The clock is ticking on the Basel IV implementation – Are you ready?

On 27 October 2021, the European Commission (EC) published its legislative package, implementing the finalisation of the Basel III reforms, widely recognised as Basel IV. The Capital Requirements Regulation 3 (CRR III) and the Capital Requirements Directive 6 (CRD VI) were put in place to signify a new era of banking and financial compliance. The countdown to the implementation deadline is underway. As we stand on the end of 2023, only one year remains before the January 2025 implementation deadline.

The clock is ticking, banks, regardless of their size and complexity, should start preparing for this monumental shift. Your readiness today will shape your success tomorrow.

The package represents significant updates to the European Union's banking regulatory framework, aiming to strengthen the risk-based capital framework without significant increases in capital requirements overall, enhance the focus on Environmental, Social, and Governance (ESG) risks in the prudential framework, further harmonise supervisory powers and tools, and reduce banks' administrative costs related to public disclosures while improving access to banks' prudential data.

Let's take a closer look at the key revisions introduced by CRR III / CRD VI.

Credit Risk (SA) - Introduction of measures aimed at enhancing the robustness and risk sensitivity of the standardised approach for credit risk (SA-CR). These measures include updates to risk weights and the introduction of new counterparty grades. Additionally, there is a notable reduction in the reliance on external credit ratings.

Credit Risk (IRB) - Limiting the use of internal rating based (IRB) approaches to some exposure classes, introduction of input floors for some risk parameters and new exposure classes introduced.

Market Risk - Introduction of binding own funds requirements based on the Fundamental Review of the Trading Book (FRTB) approaches. It also revises the criteria used to distinguish between trading book and banking book.

Operational Risk - Introduction of a new standardised approach which considers the size of the bank's business and replaces all existing approaches for operational risk. It also mandates the use of historical loss data.

Credit Valuation Adjustments (CVA) risk - Introduction of revised approaches to calculate CVA risk capital requirements.

Output Floor - Introduction of an output floor which sets a lower limit to the capital requirements that are produced by banks' internal models, at 72.5% of the own funds requirements that would apply on the basis of standardised approaches.

Disclosure - Enhancement of the transparency and proportionality in disclosure requirements. Additional reporting requirements related to ESG and extension of the requirements related to the disclosure of ESG risks to all institutions.

Environmental, Social, and Governance - Enhanced focus on ESG risks. Banks are required to systematically identify, disclose, and manage ESG risks.

Early preparation matters. The transition to CRR III / CRD VI is not just a regulatory compliance exercise, it brings many challenges and it is a strategic imperative for banks. Here's why early preparation is essential:

- CRR III / CRD VI introduces numerous changes and requirements that demand a significant investment of time and resources. Delaying preparations may result in a rushed and inefficient compliance process, impaired by the forthcoming release by the EBA, of over 100 standards, including Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS).
- Comprehensive preparation allows banks to identify and mitigate risks associated with CRR III / CRD VI. Early risk assessment is crucial for ensuring a smooth transition.
- Banks that are well-prepared for CRR III / CRD VI can position themselves as leaders in compliance and risk management. This enhances their reputation and competitiveness in the market.
- The introduction of the Output Floor challenges capital consumption. Banks should revise the profitability of business lines and launch initiatives for RWA optimisation at the product and collateral levels.
- Conduct testing and validation exercises to ensure that the systems and processes implemented for CRR III provide the results expected.
- Supervisors will closely monitor compliance with CRR III / CRD VI. Being prepared from the outset demonstrates a commitment to regulatory compliance and can result in smoother interactions with supervisors.

With extensive insights and experience in CRR and CRD implementation (including CRR III and CRD VI), Avantage Reply has been actively engaged in assisting a major European banking group during the initial framing phase of its implementation project. Building upon our track record of success, we have been supporting banks across Europe, assisting them in implementing new regulatory requirements and ensuring compliance with the latest standards.

Avantage Reply's expertise equips you to conquer challenges, ensuring a smooth transition while demonstrating your commitment to regulatory compliance. Stay ahead, stay compliant, and secure your success with our tailored solutions.

Contact us today for a personalised consultation on your CRR III / CRD VI compliance implementation strategy.

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