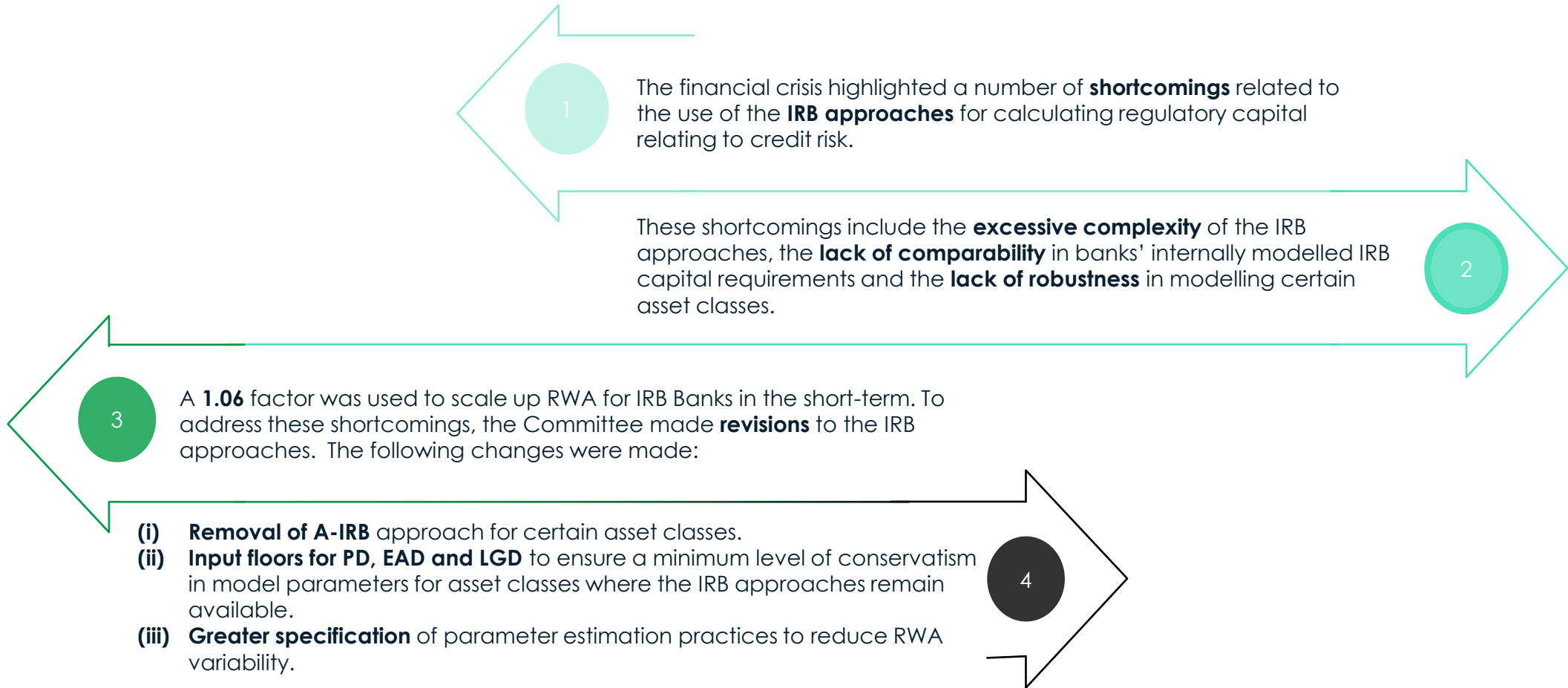


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# Changes to the IRB Approach



# Removing the use of the A-IRB for certain asset classes



## Asset Classes

These include exposures to **large and mid-sized corporates, banks and other financial institutions**.

In addition, all IRB approaches are being removed for exposures to **equities**, which are typically a small component of the credit risk of banks.

## What Changed?

The revised IRB framework removes the use of the A-IRB approach – which allows banks to estimate the PD, LGD, exposure at default (EAD) and maturity of an exposure – for asset classes that cannot be modelled in a robust and prudent manner.



The table below outlines the revised scope of approaches available under **Basel III** for certain asset classes relative to the **Basel II** framework.

## Variability

As a result, banks with supervisory approval will use the foundation IRB (F-IRB) approach, which removes the two important sources of RWA variability as it applies fixed values to the LGD and EAD parameters.

### EXPOSURE

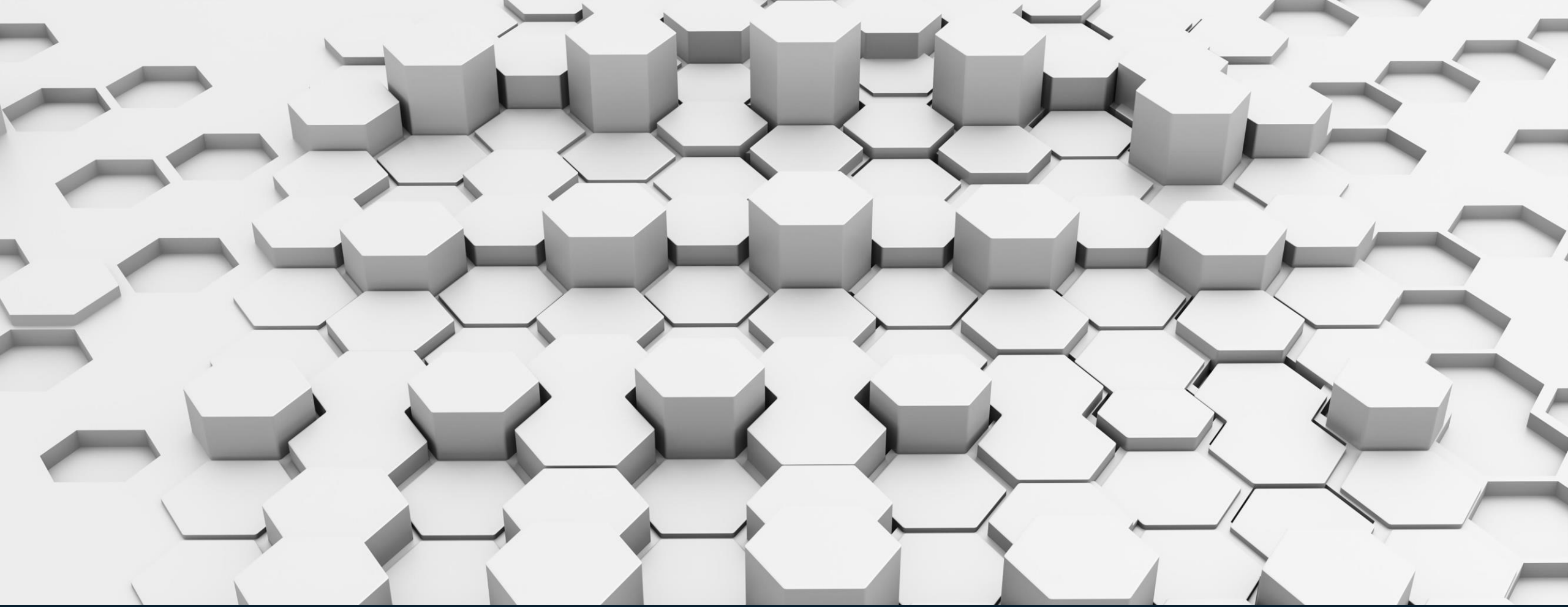
|                                                                       |
|-----------------------------------------------------------------------|
| Large and Mid-Sized Corporates (with consolidated revenue of > R15bn) |
| Banks and Other Financial Institutions                                |
| Equities                                                              |
| Specialised Lending                                                   |

