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CPD TECHNICAL UPDATE

Basel 3.1 standards implementation and other considerations

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Industry experts speaking today

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Agenda - what we will discuss today

1. Welcome
2. Basel 3.1 getting started
3. Credit risk and operational risk
4. Data challenges
5. GT Basel 3.1 survey feedback
6. Concluding remarks
7. Questions

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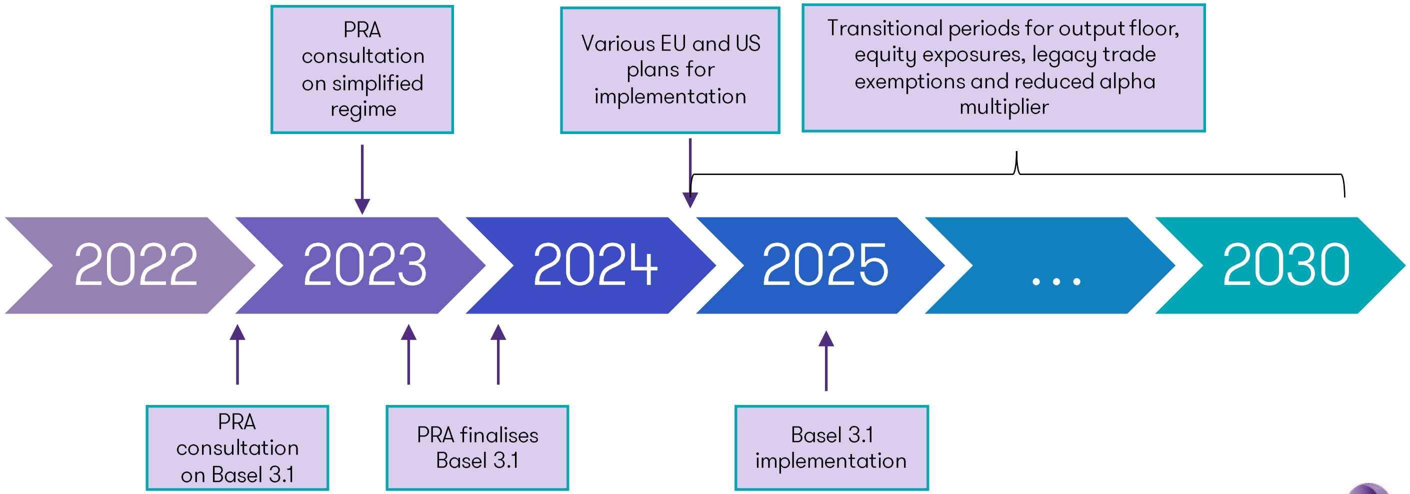
Timelines for implementation

The PRA has moved the implementation date of the Basel 3.1 by six months to 1 July 2025, with a transitional period of 4.5 years to ensure full implementation by 1 January 2030:

- The PRA plans to publish the near-final policies on market risk, credit valuation adjustment risk, counterparty credit risk and operational risk in Q4 2023,
- The near-final policies on credit risk, the output floor, and reporting and disclosure requirements in Q2 2024.



In summary

Governance and Oversight concerns

Credit Risk

Market Risk

Credit Value Adjustment and Counterparty Credit Risk

Operational Risk

Output Floor

Other Consideration

Strong and simple regime

Data and System concerns

Impact

Planning and Implementation

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Planning

Basic Compliance | Alignment | Improvement

Life Cycle

Planning and Assessment

- Gap analysis
- Impact analysis

Implementation

- Project planning
- Resources
- Skill sets
- Technical
- Processes and controls

Business Readiness

- Project management
- Strategy
- Business model
- Controls
- Training

Assurance

Impact assessment

Other critical considerations

- Reporting requirements
- ICAAP changes
- Pillar 3
- Currency re-denomination
- Risk framework

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Credit and operational risk
Sonam Nawani

Credit Risk – Internal Ratings Based (IRB) Approach

The PRA will implement the internal ratings based (IRB) approach to credit risk broadly in line with the Basel 3.1, but with some amendments to reduce complexity and improve comparability across firms.

Restrictions on using the IRB approach to credit risk	• Low default portfolios must use the standardised approach (SA) • Institutions, financial corporates and large corporates exposures must use the foundation IRB (F-IRB) or SA • Income producing real estate (IPRE) exposure class can't use advanced IRB (A-IRB) or F-IRB anymore; only slotting is available under IRB • A new high volatility commercial real estate (HVCRE) category
Changes to input floors	• Input floors won't apply the infrastructure or CRR SME supporting factors • PD input floor is 0.05% except for UK residential mortgage portfolios which are 0.1% • LGD floors range from 5% for residential mortgages and between 25-50% for other unsecured and retail exposures • The PRA has also proposed a dual approach to calculate exposure at default (EAD), depending on the firm's approach to credit conversion factors
Updated definition of default	• The PRA will review its definition of default and update existing guidance in Supervisory Statements and European Banking Authority (EBA) guidelines. It will apply to both SA and IRB firms.
Changes to model governance	• New requirements for data use and maintenance, revised guidance for IRB governance and validation, including specific requirements for the reports produced by a firm's credit risk control unit. The PRA will contact firms individually regarding timelines for submissions, and changes aren't expected until after July 2024.
Greater support for aspiring IRB firms	• These firms can use the IRB approach by demonstrating 'material compliance' with the UK CRR.

