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Basel IV - A Game Changer

The rules published by the Bank for International Settlements on 7 December 2017 are so far reaching that the banking industry has dubbed them "Basel IV".

Indeed, the drastic limits imposed on internal estimates and models are less an amendment than a radical departure from some of the principles- and innovations- that underpinned Basel II and III.

The objective of the "revisions" is to restore the credibility of risk-weighted assets calculations but, for banks, the price to pay is a maze of new regulations and reporting requirements. And for some, capital requirements will increase significantly.

All banks are affected: the enhanced risk sensitivity of the Standardised Approaches for both credit and operational risk, makes them more complicated to use and to report. IRB banks, on the other hand, will have to use the Standardised Approach to calculate the new capital floor, while Advanced Approach banks will have to use the three Approaches simultaneously.

Course description

The course puts the new rules in context and guides delegates through the revisions and their impact on the banks' various business lines. The main focus is on Credit Risk, but the new Operational Risk framework is also discussed.

The approach is practical focusing, through case studies and exercises, on the implications of the revisions on pricing and returns.

Audience

The Basel IV rules are essential knowledge not only for compliance and regulatory reporting staff but also for all those involved in the utilisation of the bank's capital and the pricing of transactions, such as senior managers, credit and risk management professionals as well as transactors and relationship managers.

Duration: 3 days

Prerequisites: Understanding of basic accounting concepts

Day 1

Introduction

- Rationale and objectives of the Basel IV revisions.
- Overview
    - Upgrade of the Standardised Approach (SA), which is now Basel's new bedrock.
    - Restrictions on the use of the Advanced Internal Ratings Based (IRB) Approach
    - Floors on IRB inputs and haircuts.
    - A new Approach to Operational Risks capital requirements.

Current status- Basel II and III: Fast track introduction - refresher

- Background to the Basel Accords
    - Underlying concepts
        - The leveraged nature of banking- Unexpected and Expected losses.
        - The relationship between Capital, Returns and Pricing - Calculations
        - Rorac /Raroc concepts
        - Pricing as a credit issue

- The Basel I Accord-What has survived in Basel II-III-IV
    - Definitions and purpose of capital, provisions and risk weights
    - Risk weight, Credit Conversion Factors and Return on Equity (ROE).

- The Basel II Accord – Understanding the Basel IV revisions.
    - Objectives and Overview.
    - The three Approaches and the three pillars system

1. The Standardised Approach
    - Asset Classes
    - Risk Weights-External ratings
    - Credit Risk Mitigation Techniques

2. The IRB Approaches-Foundation and Advanced
    - Underlying concepts
        - Economic capital
        - Internal Credit Ratings
        - Expected and Unexpected losses
    - Capital requirements
        - Asset Classes
        - The Risk Weight Function
        - PD, LGD and EAD.
        - New Credit Risk Mitigation Techniques-Collateral and Guarantees

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Day 2

- Knowledge consolidation: Exercises-Case Studies.

    - Application of the rules to transactions across the various areas of banking: Corporate transactions, Retail, Real estate, Project Finance etc.

    - Calculation of Return on Equity based on the Standardised Approach and IRB rules.

- The Basel III Accord (Quick overview).

New Definitions and Amounts of Capital

- "Going Concern" and "Gone Concern."
- New definitions of Tier1 and Tier2.
- New treatment of adjustments.
- Additional Capital buffer.
- Maximum leverage ratio.

Basel IV

1. Revision of the Standardised Approach for Credit Risk

- The Standardised Approach (SA) is the new Risk Weighted Assets output floor for the IRB Approaches.

    - The Basel I rules are replaced with the new Standardised Approach rules.
    - IRB banks must also use the Standardised Approach to calculate Risk Weighted Assets.
    - Calculation of the new floor.

- A more risk sensitive and granular Approach:

    - New regime and risk weights for exposures to banks, rated and unrated.
    - New regime and risk weights for exposures to corporates, rated and unrated.
    - New specific risk weight for SME's.
    - New stand-alone treatment for Object Finance, Commodities Finance and Project Finance. (Specialised Lending).
    - LTV based risk weights for residential real estate.
    - New regime and risk weights for Income Producing Real Estate (IPRE).
    - More granular treatment for retail exposures.
    - Three new regimes and risk weights for commercial real estate exposures.
    - New Credit Conversion Factor (10%) for Unconditionally Cancellable Commitments.

- **Exercises-Case studies**

Application of the new rules to transactions across the various asset classes: Corporates, Banks, Residential and Commercial real estate, retail etc.

Calculation of Risk Weighted Assets, capital and returns based on the new rules.

Day 3

2. Revision of the Foundation IRB Approach for Credit Risk

- New PD floors-Corporate.
- New supervisory LGD for non-financial corporates.
- New collateral haircuts and LGD parameters.

3. Revision of the Advanced IRB Approach for Credit Risk

- Withdrawal of the Advanced Approach for the:
  - Exposures to banks.
  - Exposures to large and mid-sized corporates.
  - The Foundation Approach replaces the Advanced Approach.
- New input floors
  - PD floors-Corporate -retail.
  - LGD floors-secured and unsecured.
  - EAD floor.

Exercises-Case studies

Application of the new rules to transactions across the various asset classes: Corporates, Banks, Residential and Commercial real estate, retail etc.

Calculation of Risk Weighted Assets, capital and returns based on the new rules.

Leverage Ratio Framework

- Refinements to the leverage ratio exposure measure.

Operational Risk Framework

- Withdrawal of the existing standardised and advanced approaches.

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The Instructor

Jean-Charles spent seven years in the Credit, Corporate and Investment Banking divisions of Citibank, including three years in the World Corporation Group in London as Vice-President, managing a portfolio of UK multinationals on a worldwide basis.

He subsequently worked as Director of Project Finance and Acquisition Financing for Security Pacific in Frankfurt before returning to South Africa in 1993 as Head of Corporate Banking (Senior Vice-President) for the local operation of ABN-Amro.

Jean-Charles has broad credit experience gained over 20 years as credit analyst, credit officer and credit committee member at Citibank and ABN-Amro, covering Corporate Investment Banking, including, inter alia, Syndications, Project Finance, Leveraged Transactions and Asset Securitisation.

He was also in charge of ABN-Amro’s Financial Institutions Unit for the whole of Africa for a number of years and acquired extensive specialist credit and transactional experience in that field.

He has provided in-house training to international banks such as Citibank, Deutsche Bank, ING, Nordea, CIBC, Investec and many others.

He is Director, Credit and Basel IV Services, at BankT&D Consulting Limited, a London-based consulting firm.

He holds an LLB and an LLM in Tax Law from the University of Liège in Belgium.