### Basel II: available approaches

|                            |
|----------------------------|
| A-IRB, F-IRB, SA           |
| A-IRB, F-IRB, SA           |
| A-IRB, F-IRB               |
| A-IRB, F-IRB, SA, slotting |

### Basel III: available approaches

|           |
|-----------|
| F-IRB, SA |
| F-IRB, SA |
| SA        |
| No Change |



# Credit Risk: Standardised Approach



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# CRSA – Essential Changes



## Increasing risk sensitivity

|                                                                                                                                      |                                                                                                                                                                                                                                                                                                                                                                |
|--------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|  Reducing dependencies on external ratings          | <ul style="list-style-type: none"><li>• <b>Usage of external ratings</b> for the purpose of weighing risk at national discretion</li><li>• Mandatory <b>internal due diligence</b>, potentially increasing risk weight</li></ul>                                                                                                                               |
|  More differentiated methods to derive risk weights | <ul style="list-style-type: none"><li>• Introducing new calculation practices for the purpose of deriving risk weights</li><li>• <b>LTV</b> (Loan to Value) for <b>real estate financing</b></li><li>• <b>Regulatory ratios based on internal assessments</b> for unrated institutions under the Standardised Credit Risk Assessment Approach (SCRA)</li></ul> |
|  Recalibration of risk weights and CCFs             | <ul style="list-style-type: none"><li>• Adjusted risk weights and modified conversion factors (e.g. unconditionally cancellable credit lines)</li></ul>                                                                                                                                                                                                        |
|  Revised definition of exposure classes            | <ul style="list-style-type: none"><li>• New exposure classes put stronger focus on the <b>type of borrower</b> and the <b>purpose of financing</b></li><li>• Higher differentiation within certain risk exposure classes (i.e. specialised lending)</li></ul>                                                                                                  |
|                                                   | <ul style="list-style-type: none"><li>• The output floor and the related transfer of exposures from IRB to CRSA highlights the importance of the increased risk sensitivities and the revised definition of exposure classes</li><li>• CRSA as input for the output floor has to be implemented also by banks using the IRB</li></ul>                          |

# CRSA – Essential Changes



## Real Estate

- The changed risk weighting (LTV) tends to affect banks with high real estate portfolios with high mortgage lending rates
- Product design (term, pricing etc.) or customer focus must be tested



## Banks

- The omission of the home country principle may increase the pressure on portfolios with financially weak unrated banks
- New investment and refinancing strategies may become necessary



## Corporates

- Specialised lending will only be valued on the basis of the issue specific rating
- Specialised lending likely to be less profitable
- Level playing field endangered through different rules (no external ratings in some countries)



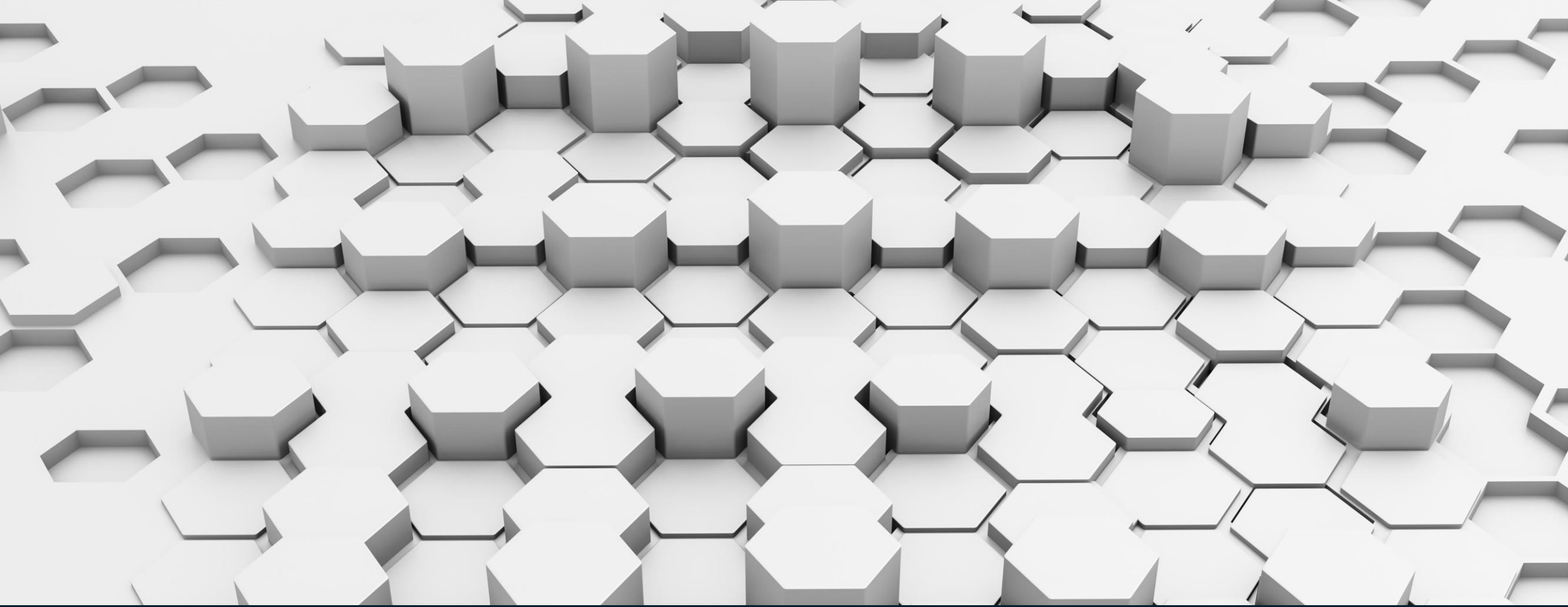
## Retail

- Comparatively low impact for banks with large retail portfolios
- The lending criteria and the pricing for foreign currency loans may need to be adjusted