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Credit Risk – Revised Standardised Approach

Number of changes to the standardised approach (SA) to increase risk sensitivity, reduce reliance on external ratings and lower variability of risk weights to improve comparability across firms and jurisdictions.

External credit assessment institutions (ECAIs) credit ratings	Consistent use of external credit assessment institutions (ECAIs) credit ratings for all exposure types for risk management and risk weighting
Due diligence requirements	New due diligence requirements for monitoring counterparties and for externally rated exposures (if due diligence shows a higher credit risk than the external credit rating then firms must increase the risk weight)
Removal of SME Support Factor	Remove SME support factor as "imprudent, is not risk-based, and had not materially supported lending to SMEs". Applies to both SA and IRB exposures in retail, corporate or secured by mortgages on immovable property exposures.

Retail exposures excluding real estate	More granular exposure classification, wider range of risk weights , new currency mismatch risk sensitivity factor and threshold updated from EUR 1 million to GBP 0.88 million
Real estate exposures	Introduction of a new "*real estate exposures*" exposure class and more detailed classification of real estate exposures based on exposure type to provide a more precise assessment of risk associated with different types of real estate exposures.
Exposures to institutions	Implementation of a new risk-sensitive approach to assign risk weights, along with changes in base maturity and due diligence requirements.
Exposures to corporates/SMEs	Changes in risk weights, due diligence requirements, a new more risk-sensitive approach for unrated exposures to corporates and a new approach to determine risk weights for issue-specific unrated specialised lending exposures.
Exposures to multilateral development banks (MDBs)	Risk weights as per CQS are introduced for externally rated MDBs (excluding those MDBs eligible for a 0% risk weight). A risk weight of 50% would apply to unrated MDBs.
Exposures in default	Outstanding amount of facility to determine credit risk adjustment threshold instead of unsecured portion of exposure value. For residential real estate exposures where repayments not significantly reliant on property's cash flows, use 100% risk weight.
Exposure to off balance sheet items	Off-balance sheet items have been re-categorised, changes in conversion factors and commitments, as well as self-liquidating documentary credits are further bifurcated into short-term and long-term facilities

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Operational Risk

In a nutshell

The current operational risk approaches, namely the Basic Indicator Approach (BIA), Standardised Approach (SA), and Advanced Measurement Approach (AMA), **will be replaced with the new Standardised Approach (SA).**

Description

Own funds requirement

Elements

Basic Indicator Component (BIC)

Internal Loss Multiplier

Approach

Basic Indicator (BI)

X

Marginal Coefficients (αi)

Set to 1 per national discretion

Output floor

$$Total\ RWA = \max\{RWAs(all\ approaches), 0.725 * RWAs(SA\ only)\}$$

In a nutshell

The output floor is intended to promote the safety and soundness of firms with IM permissions, and to facilitate competition between SA and IM firms.

Firms determine their Risk-Weighted Assets (RWAs) by selecting the higher value between:

1. Calculating total RWA using all approved approaches, including internal models
2. Calculating 72.5% of RWAs using the standardised approach alone.

The latter option is referred to as the "output floor" or "floored RWAs."

The requirement is to be phased in over five years

SA RWA	72.5% of SA RWA	IRB RWA	IRB RWA Floor
1,000	725	680	725

Strong and Simple Regime

Basel 3.1 will go live on 1 July 2025 in parallel with the new simplified prudential regime for smaller firms. Firms meeting the Simpler-regime criteria on 1 January 2024 can choose to either:

1. Apply the Basel 3.1 standards on the same timetable as other firms to which the new rules, or

2. Apply the Transitional Capital regime that would be in place until the implementation date of a permanent risk-based capital framework for the simpler regime

Total balance sheet of up to £20 billion	Limited trading activity	Limited foreign exchange position	No Commodity position	**Criteria**
No IRB capital requirement approach	Limited business activity	No operating payment systems	Limited non-UK credit exposures (geographical footprint)	
New retail deposit ratio (RDR)	Pillar 2 liquidity	Liquidity reporting	Pillar 3 disclosures	**Announced**

In a nutshell…

Aims to create a more proportionate prudential framework for non-systemically important banks and building societies; discusses liquidity and disclosure requirements, and explores how a simpler regime could boost competition, while maintaining a safe and sound financial system. However, the strong and simple regime sits alongside Basel 3.1, and builds on many of the same themes.

