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A New Standardised Approach

In the greater scheme of things, the Standardised Approach, where banks *must* use risk weights (percentages) imposed by the regulator to calculate their capital, was not meant to be the bedrock of the system.

Quite the opposite. It was intended for those banks without the financial resources, the systems, or the skills, required to use the Internal Ratings Based (IRB) Approaches, which were very much the “holy grail” of the system.

The Standardised Approach was only meant to be a temporary entry level, from which banks were meant to upgrade. And to encourage them to do just that the system “punished” them with, all other things being equal, heavier capital requirements and no access to risk mitigation techniques.

No wonder that some kind of “second class bank” stigma was somehow attached to standardised banks.

Not anymore it seems. The reality check brought about by the financial crisis has shifted the centre of gravity of the Basel architecture. Under the Basel IV rules it is now the IRB Approaches that must be constrained, and it is the Standardised Approach, now deemed more reliable, that defines the minimum capital required.

The corollary of all this, however, was that the existing Standardised Approach was too rudimentary, in fact too much like Basel I, for this new “status”.

Accordingly, the first objective of the Basel IV revisions, as indicated in the introduction to this series, is to enhance the risk sensitivity of the Approach, which they seek to do by:

1. Importing IRB asset classes into the Standardised Approach to replace broad “flat rate” generic asset classes.
2. Recalibrating the Standardised Approach risk weights to align them more closely to the equivalent risk weights of the IRB Approaches. This removes, or at least softens, the “punishment” of higher capital requirements mentioned above.
3. Granting more discretion to banks.



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This paper examines the changes to the capital treatment of corporate exposures, which are first summarised and then explained in more details. An overall assessment is provided at the end.

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