The interdependencies of the portfolios and their capital requirements are to be considered in the analyses



The future profitability and capital allocation should already be taken into consideration



# Operational Risk



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# Operational risk



The revised approach includes some recalibration and simplification, looking to impose consistency across the industry, particularly regarding the identification and recognition of prior operational losses

## The BCBS's objectives

- **Given lack of consistency in modelling of Operational Risk, to remove the modelling option**
- **Increase consistency of recognition of prior losses in the Operational Risk capital charge**

## Content of the final standards agreed

- **REMOVAL** of the modelled (AMA), Basic Indicator and Standardised approaches
- **SINGLE** Standardised Measurement Approach (SMA) for all banks; Operational Risk Capital requirement calculated by multiplying Business Indicator Component by Internal Loss Multiplier.
  - **BUSINESS INDICATOR COMPONENT** Set as financial statement-based **proxy for operational risk**. **BI = Interest, leases and dividend component (ILDC) x Services component (SC) x Financial Component (FC) x marginal coefficient**
  - **INTERNAL LOSS MULTIPLIER** **Historical operational risk losses of the previous 10 years** have to be collected according to **minimum data standards** (in order to guarantee their quality and integrity), and have to be considered as an **input for the capital calculation**.

SMA Capital Requirement

=

Business Indication Component (BIC)

X

Internal Loss Multiplier (ILM)

- **Operational risk capital increases** in an increasing rate with banks' income and with operational risk losses.
- Must have documented procedures and processes for the identification, collection and treatment of internal loss data. This must be subject to validation and be regularly reviewed by independent internal and/or external audit
- Loss data must be comprehensive and capture all material activities.
- Banks must have processes to independently review the comprehensiveness and accuracy of loss data (internal or external audit).



# Fundamental Review of the Trading Book (FRTB) – Traded Market Risk



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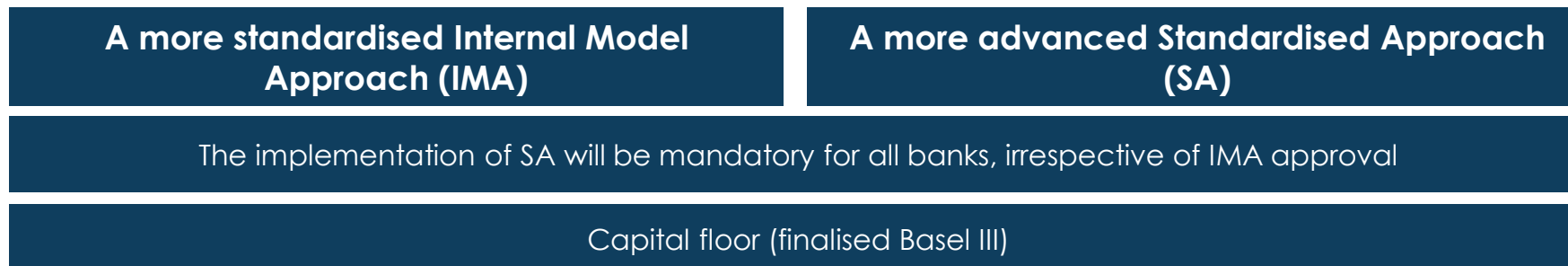
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# Overview of the FRTB



The impact of the FRTB stretches far **beyond just changes to model methodology**

## Revised capital calculations



## Major changes

IMA only IMA & SA



# Overview of the FRTB



The impact of the FRTB stretches far beyond just changes to model methodology

## A more standardised Internal Model Approach (IMA)

- **99% VaR → 97.5% Expected Shortfall**
- **Incremental Risk Charge (IRC) → Default Risk Charge** (excludes migration risk BUT inclusion of equity and default risk charge)
- **VaR + Stress VaR → ES calibration to 1 year stress period**
- **10 holding period → Liquidity horizons** ranging from 10 to 120 days depending on the asset class and risk type
- **Securitisations → Standardised approach only**
- **RniV → Non-Modellable Risk Factors (NMRF)** – capitalised using a stress testing approach if there are not sufficient real price observations
- Restricts asset class **diversification** benefits
- **CVA hedges excluded → CVA exposures and hedges capitalised under a separate framework**

## A more advanced Standardised Approach (SA)

- **More complex and risk sensitive** approach
  - Uses Front Office / Finance sensitivities
- 3 risk charges figures (**delta, vega, curvature**) must be calculated based on 3 different correlation scenarios (base, high and low)
  - Basic calculation is sensitivity x risk weight x correlation, for delta, vega, curvature
  - Risk weights in line with ES (97.5% confidence level)
  - Calculate for high, medium and low correlation scenarios → capital charge is based on the worst of the three
  - Limited diversification within each component (but not across components)
- **Specific Risk → Default Risk Charge**
- **RRAO (Residual Risk Add On) for exotic or complex instruments**

One impact of the FRTB is to “move Pillar 2 into Pillar 1” with rules-based capitalisation of poor models or data...

### Desk level approvals

- Banks have to define a Trading Desk structure, which is submitted to regulator
- Governance and process requirements for each desk
- IMA approval at a desk level, not portfolio wide

