



The Basel Agenda for 2016

With the Basel Committee on Banking Supervision (BCBS) indicating that changes to the capital framework will be finalized this year, 2016 is already shaping up to be another significant year in banking regulation. There are far-reaching consequences for the banking sector, including the future of Risk Weighted Assets (RWA) and the overall new shape of the regulatory capital framework, with an extensive series of consultations and amended standards anticipated.

Concurrent to the capital framework, other developments at BCBS are underway in respect of 'Step-in risk' and holdings of investments in Total Loss-Absorbing Capacity (TLAC) instruments, whilst implementation activity at regional and national-level continues in liquidity and funding standards and the application of accounting treatments for expected credit loss.

CAPITAL FRAMEWORK

The BCBS's efforts to finalize changes to the post-crisis capital framework in 2016 could fundamentally change the methods of RWA calculation that were a cornerstone of Basel II & III. Whilst some have termed this suite of changes 'Basel IV', given the potential magnitude of the changes, this is a label that policy-makers have repeatedly conveyed an aversion to; the eventual design and calibration of some of the announced initiatives will ultimately help determine the appropriateness of such terminology.

Within the realm of capital and RWA, the BCBS continues to undertake an intensive debate among its members as to the final content of its overall agenda, with different views within the Committee as to the appropriate mix of new and revised standards, all of which will need to be completed by December 2016. The BCBS's specific current and upcoming activities include:

- **Continued consideration of the introduction of a 'capital floor' based on Standardized Approaches:** following the BCBS's December 2014 Consultative Document, an updated proposal is anticipated, with associated QIS activity to inform the calibration.
- **Proposed constraints on Internal Ratings-Based (IRB) modeling:** a new Consultative Document is anticipated in March, proposing some constraints on the use of IRB models, such as PD and LGD floors. Revised approaches for exposures to so-called 'Low-Default Portfolios' (sovereigns, banks, other financial institutions and possible large corporates) are also anticipated, perhaps even eliminating the use of internal models for such portfolios.
- **Credit Risk Standardized Approach:** the BCBS released a revised [Consultative Document](#) in December 2015, removing some of the proposals from the December 2014 consultation, for instance, preserving some role for the use of external ratings for bank and corporate exposures.
- **Credit Risk treatments for Sovereign exposures:** this was again excluded from the scope of the Consultative Document for the Standardized Approach, but the BCBS has

The Basel Agenda for 2016

indicated that a specific review and proposal on such exposures is due later this year, although some divergences within the official sector may delay this.

- **Operational Risk:** a new Consultative Document has been foreshadowed to be released by the end of February, which will include a proposal to abolish the Advanced Measurement Approach (AMA).
- **Market Risk:** the [final requirements](#) under the Fundamental Review of the Trading Book (FRTB) have been published in January 2016; national supervisors have substantial activity ahead in finalizing their rules, including provision for desk-level model approvals.
- **Interest Rate Risk in the Banking Book (IRRBB):** following the 2015 Consultation process, the BCBS is expected to announce its way forward for the inclusion of IRRBB in the capital framework in the coming months.
- **Pillar 3 phase 2:** Following the finalization of phase 1 in 2015, we expect a BCBS consultation on phase 2 in Q1-2016 which includes disclosures on TLAC holdings.

Concurrent to these developments in RWA, the BCBS has agreed on a final 3% calibration for the Leverage Ratio, and continues to consider a potential add-on for globally systemic banks (notwithstanding that national regulators in some jurisdictions have already adopted higher levels). This may have a significant bearing on banks' capital management, in terms of the Leverage Ratio's interplay with RWA and the emergence of a particular measure as the binding constraint on a bank's business.

The IIF RWA Task Force continues to advocate for the preservation of risk-sensitivity and a prominent role for internal models within the capital framework, whilst acknowledging that models do need to be improved, including the harmonization of some credit and market risk parameters and assumptions.

It should be noted that the Financial Stability Board (FSB), regional and national regulators are undertaking parallel work for the practical application of the finalized standards for TLAC. This stands to have downstream impacts for banks' capital management under Risk-weighted Capital Ratios and the Leverage Ratio, at least for Global Systemically Important Banks (G-SIBs) and some countries' Domestic Systemically Important Banks (D-SIBs).

Importantly, the Governors and Heads of Supervision (GHOS) have indicated that the final design and calibration of the multiple reforms will be informed by a comprehensive QIS exercise, and that the BCBS's focus is not on raising overall capital requirements. The IIF will spearhead an industry-led shadow exercise which will aim at comprehensively assessing the overall impact of the proposals and producing the necessary data and analysis to inform its advocacy activities vis-à-vis the BCBS.

