Simplification of the Regulatory Framework

EBA Workshop on Proportionality

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3 July 2015

What Problem is Being Addressed?

- ”Granular issues” with the IRB models
  – risk weights vary too much
  – risk weights are not transparent
  – risk weights are too low
- Fundamental issue with IRB models
  – should all exposures and risk parameters be modelled?
  – IRB models lack credible backstops
- New standardized approaches need to be more risk-sensitive
  – are two-risk driver models enough?
  – is global calibration sufficiently risk-sensitive?
  – use of ratings – minimize reliance or abandon?

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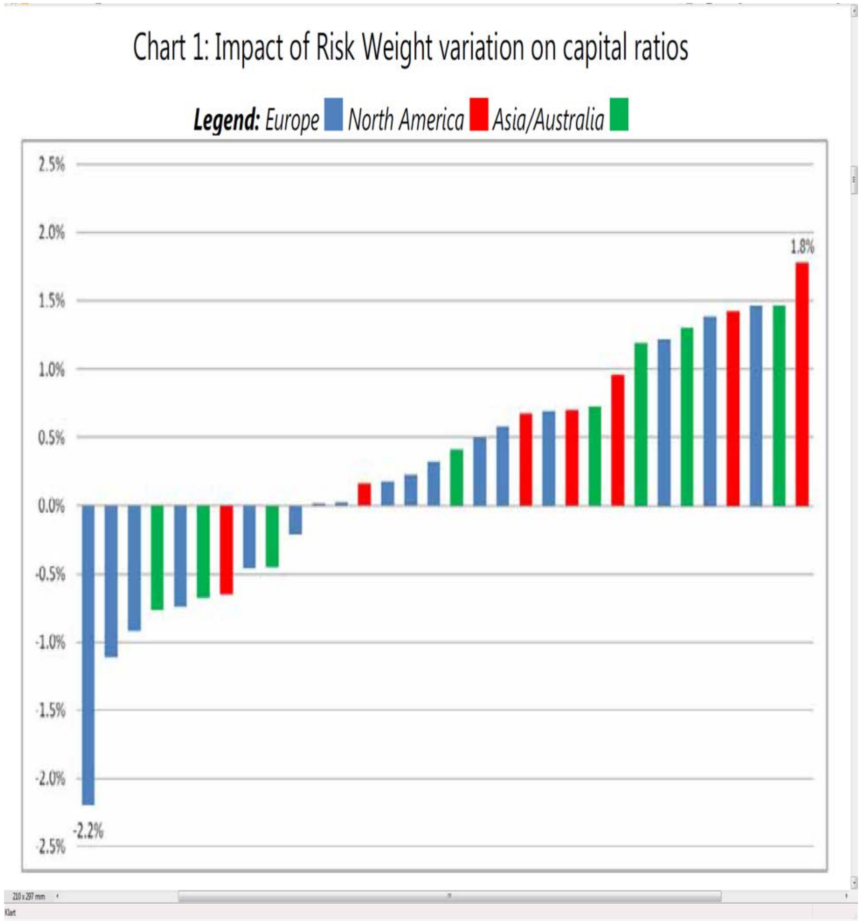
How big is the problem?

- Capital ratios of most banks within 1 percentage point of 10% benchmark (BCBS 2013 study of sovereign, bank and corporate exposures)

- Within market risk, the variation is "substantial" (BCBS 2013 first report on analysis of RWAs for market risk)



Response to “Granular Issues”

- EBA March 2015 Discussion Paper ”Future of the IRB Approach”
- IIF 2014 Report on Risk Sensitivity
- Specific proposals to improve robustness of IRB models and reduce discretion in modelling of low probability events

Response to Fundamental Issues

- Agenda set by Haldane (2012) Jackson Hole speech on the Dog and the Frisbee
- Basel Committee November 2014 report to the G20 to address variability of Risk Weights
- Basel Committee December 2015 consultation on permanent floors
- The fundamental question is whether all exposure classes (banks, sovereigns, large corps, SMEs, retail etc.) CAN and SHOULD be modellable

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New standardised approaches and floor(s)

- New standardised approaches (”SA") for credit, market, operational and counterparty credit risk consulted upon during 2014-2015
- New permanent floor(s) based on new SAs proposed in December 2014
  - cover all risk categories
  - affect risk weights (as opposed to existing EU RW floor)
  - ensure that IRB-based requirements ”do not fall below prudent levels”

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Summary reflections

- Pillar 1 capital requirements are likely to increase:
  - increase is expected to be considerable as a result of "granular" changes to models
  - increase can be even bigger if the floors are calibrated on the basis of not-so-risk-sensitive standardised approaches

- It may reduce the gap between banks using standardised approach and IRB banks

- Increase in capital requirement is welcome, but…

- If non-risk based capital requirements (floors) become binding, this may lead to structural changes:
  - smaller but more risky banking system?

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