Data

Nikhil Asthana

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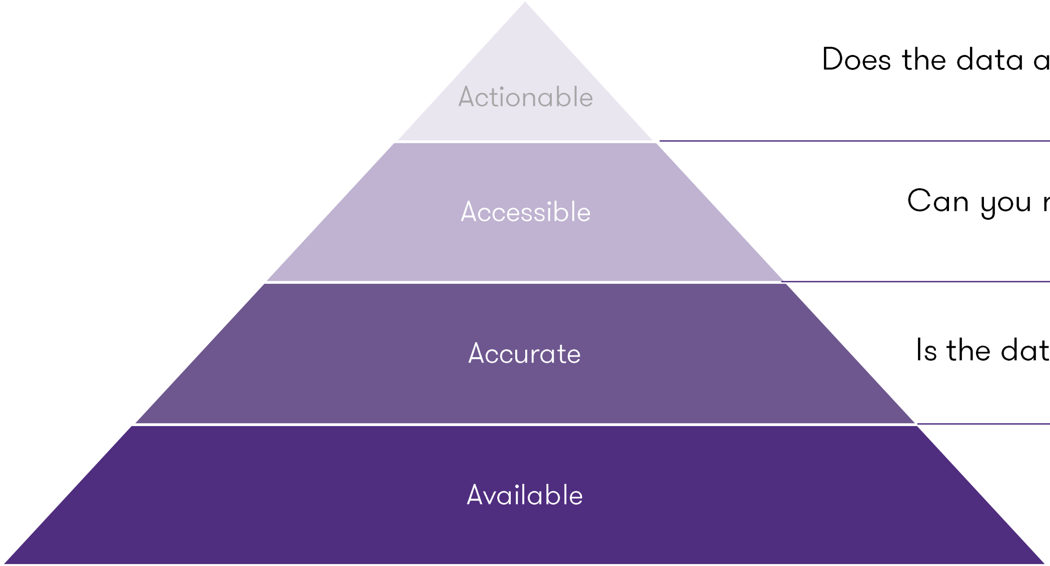
Basel 3.1 Implementation challenges

Basel 3.1 data requirements	Grant Thornton's Delivery Principles
Data Availability and Accuracy Access to accurate and reliable data required for regulatory reporting including information on capital, risk exposures, and liquidity.	Establish robust data governance frameworks, implementing data quality controls, and investing in data infrastructure and technology. Firms should focus on data validation, reconciliation, and integration processes to ensure data accuracy and availability.
Data Aggregation and Reporting Basel 3.1 requires firms to aggregate data across various systems and business lines to provide a comprehensive view of their risk profile posing data integration, consolidation, and reporting challenges	Centralised data repositories and data integration platforms. These platforms should enable automated data aggregation and reporting, allowing banks to consolidate and analyse data from disparate sources efficiently.
Granularity and Granular Data Requirements Basel 3.1 places an emphasis on granular data, requiring banks to report data at a more detailed level than before. This means banks must collect and report data on a transactional or account level, rather than relying solely on aggregated data.	Reviewing and enhancing data capture mechanisms and implementing systems that can collect, process, and report granular data. Firms may need to update their data models, data dictionaries, and reporting systems to accommodate the increased granularity requirements.
Data Governance and Data Lineage Basel 3.1 requires firms to establish effective data governance frameworks to ensure data quality, traceability, and accountability. Firms must be able to demonstrate the lineage of their reported data, from the source systems through to the final reports.	Data governance frameworks that encompass data lineage tracking, data quality controls, and data ownership. Banks should establish clear processes and responsibilities for data management, including data validation, documentation, and audit trails.
Data Modelling, Analytics and Visualisation Implementing Basel 3.1 poses challenges in data modelling, analytics, and visualisation for firms. Complex risk models are required to assess capital adequacy and liquidity risk. Validating these models demands advanced statistical techniques and robust back-testing procedures.	Development of data platforms with internal data applications and strategic alliances with emerging technologies, automating data processes and modelling to reduce time, improve repeatability and consistency to allow enhanced executive decision making.

Data Availability and Accuracy

Firms must ensure they have access to accurate and reliable data required for regulatory reporting. This includes information on capital, risk exposures, and liquidity. Data must be complete, timely, and consistent to meet the regulatory requirements.



Does the data address key requirements?

Can you reach the right data?

Is the data correct and complete?

Does the data exist?

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Data Aggregation and Reporting

Firms are required to aggregate data across various systems and business lines to provide a comprehensive view of their risk profile. This poses challenges in terms of data integration, consolidation, and reporting.

Data Management Foundations blocks need to be in place before an organisation embarks on their regulatory journey. The key foundation blocks are in:

1. Data Strategy
2. Data Governance,
3. Master Data Management
4. Data Quality
5. Data Lineage
6. Data Architecture &
7. Reference Data

Data Strategy

Data Governance

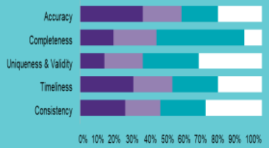
- Accountabilities and RACI
- Data domains by products and businesses
- Data stewards
- Forums
- Policies and standards
- Legal entities/jurisdictions

Master Data Management

- Prioritisation and management of Critical Data Elements (CDE)

