11th High-level Meeting for the MENA Region

Potential Impact of the Changes to Standardised Approaches for the Banking Industry

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I. The Standard Approach reform in the context of so-called “Basel IV”

Standard Approach (SA) is part of pending reforms to complete Basel III:

- Interest Rate Risk in the Banking Book (IRRBB)
- Fundamental Review of the Trading Book (FRTB)
- Standardised Approach
- Floors for IRB (based on new Standardised Approach)
- Credit Valuation Adjustment (CVA) risk framework
- Pilar III disclosure requirement
- LGD, EAD fixed by supervisors?

Industry calls this “Basel IV”

II. Why market participants talk about “Basel IV”

Due to the potential accumulated impact on RWA (ΔRWA)

Reforms

- aim to complete Basel III
- not to increase Capital Requirements (ΔK)

But all changes forecasts ⇨ ΔRWA ⇨ ΔK

Comprehensive impact assessment needed:

- ΔRWA
- Time frame for ΔRWA
- Only to “outliers”? Or affecting all?
- Side effects: TLAC is based on RWA

III. Internal Models

- Use of internal models in the heart of Basel Accord as capital requirement calculation, but also as risk management tool

- Standard Approach used as floor (USA; 100%)

- Then, … What about internal models?

IV. The uncomfortable truth

① ΔRWA ⇨ ΔK ⇨ ∇Balance sheet size ⇨ **less financing to the real economy**

② ∇ Risk sensitivity ⇨ Δ Average risk of Banks' Balance Sheet

Low Risk Bank: IRB ⇨ K_{IRB} ⇨ ROE $>$ Cost of capital

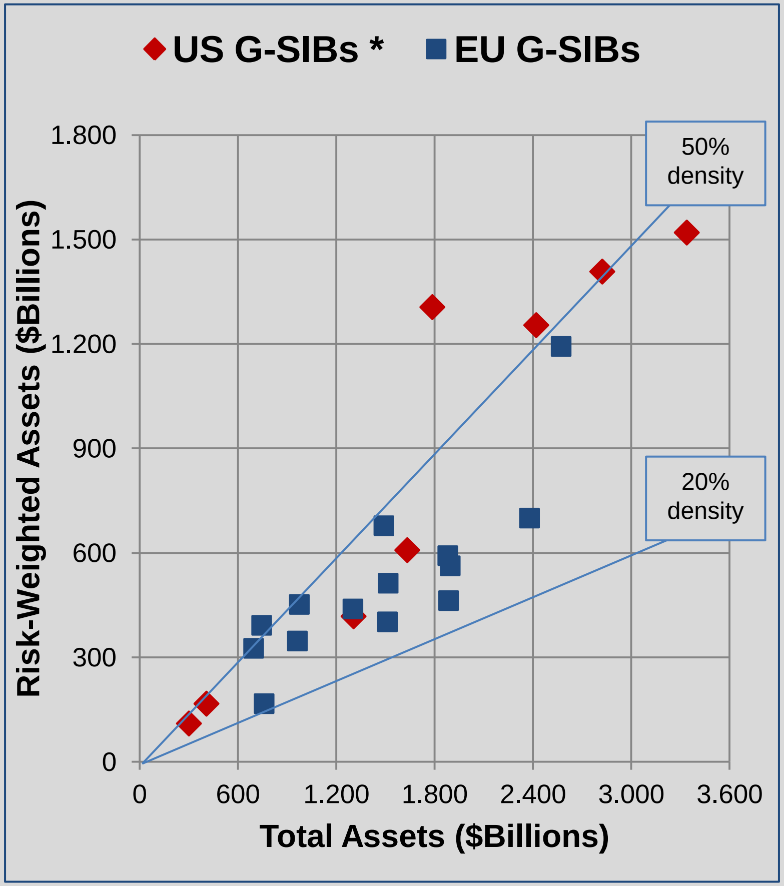
But... With SA floor ⇨ if K_{SA} floor 30% $>$ K_{IRB}

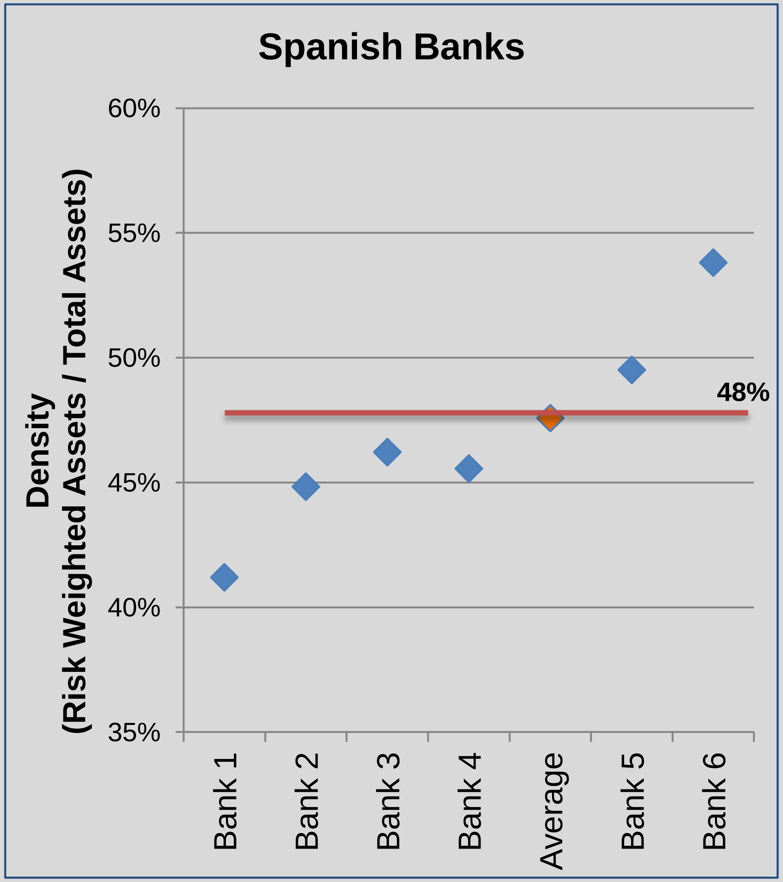
⇨ then ROE ∇ 30% and .... $>$ **Cost of capital ?**

The risk of going back to the problem of Basel I:

Low risk banks and high risk banks treated the same way

V. Density of RWAs





*US G-SIBs: Total Assets IFRS estimated
Source: FDIC

VI. The need to finalise reforms

- Capital uncertainty
- Problems to capital planning
- Avoiding *pendulum effect*
- Making risks manageable
- Limited complexity
- Back to basics:
  - ✓ Banking business is about financing the real economy
  - ✓ ... and not only regulatory compliance

Thank you very much