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SYNOPSIS

SHIFTING SANDS IN BANKING REGULATION: BASEL 4 AND IFRS 9

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Synopsis: Banks are facing two sets of key regulatory changes over the next 3 years: 'Basel 4' and IFRS 9. These impact regulatory capital requirements, and credit loss provisioning and reporting respectively. The Basel Committee for Banking Supervision has flagged a series of changes to regulatory capital regime for banks. The details for Basel 4 will be finalized in the coming year. On the other hand IFRS 9 is well progressed. Banks are at various stages of implementation. IFRS 9 changes the way that banks model, calculate, report and analyse credit default provisions, a key item in a bank's profit and loss.

Basel 4 refers to a series of changes flagged by the Basel Committee for Banking Supervision (BCBS) late in 2014. BCBS has raised concerns with comparability and consistency in the current regime, in particular with banks using internal models for calculating regulatory capital. Changes include the introduction of capital floors based on standardised formulae for different risk types, and a leverage ratio. Many banks may need to increase the level of capital required if the proposals are accepted. Banks will need to review the approach to financial management including capital allocation, performance measurement, and loan pricing.

IFRS 9 changes the banks classify transactions in their portfolio and how they calculate provisions for credit impairment. IFRS 9 requirements are designed to recognise credit impairment for loans earlier, i.e. before the actual default event. This is done using triggers signaling significant changes in credit quality. A key challenge is developing suitable triggers. This requires building or leveraging current credit risk models. This feature of IFRS 9 also means that credit provisions can be more volatile, presenting challenges in analysis and reporting of financial results.

This presentation explains the regulatory changes and implications for modelling, reporting and financial management of banks.