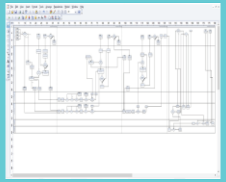
Data Quality

- Data quality rules
- Data quality measures
- Data profiling



Data Lineage

- Gaps
- Source to target mapping of data flow
- Identification of control



Data Issues Remediation

Data Execution Plans

Data Architecture — Development of authoritative data sources

Reference Data — Organisation wide reference points and industry reference

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Granularity and Granular Data Requirements

Liquidity

Capital

Foreign Exchange

Real Estate

Market

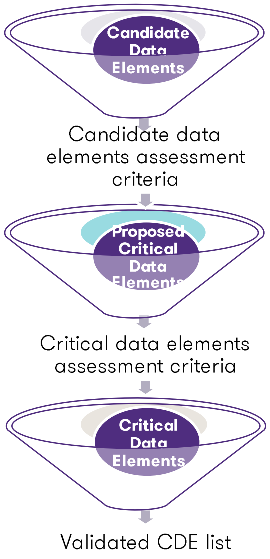
P&L

Balance Sheet

Business Plan

- Credit Risk (SA)
- Credit Risk (IRB)
- Credit Risk Mitigation
- Market Risk
- Credit Valuation Adjustment
- Operational Risk
- Output Floor
- Pillar 2
- Disclosure (Pillar 3)
- Reporting
- Currency redenomination

Outputs



Data elements identified — **1779 DEs candidates**

Critical data elements identified — **450 proposed CDEs identified**

Basel 3.1 places an emphasis on granular data, requiring banks to report data at a more detailed level than before. This means banks must collect and report data on a transactional or account level, rather than relying solely on aggregated data. Grant Thornton can help support firms identifying critical data elements in structured and measured approach to help simplify the reporting process and focus on the key data elements.

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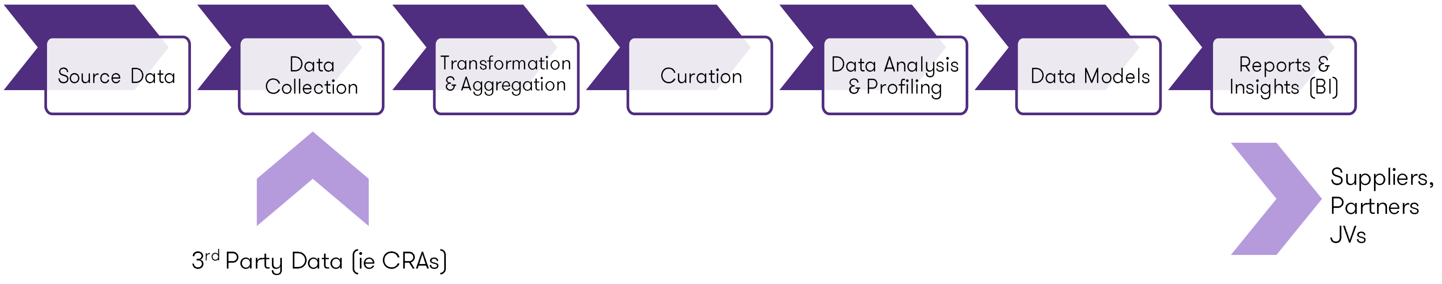
Data Governance and Data Lineage

1. Data Protection Risk (GDPR)
2. Data Ethics
3. Data Quality, Lineage, Governance & Metadata
4. Data Security (Cyber risk)
5. Information Risk Management (Access controls, classification)
6. Data Leakage & Loss (inc Prem & Cloud)



7. 3rd party (inbound) – Data Controller/Data Processer
8. 3rd party data (outbound) – data processes controller
9. Social Media Marketing risk – ie Facebook
10. Model Data Risk (customer & account decisioning)
11. Data execution risk (Migration, ETLs, testing etc)
12. Data Decisioning/ Algorithm (Bias Risk)

- Basel 3.1 requires firms to establish effective data governance frameworks to ensure data quality, traceability, and accountability. Firms must be able to demonstrate the lineage of their reported data, from the source systems through to the final reports. Grant Thornton can help firms develop controls with ownership and monitoring to respond to twelve holistic risk items.

There are multiple risks in managing Data that an organisation will need to consider; these do not cover only the obvious legal and regulatory risk from Data Protection (ie GDPR) but beyond this the reputational and conduct risk. Reputation risk centres on negative press through issues by association with 3rd parties (partners, suppliers) and social media interaction. Some of these are intrinsically related to third parties, legal entity structures, joint ventures, jurisdictions in which the organisations operate, and social media interaction, for which organisations have little control over.

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Data Modelling, Analytics and Visualisation

Implementing Basel 3.1 poses challenges in data modelling, analytics, and visualization for firms. Grant Thornton can support firms with their business objectives for modelling, analytics and visualisation to enhance executive decision making.

