Basel 3

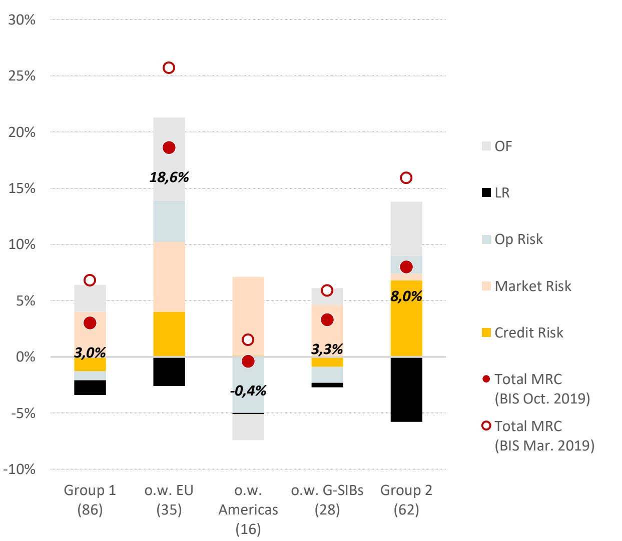
Context & Key stakes at international level

Basel 3 regulation aimed at providing a common level-playing field across all regions, business models and size. From a worldwide perspective, its primary objective is not increase minimum required capital but rather (i) to provide better comparability and harmonisation of regulatory playing field at worldwide level ; (ii) limit potential bias provided by internal model approach.

Nevertheless, preliminary impact studies – yet known to be based on conservative hypothesis – demonstrate Basel 3 may indeed generate a non negligible increase in capital for some banks. The cost of a level playing field is already under scrutiny, especially in Europe, where the legal transposition of Basel 3 raise many questions at regional level.

Preliminary impact studies illustrate a wide variety of impacts depending on the region and bank business model

Basel 3 Impact Studies (sample of international banks)



Source : BIS Impact study (BIS, March & October 2019, Basel 3 Implementation), Credit Risk (CCR, IRB, SA, excl. SEC), Market Risk (FRTB 2019, CVA), Operational Risk (SMA), Output Floor (aggregated impacts)
October 2019: sample of 86 international banks, of which 35 UE
March 2019: sample of 80 international banks, of which 32 UE

Capital impact studies show a **wide dispersion across regions, bank size** and **business model**, demonstrating variable degree of sensitivity across Basel 3 features:

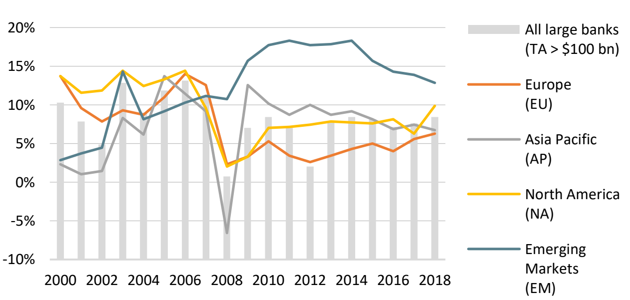
- **Large European banks** and, in a lesser extent, Medium to Smaller banks present the **largest average impacts**
- Large European and American banks show on **par sensitivity to Market Risk updates**
- Medium to Smaller banks and European banks are particularly impacted by **Output floor and Credit Risk** framework review
- SMA (Op Risk) is **asymmetrically impacting large banks across EU** and **Americas** (+3,7% vs.-5,0%)

Beyond CET1 impacts, banks across the globe are further **questioning the overall burden** in terms of solvency, cost of funding, operational implementation ; and in a broader extent **economic profitability**:

- How will Basel 3 impact **capital**? How will this affect the banks' **funding**? **economic profitability**?
- How will Basel 3 be **transposed in national law**? Is there any room for negotiations and adaptation of the framework given the important amount of capital?
- More specifically, how will this new set of rules address existing **risk framework, local specificities** and **capital structure?**
- How will the new capital framework articulate with **Pilar 2 existing requirements**?
- How will this impact the already large **regulatory agenda** and objective towards a **common level playing field**?

Basel 3 impacts on Profitability and business sustainability remain a strong concern at regional banking level

Return on Equity (large banks profitability by region)



Source: FitchConnect

Return on equity for all global banks with total assets exceeding US$100 billion as of end-2015, weighted by total assets as of end-2015 and grouped by region as follows:
- *Asia Pacific advanced economies (AP) include Australia, Hong Kong, Japan, Korea, Singapore*
- *Europe (EU)*
- *North America (NA) include Canada and the United States*
- *Emerging Markets (EM) include Brazil, China, India, Malaysia, Mexico, Qatar, Russia, Saudi Arabia, Taiwan, Turkey, UAE*

A few outlier banks were removed from the sample (2002-03 for the AP advanced region, 2010-12 for Europe)

At international level, supervisors are willing **to align and converge** towards a more uniform framework.