### Backtesting

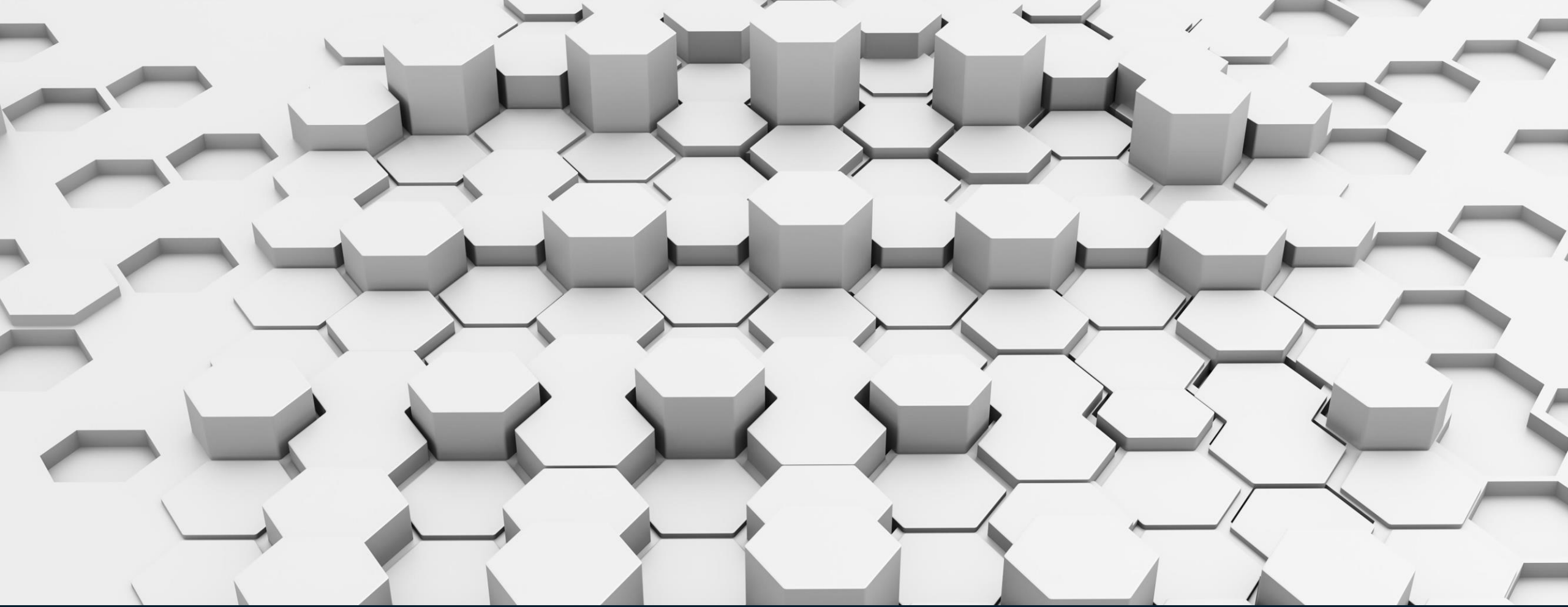
- Backtesting at desk level as well as bank level
- On actual and hypothetical P&L
- >30 exceptions at 97.5% confidence or >12 exceptions at 99% confidence within 12 months → desk must be on standardised
- Bank's multiplier linked directly to number of bank level exceptions

### P&L attribution

- Desk level P&L attribution tests based on risk theoretical and hypothetical P&L
- > 4 exceptions → desk must be on standardised

### Banking / trading boundary

- Strict rules re. banking / trading book allocation – no capital benefit from changes and onerous public disclosure for any changes
- Internal risk transfers between banking and trading books strictly controlled



# Credit Valuation Adjustment (CVA) Risk



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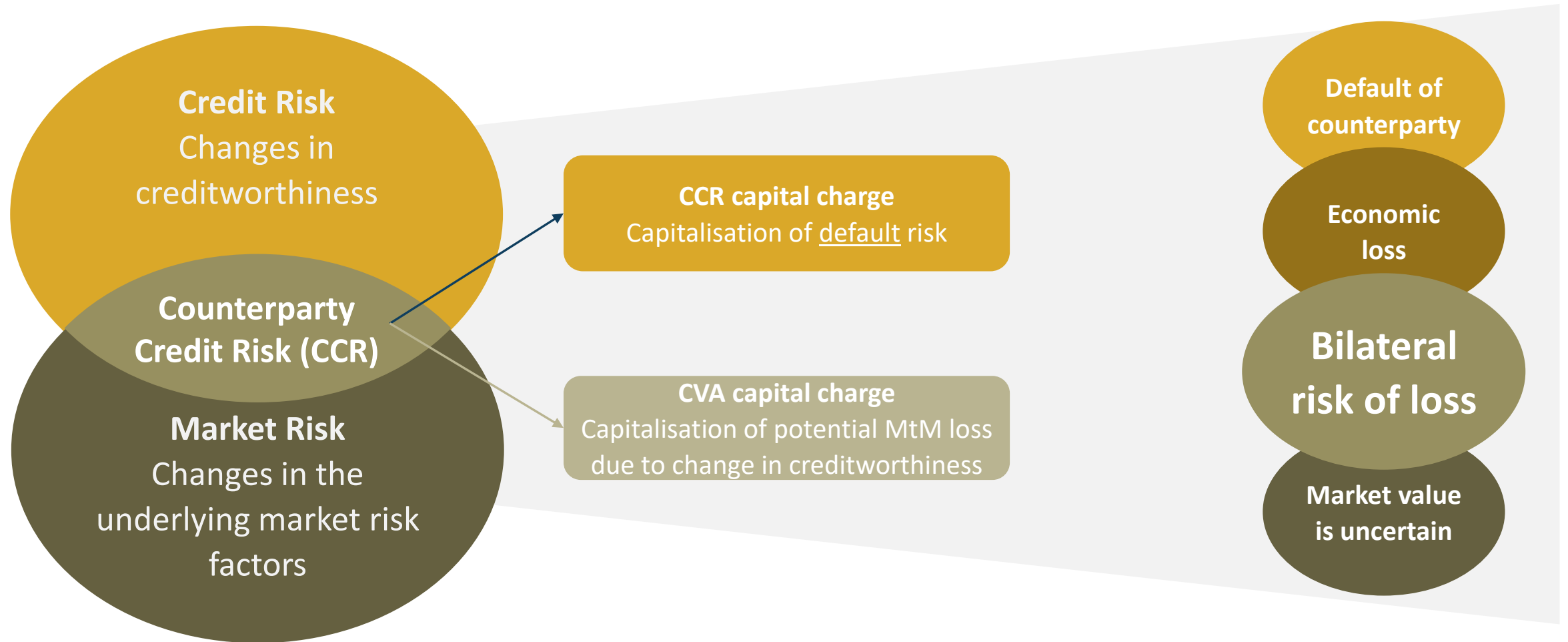
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# Credit Valuation Adjustment Risk



CVA adjusts the market value of a derivative to account for the risk that the counterparty might default on their obligation before the maturity of the contract.