Tools and Capabilities

Data Modelling

- Automation, APIs and systems integration
- Financial services organisations as full service platforms for SMEs and corporates
- Data Trusts

Platform & Ecosystem

- Development of data platforms with internal data applications and strategic alliances with emerging technologies
- Enabling mutually beneficial data and digital ecosystems for clients

Data analytics

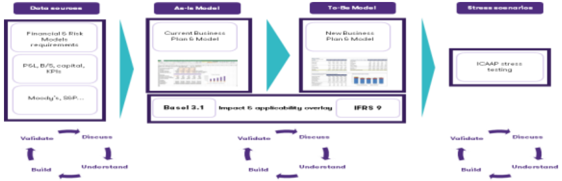
- Expertise in many of the leading analytics tools available on the market. Our specialists have worked with FTSE 100 organisations. From using machine learning, to understanding in detail customer relationships using graphical network analytics

Benefits

- Ability to leverage external data integrated with internal data utilising secure data platforms presents new opportunities
- Developing digitised client journeys through business lens
- New Target Operating model leveraging data and automation
- Data Platforms and ecosystem enabled through ‘open data’
- Integrate internal data, external data and data signals for advanced insights
- Implementing use case orientated Data Labs
- Leveraging financial modelling techniques to solve customer issues

Tools

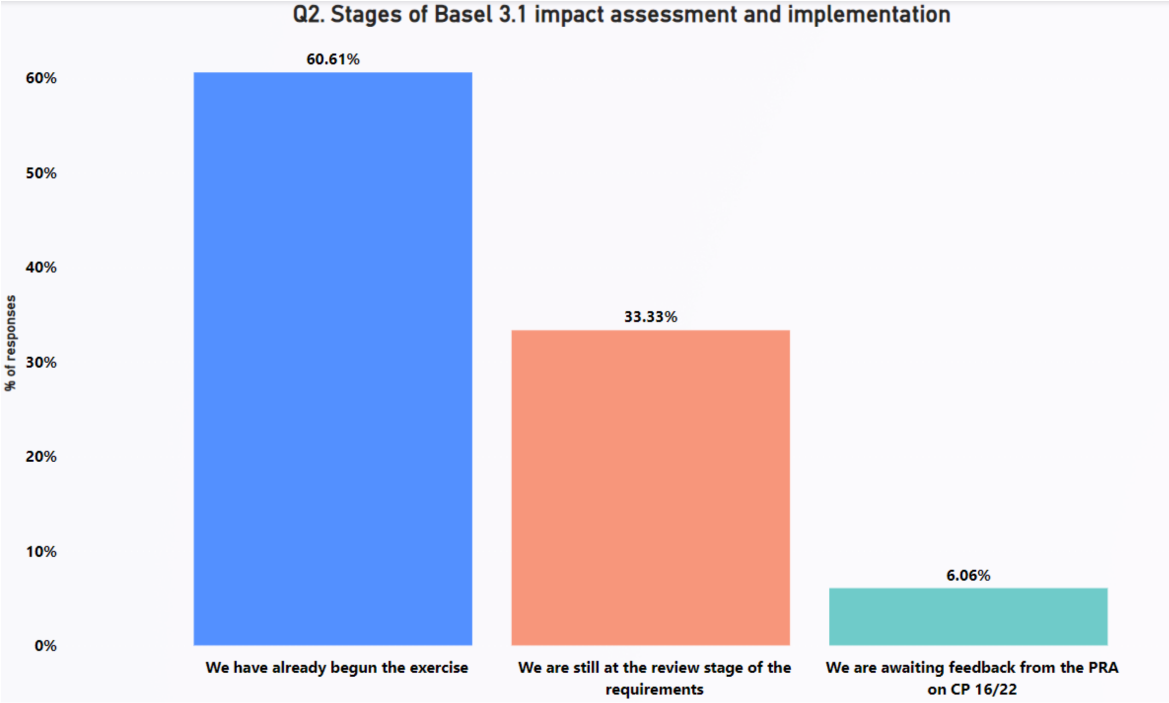
Use cases



Survey results

Paul Cook

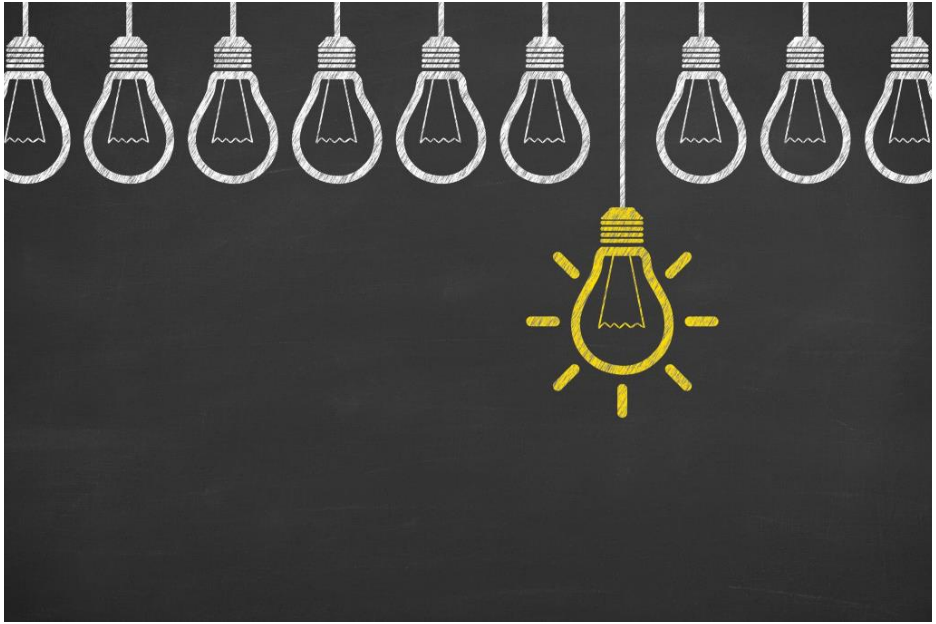
Selected survey insights



At the time of the survey, majority of the respondents had already begun the impact assessment and set up project steering groups for Basel 3.1 implementation. Although, there remains a small population who are yet to start the assessment and develop an implementation programme.

Selected survey insights

An alternative strategy?



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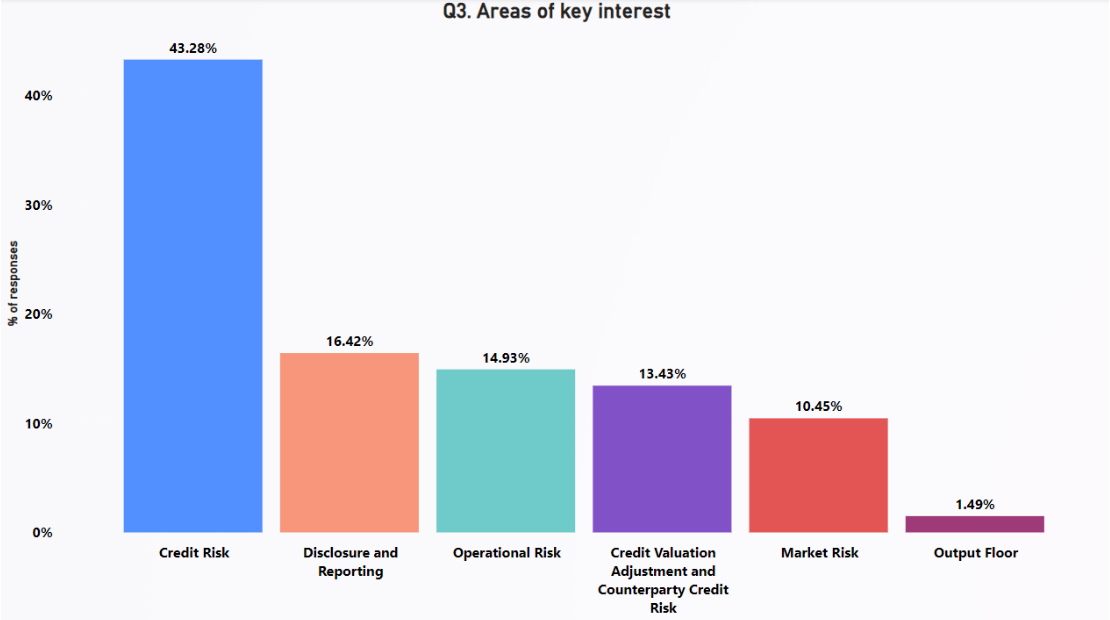

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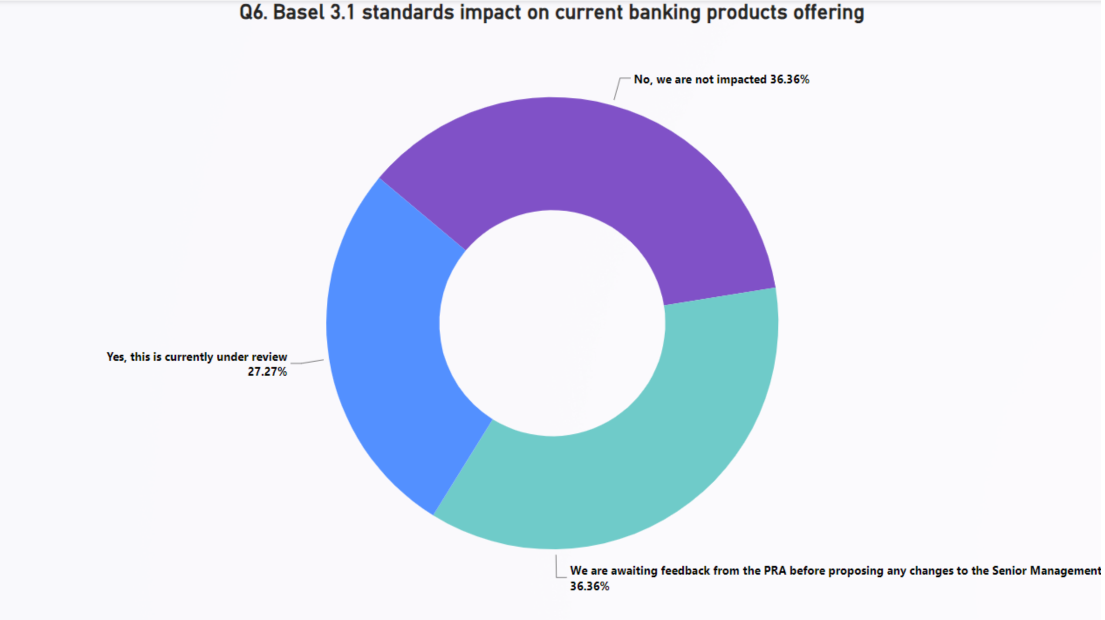
Selected survey insights