Yet, at regional level, such a reform raises concerns in terms of adequation with local economic agendas, suggesting **local transposition may require adaptations to local specificities**.

- In Europe, recent publications[1] specifically pointed out the **adverse effects of Basel 3**, arguing these may have economical spill overs from **direct impacts** on banks' funding and profitability, to **indirect effects** on client fees[2]. These concerns take place in an already challenging profitability environment for the EU banking industry[3]
- In Emerging Countries, a Task Force dedicated to Basel 3 implementation provided a detailed report[4] to address alternative solutions and find an **equilibrium between fostering proper growth of EMDEs banking sector and meeting Basel 3 requirements**

(1) Notably; FBF, The Basel Accords and their Consequences for the Economy (2019) ; AFME and ISDA final response to EBA Basel 3 Finalisation (2018)

(2) Copenhagen Economics, EU Implementation Of The Final Basel 3 Framework (2019)

(3) Mario Quagliariello, EBA, EU-wide Transparency Exercise and Risk Assessment report (2019)

(4) CGD Task Force on Making Basel 3 Work for Emerging Markets and Developing Economies Report (2019)

Benoit Genest, Associé
bgenest@chappuishalder.com
+33.7.87.68.81.77

Hélène Fréon, Manager
hfreon@chappuishalder.com
+33.6.62.58.34.00

Basel 3

Our approach

In view of the intricate effects related to Basel 3 implementation, our expertise-driven approach builds on the capabilities of 3 departments - Regulatory, Risk & Finance, Quantitative - to address the full spectrum of impacts and challenges ahead of banks.

On top of our expertise, our consulting firm has a vast experience and benchmark to share. Beyond Basel 3, our vision embraces all regulatory ramifications, reshaping risk standards and in fine risk organisation and optimisation levers.

Our approach aims at providing both a tactical and strategic approach to tackle Basel 3 implementation challenges, in line with the ambitions and agenda of our banking clients across the world.

Standardisation and harmonisation is no synonym of simplification when it comes to Basel 3

Though BIS impact studies outline **quantitative impacts** in terms of Pilar 1 Capital, **qualitative impacts** should not be overshadowed, especially in terms of **data quality**, **data granularity, robustness and auditability** of the target risk framework and governance.

Our value proposition to navigate Basel 3 challenges with you

Our areas of expertise

	Regulatory	*Risk*	*Quantitative*
I As is & Monitoring of regulatory developments			
Gap analysis	■	■	■
Benchmarking		■	■
II Impact Assessment			
Impact simulations		■	■
Impact study		■	■
III Action Plan			
Action Plan & Arbitrage	■	■	■
Basel 3 Road Map	■	■	
RWA optimisation		■	■
IV Implementation			
Programme Management		■	
Methodological review	■	■	■
IT & Data Framework Review		■	■

Our contributions to your Basel 3 challenges are articulated across 4 types of intervention

Grasp the broader regulatory picture

- Qualify **criticity and sensitivity** of Basel 3 implementation
- assess interdependencies between **global regulatory road maps & local supervisory agendas**
- Define your **level of readiness** and benchmark your position against your peers

Assess Basel 3 implementation impacts

- **Assess qualitative impacts**: organisation, processes, data & IT
- **Analyse RWA & Capital simulations** from multiple angles (consolidated vs. entity, geographical or portfolio-level)
- Anticipate consequences in terms of **scarce resources planning** (Pilar 2 P2R/P2G, funding, solvency, liquidity)

Adopt a tactical approach towards resource allocation

- Build on impact studies and sensitivity analysis to draw a **regulatory road map**
- Identify **levers of optimisation** in spite of the limited use of internal models and increased requirements pertaining to methodological standardisation
- Bring together **synergies** with existing regulatory programs
- Adopt a phased approach to plan **resources allocation** in build and then run mode

Navigate regulatory changes towards Basel 3 entry into force

- Ensure program are coordinated and delivered in line with regulatory deadlines and **budgetary constraints**
- Ensure **consistent and tactical regulatory compliance** for international groups under multiple line/level of supervisions
- Assist modelling teams in the **methodological review:** adapt and **standardise** methodologies, ensure **homogeneous model framework monitoring** to meet regulatory requirements
- Contribute to **redesign IT & Data frameworks** to meet qualitative and methodological standards

Benoit Genest, Associé
bgenest@chappuishalder.com
+33.7.87.68.81.77

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hfreon@chappuishalder.com
+33.6.62.58.34.00