OTHER KEY BCBS INITIATIVES

Beyond RWA and capital measures, other current and upcoming BCBS initiatives include:

- **TLAC Holdings:** as the FSB's implementation of TLAC continues, the BCBS released a [Consultative Document](#) in November 2015 on the required capital treatments for banks' holdings of investments in other banks' TLAC instruments.
- **'Step-in risk':** the BCBS released a [Consultative Document](#) in December 2015, with a proposed conceptual framework that sets our primary and secondary indicators for identifying unconsolidated entities where significant 'Step-in risk' exists for banks.

The Basel Agenda for 2016

- **Net Stable Funding Ratio (NSFR):** whilst the NSFR (and other liquidity standards) have been finalized by the BCBS, the industry continues to advocate for adjustments on the treatments for linked transactions and derivatives.
- **Accounting for Expected Credit Losses (ECL):** with the BCBS having issued its [final Guidance](#) in December 2015, dialogue continues with the Basel Accounting Expert Group to discuss points of interpretation or clarification as banks undertake implementation. US rules (separate to IFRS) are expected to be published in the First Quarter, whilst the relationship of ECL accounting to regulatory capital is also topical.

The implementation of liquidity standards continues, with BCBS guidance for intraday liquidity finalized and being progressively adopted at national levels, while the incremental Liquidity Coverage Ratio (LCR) implementation continues, with the minimum threshold having just increased to a minimum 70% requirement, and increasing to 80% at January 1, 2017.

Lastly, this BCBS agenda should also be viewed alongside other initiatives from the FSB and IOSCO, including cross-border regulation of derivatives and haircuts on non-centrally cleared securities, as well as the FSB's commitment to monitor the impacts of regulation. One particular area of note is Anti-Money Laundering (AML) and Counter-Terrorism Financing (CTF), where BCBS guidelines have already been finalized, but there is ongoing review with the FSB and the Financial Action Task Force on Money Laundering (FATF).

IIF ACTIVITIES

The above-mentioned issues are each being addressed by the different IIF Working Groups and Committees. Specifically, the groups involved are:

Issue/Consultation	IIF Working Group	IIF Principal Contact
Constraints on internal modeling for credit risk	IIF RWA Task Force	Brad Carr
Capital floors, based on standardized approaches	Working Group on Capital Adequacy, IIF RWA Task Force	Brad Carr
Revisions to the standardized approach for credit risk	WGCA, IIF RWA Task Force (credit risk subgroup)	Matt Ekberg
Revisions to operational risk	Working Group on Operational Risk	Martin Boer
Fundamental review of the trading book	Working Group on Capital Adequacy	Martin Boer
TLAC Holdings	Cross-Border Recovery and Resolution Working Group	David Schraa
Step-in risk	Shadow Banking Advisory Group	Thilo Schweizer
Accounting for expected credit losses	Senior Accounting Group	Dorothee Bucquet
Revised Pillar 3 disclosure requirements – phase 2	Disclosure Working Group	Dorothee Bucquet

The IIF will continue actively engaging with the BCBS on each of these specific items, as well as identifying where there are points of intersection with the FSB, International Association of Insurance Supervisors (IAIS) and IOSCO developments. All IIF submissions to regulators' consultation processes can be found on the IIF website at:

<https://www.iif.com/advocacy/comment>.

The Basel Agenda for 2016

SCHEDULE OF BCBS ACTIVITIES

The following represents our understanding (as of January 2016) of the BCBS's intended workplan for 2016, acknowledging that this continues to be shaped and reviewed by the BCBS:

	2016			
	Q1	Q2	Q3	Q4
Credit Risk: constraints on internal models	Consultation anticipated	Consultation response deadline	Analysis and review	Finalization of standard
Credit Risk: revisions to Standardized Approach	Consultation (ends March 11)	Analysis and review	Finalization	
Capital Floors (based on Standardized Approach)	Consultation anticipated		Ongoing analysis and review	Finalization, incl. Calibration
Sovereign Risk			Possible Consultation	
Expected Loss			Review Of EL in light of ECL Accounting	
Operational Risk	Consultation anticipated	Consultation response deadline	Analysis and review	Finalization of standard
Market Risk: Fundamental Review of the Trading Book	Standard finalized			
IRRBB	Finalization anticipated			
TLAC Holdings	Consultation (ends February 12)		Analysis and review	Finalization of standard
Step-in Risk	Consultation (ends March 17)		Analysis and review	Finalization of standard
Liquidity Coverage Ratio	Increased to 70% (January 1)			

If you have any questions, feedback or input on any item, please contact Andres Portilla, Managing Director of the Regulatory Affairs Department, at aportilla@iif.com