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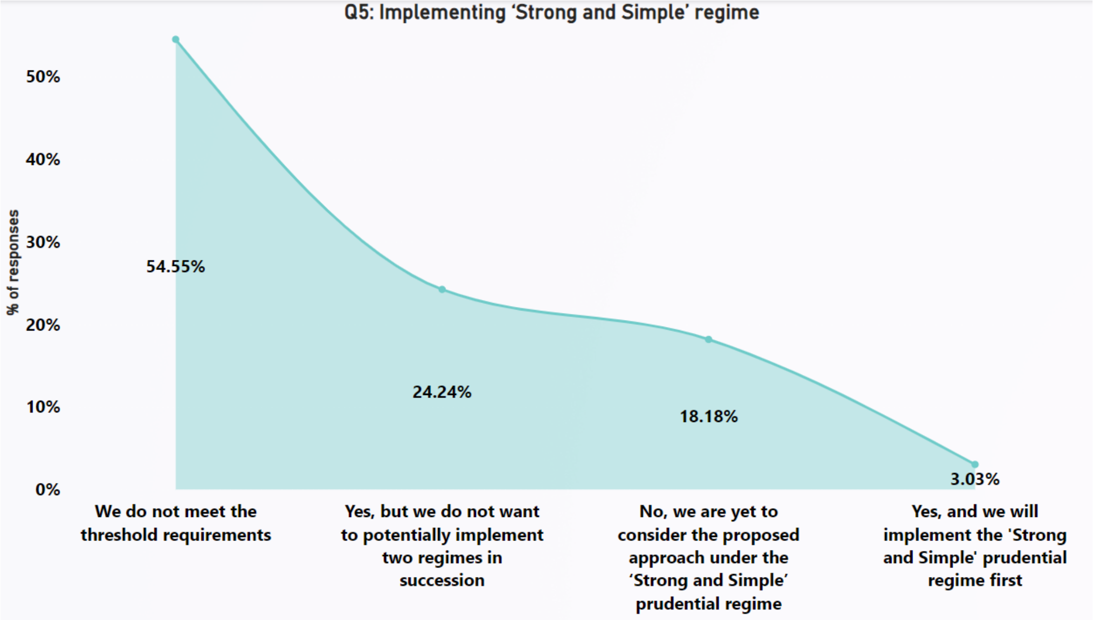

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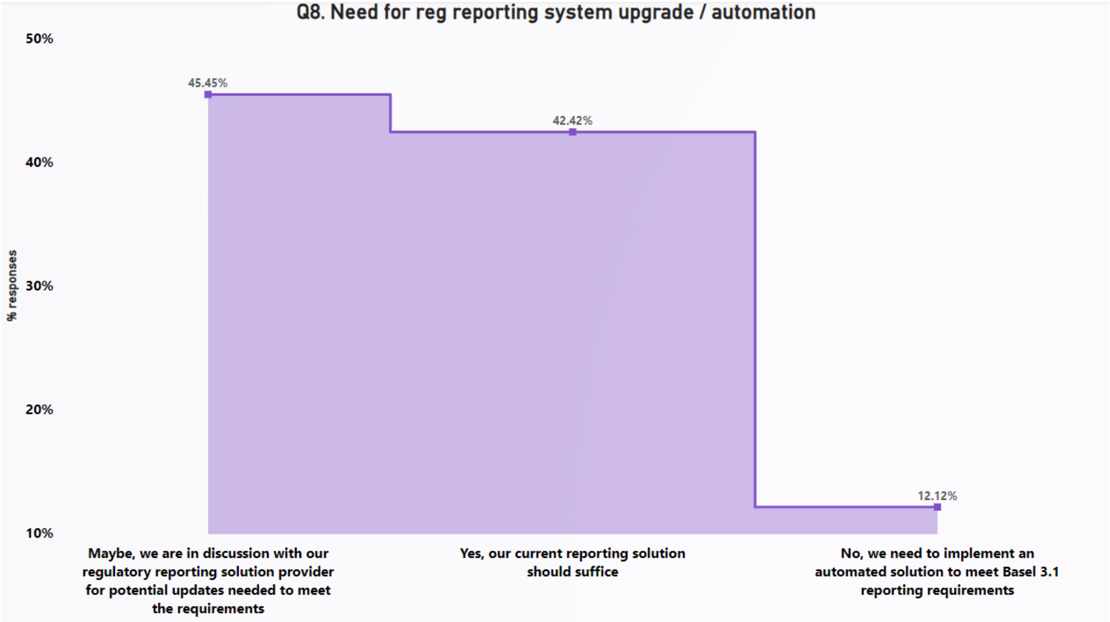