## Issues with the original Basel II.5 approaches:

**Only** captured potential changes in the **credit spreads** of counterparties – it did not cover the market risk exposure component of CVA risk

=> **market risk incorporated**

**Only** recognised **CDs as hedges**, and did not account for market risk hedges for CVA hedges. This also resulted in misaligned market risk capital charges

=> **Scope of eligible hedges widened**

**No alignment** with the capital charge for **market risk**.

=> **better alignment in terms of both approaches.**

The finalized document presents a revision of the Basel IV CVA framework and addresses three major reforms:

1

Enhanced risk sensitivity by including the exposure component of CVA risk, along with its associated hedges

2

Enhanced robustness by removing internal model approach – only a standardised approach (SA-CVA) and a basic approach (BA-CVA)

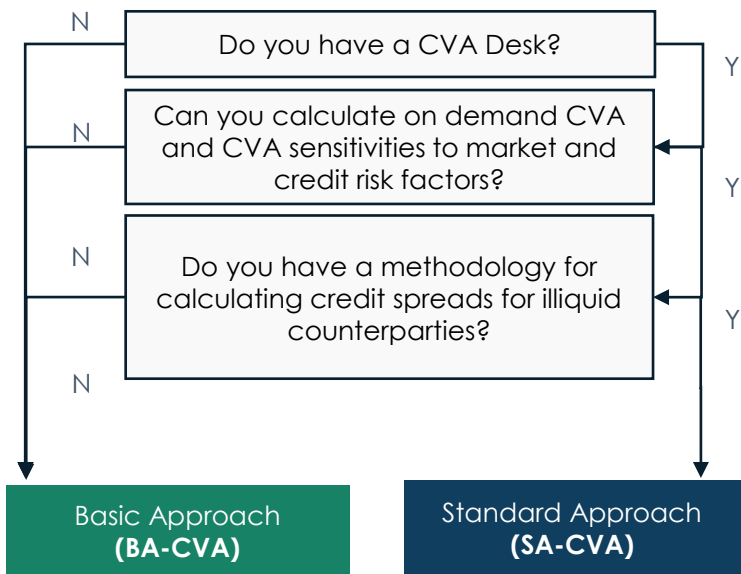
3

Consistency with SA approach under FRTB as SA-CVA uses the same sensitivities

# CVA capital approach criteria



## Hierarchy of Approaches



## Standardised Approach

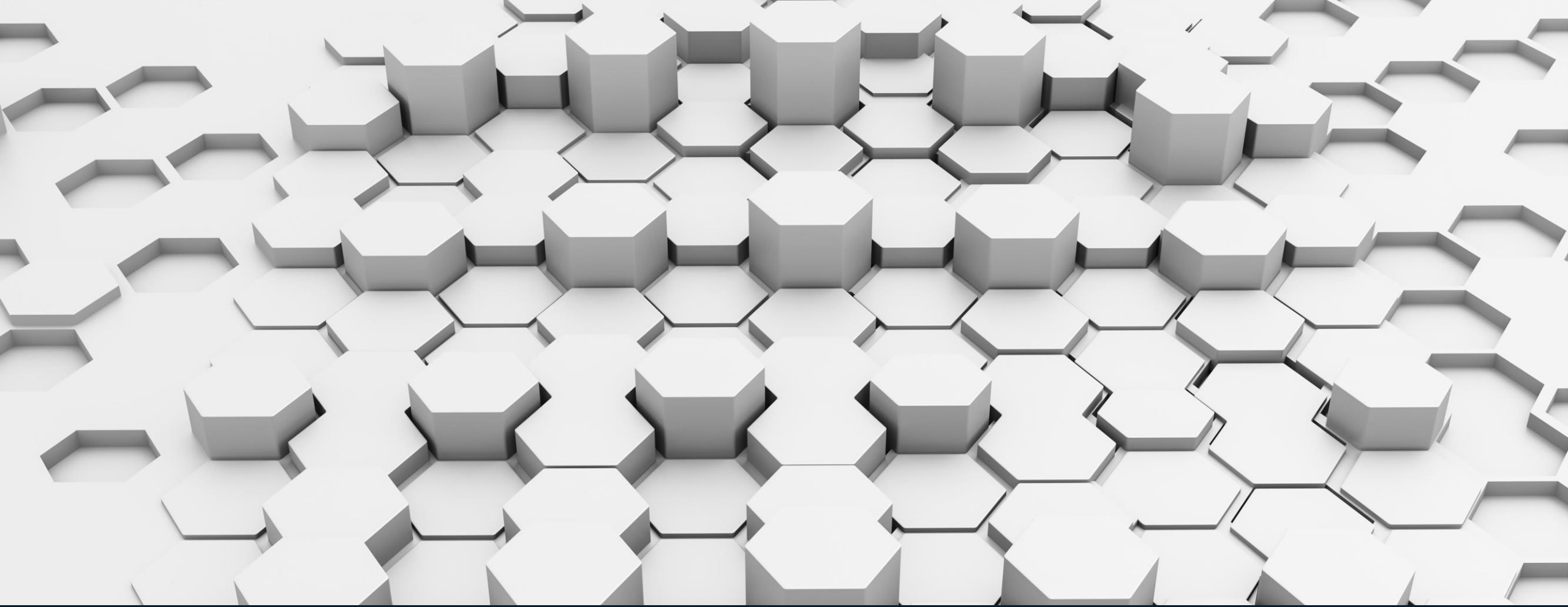
- Regulatory CVA is the base for the calculation of the CVA risk capital requirement under the SA-CVA.
- SA-CVA is an adaptation of the SA under the FRTB.
- Recognises hedges of both market risk and counterparty credit spread components of CVA risk.

## Key Changes

- The framework consists of **two tiers**: banks who meet a set of minimum standards, regarding:
  - **active CVA management**;
  - reliable production of **CVA and CVA sensitivities** to credit and slightly reduced set of FRTB market risk factors;
  - an objective process to map **illiquid counterparties** to traded credit spreads;
  - **Regulatory approval** for SA-CVAcan use SA-CVA. All other banks are required to use a conservative fall-back approach (BA-CVA).
- SA-CVA allows banks to run internal CVA sensitivities through a prescribed risk-weighted sensitivities based model. In recognition of CVA's exotic nature, it uses a slightly reduced risk-factor set relative to the FRTB SA model.

## Basic Approach

- Only recognises hedges of the counterparty credit spread components of CVA risk, i.e. Single-name CDS, single-name contingent CDS and index CDS
- Eligible single-name credit instruments must:
  - reference the counterparty directly;
  - reference an entity legally related to the counterparty; or
  - reference an entity that belongs to the same sector and region as the counterparty.