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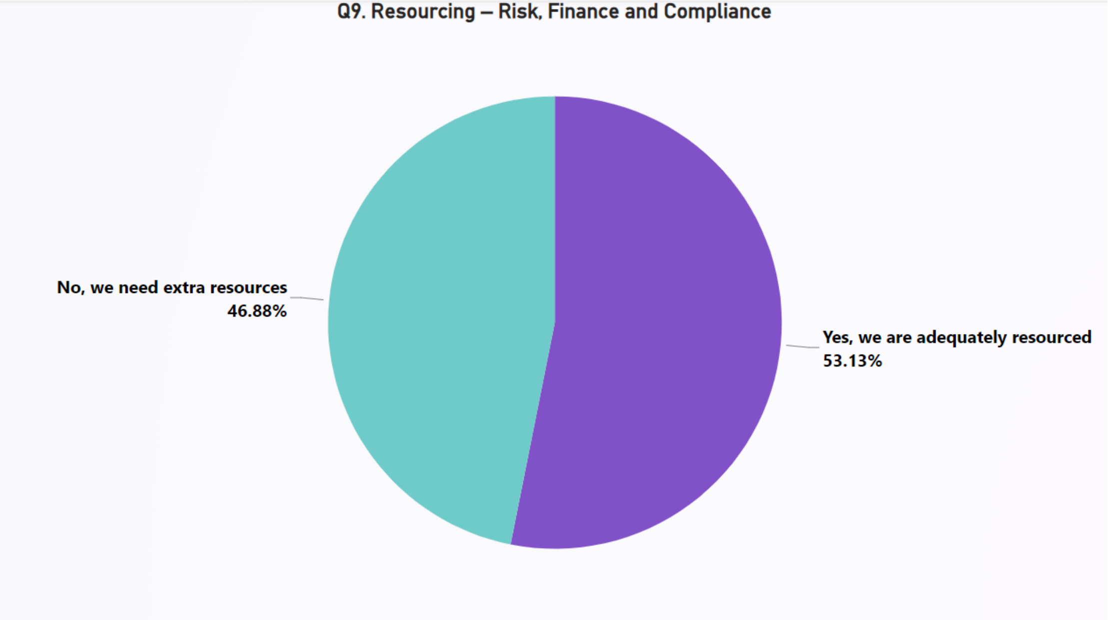

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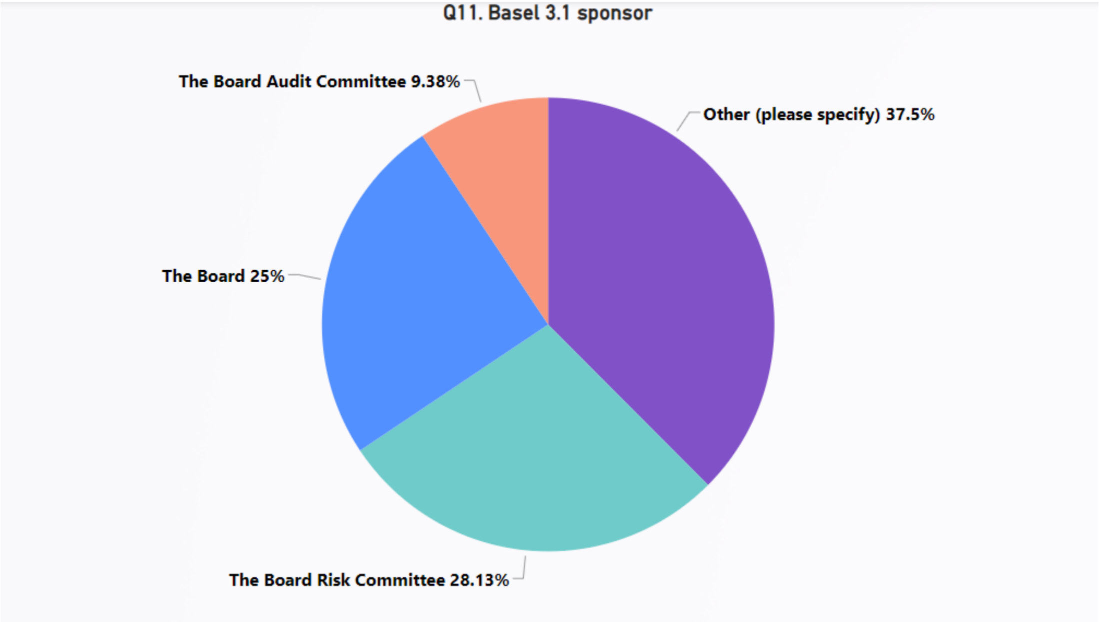

Questions

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