# Interest rate risk in the Banking Book (IRRBB)

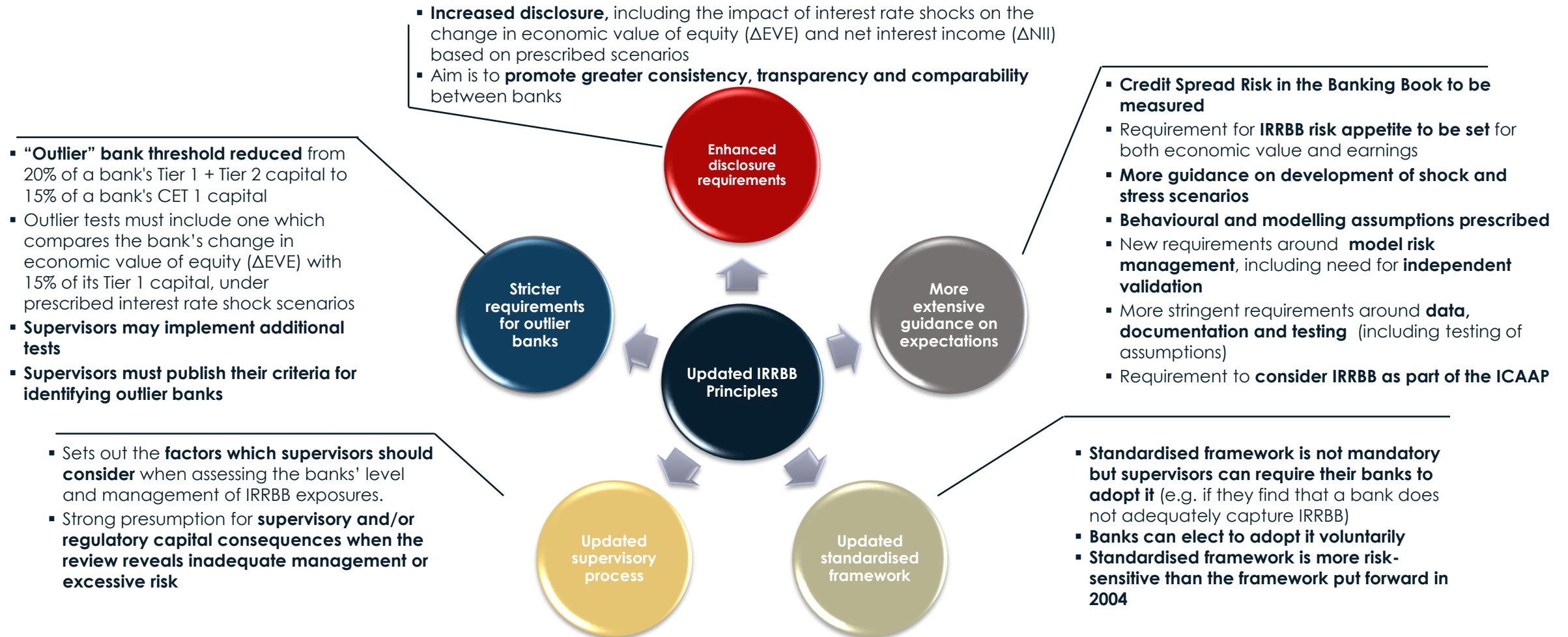


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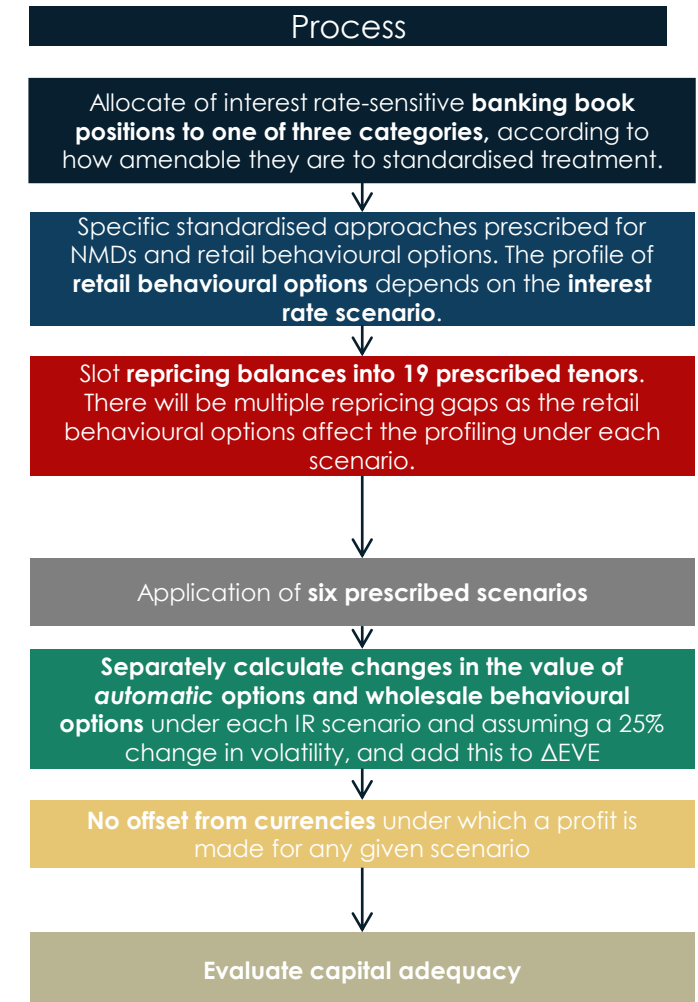
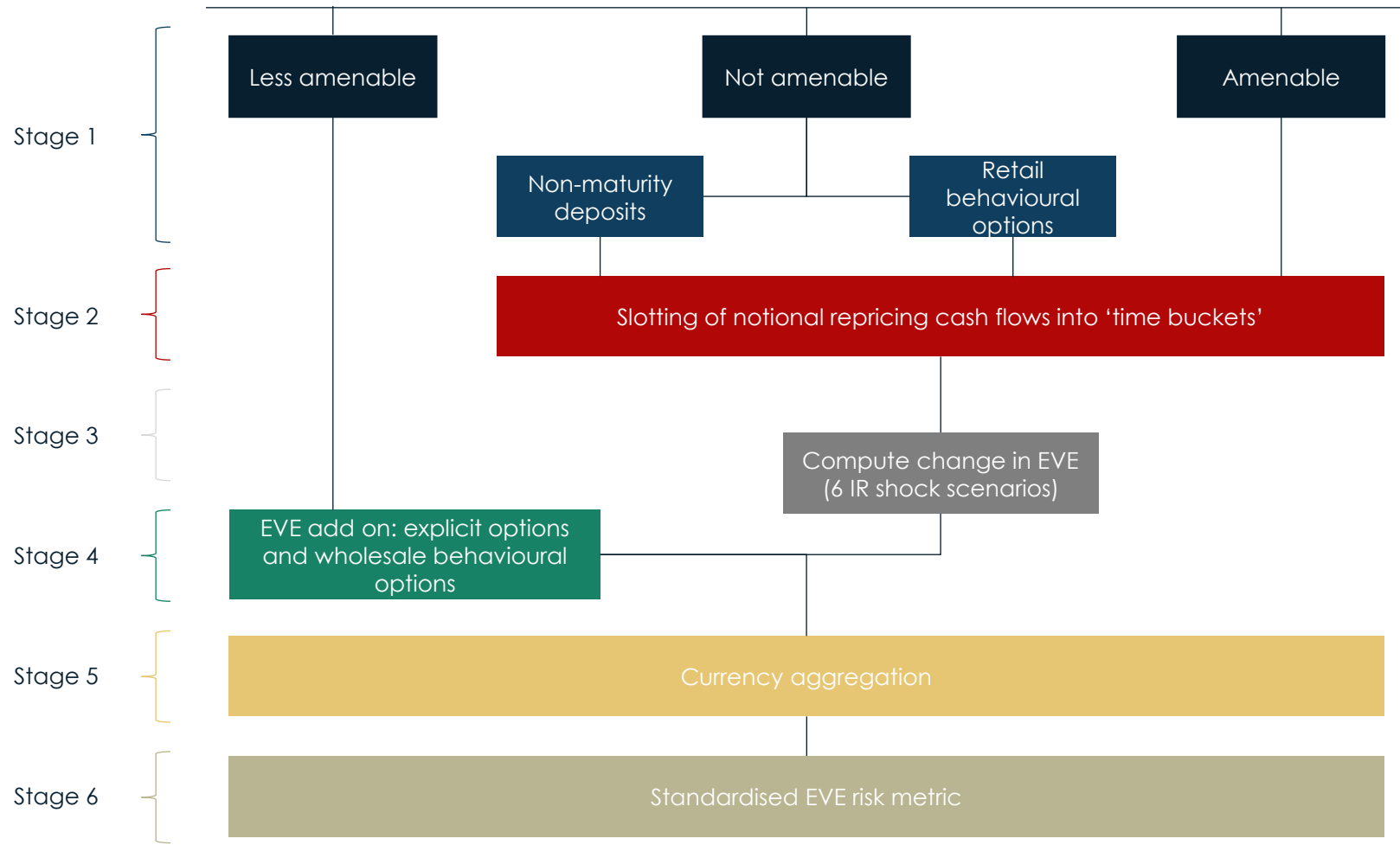
# Key updates to IRRBB principles



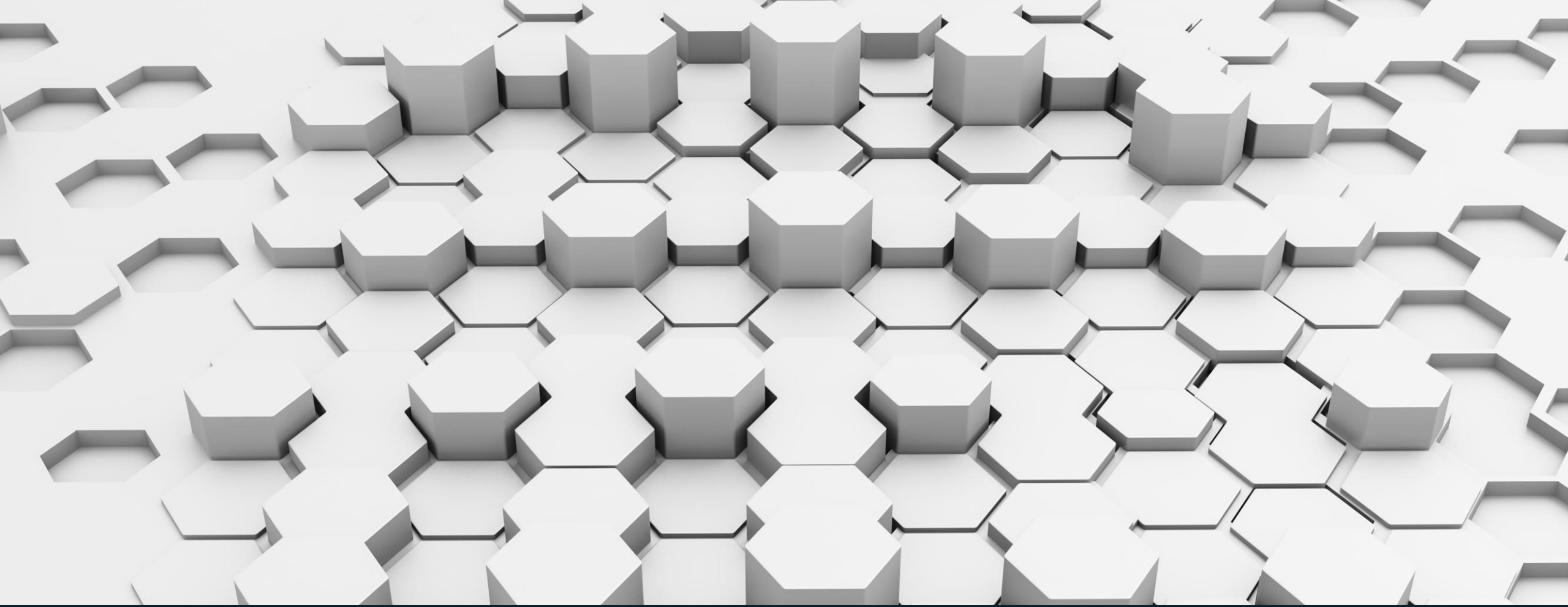
# Regulatory indicators



## Standardised framework: Methodology overview







# Output Floor



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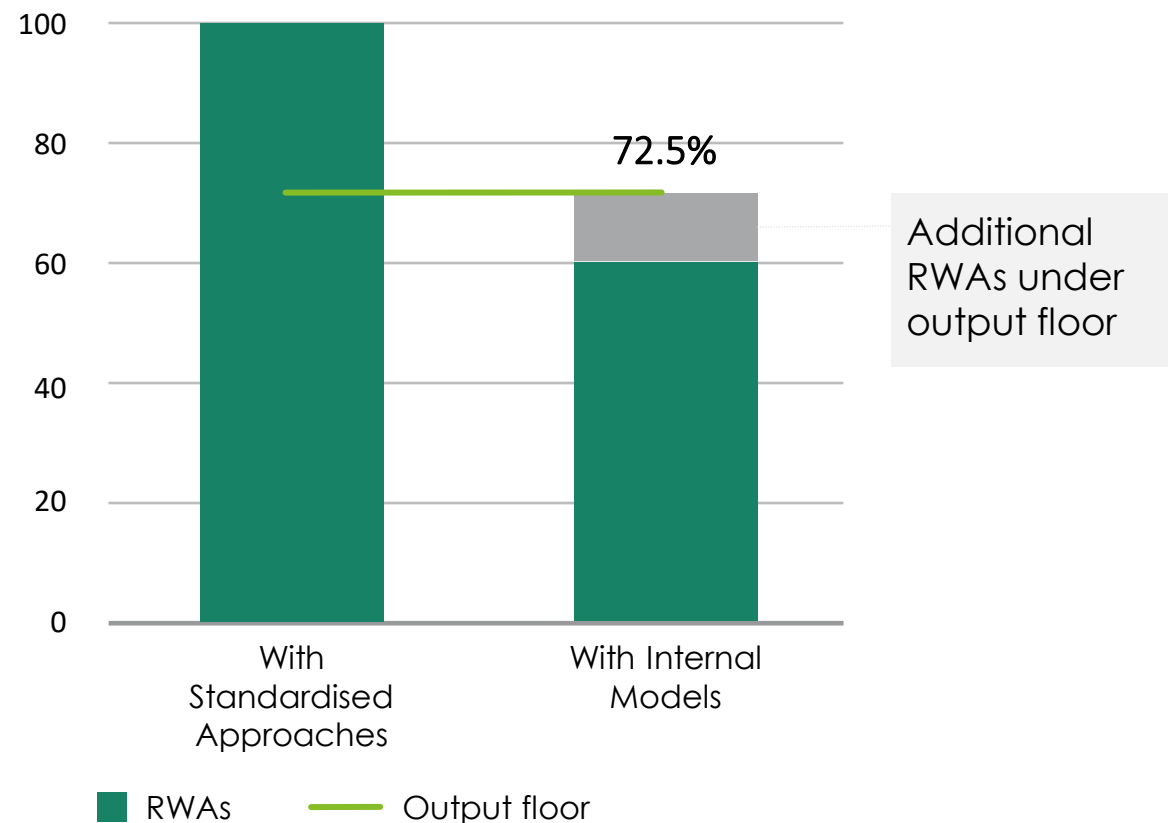
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# Impact on strategy and profitability: Operation of the Output Floor



The floor operates at the aggregate level, across all risk types.

## The output floor at work



- The revised output floor limits the amount of capital benefit a bank can obtain from its use of Internal approaches, relative to using the Standardised Approaches.



- Banks' calculations of RWAs generated by internal models cannot, in aggregate, fall below 72.5% of the risk-weighted assets computed by the Standardised Approaches. This limits the benefit a bank can gain from using internal models to 27.5%.



- Standardised RWAs must be calculated for all portfolios.

# Impact on capital: Output Floors



Calibration and phase-in of output floors.



## The BCBS's objectives in the revision

- To calibrate an output floor for RWAs based on Standardised Approach
- Meant to set a lower limit on differences in RWA between banks using modelled approaches and those using Standardised

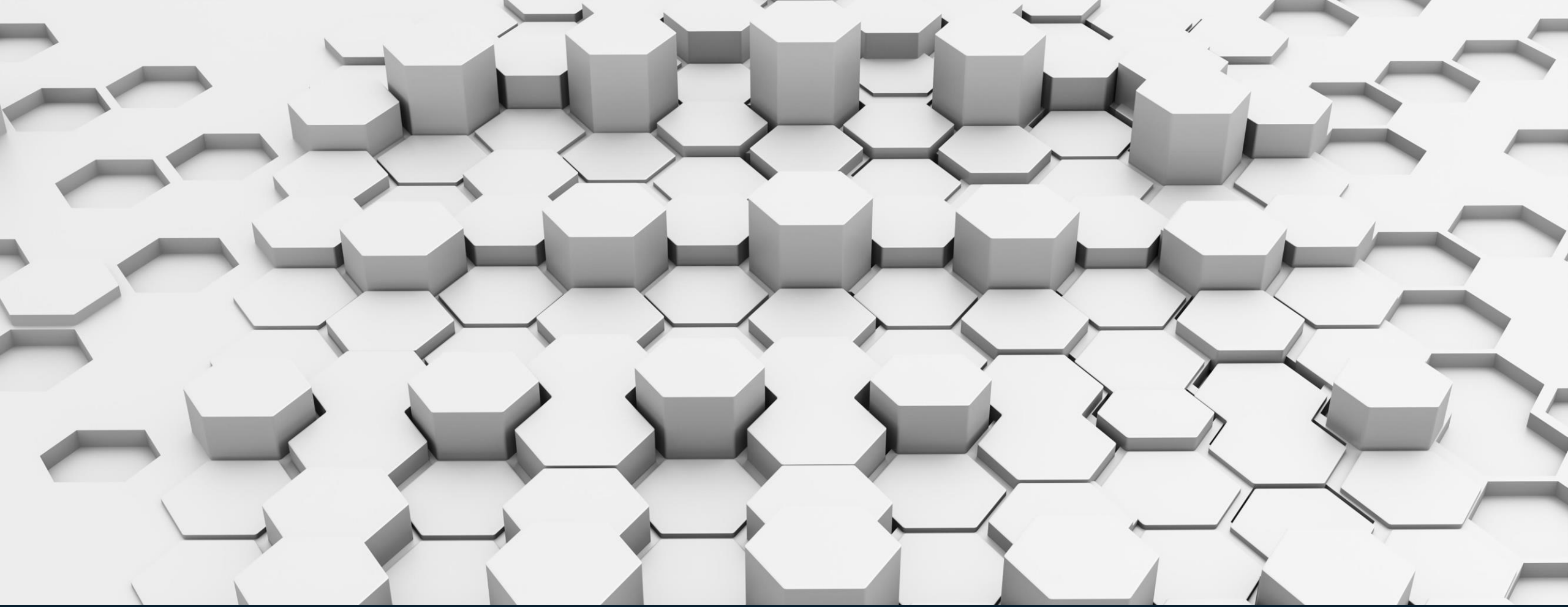
| Risk type        | Standardised Approach (floor)                | Internal Approach |
|------------------|----------------------------------------------|-------------------|
| Credit Risk      | CRSA                                         | IRBA              |
| CCR              | SA-CCR                                       | IMM               |
| CVA              | SA-CVA;<br>BA-CVA; or<br>= CCR               | n/a               |
| Securitisation   | SEC-ERBA;<br>SEC-SA; or<br>1250% risk weight | SEC-IRBA          |
| Market Risk      | SA                                           | IMA               |
| Operational Risk | SA                                           | n/a               |



## Content of the final standards agreed

- **CALIBRATION at 72.5%** of the output of Standardised Approaches.
- **AGGREGATE** level application meaning that the output floor will be set at 72.5% of the RWAs produced by Standardised Approach across the entire balance sheet (i.e. credit risk, market risk, CVA risk, operational risk together)
- **PHASE-IN PERIOD** of 5 years

| Year | Output floor                     |
|------|----------------------------------|
| 1    | 50%                              |
| 2    | 55%                              |
| 3    | 60%                              |
| 4    | 65%                              |
| 5    | 70%                              |
| 6    | 72.5% (steady state calibration) |



# Q&A



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