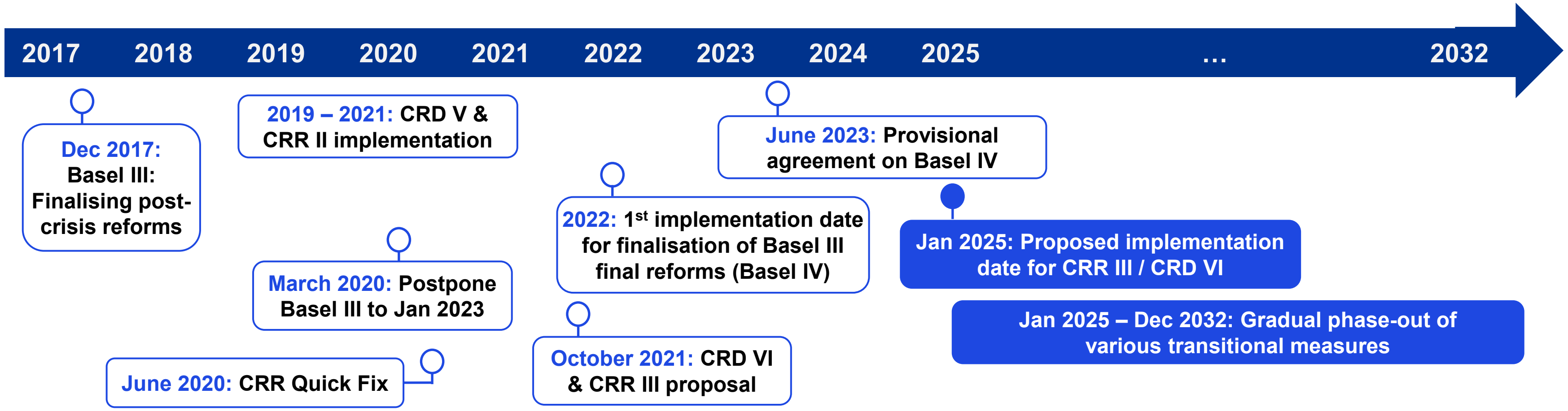
Basel 4

Don't delay: the time for action is now

After a preliminary agreement was reached in the trilogue procedure between the EU Commission, Parliament and Council on 27 June 2023, and the preparatory bodies of the Council and Parliament have endorsed the banking package in December 2023, nothing more stands in the way of implementing the Basel 3.1 finalization (a.k.a. Basel 4) in the EU.

The comprehensive new regulations for determining risk-weighted assets are to be applied as of January 2025, with gradually phasing out various transitional measures until the end of 2032. Banks now have less than 12 months left for their preparation.

The timeline



The implementation of Basel 4 is one of the biggest priorities for banks as they move into 2024. They have a last window of opportunity to recalibrate their compliance approaches and strategies, refine their systems and ensure that they are fully equipped to navigate the complexities of the Basel 4 landscape.

Even for the small financial institutions that calculated their capital requirements based on the standardised approaches up until now, there are plenty of important amendments that they need to implement and comply with as from January 2025.

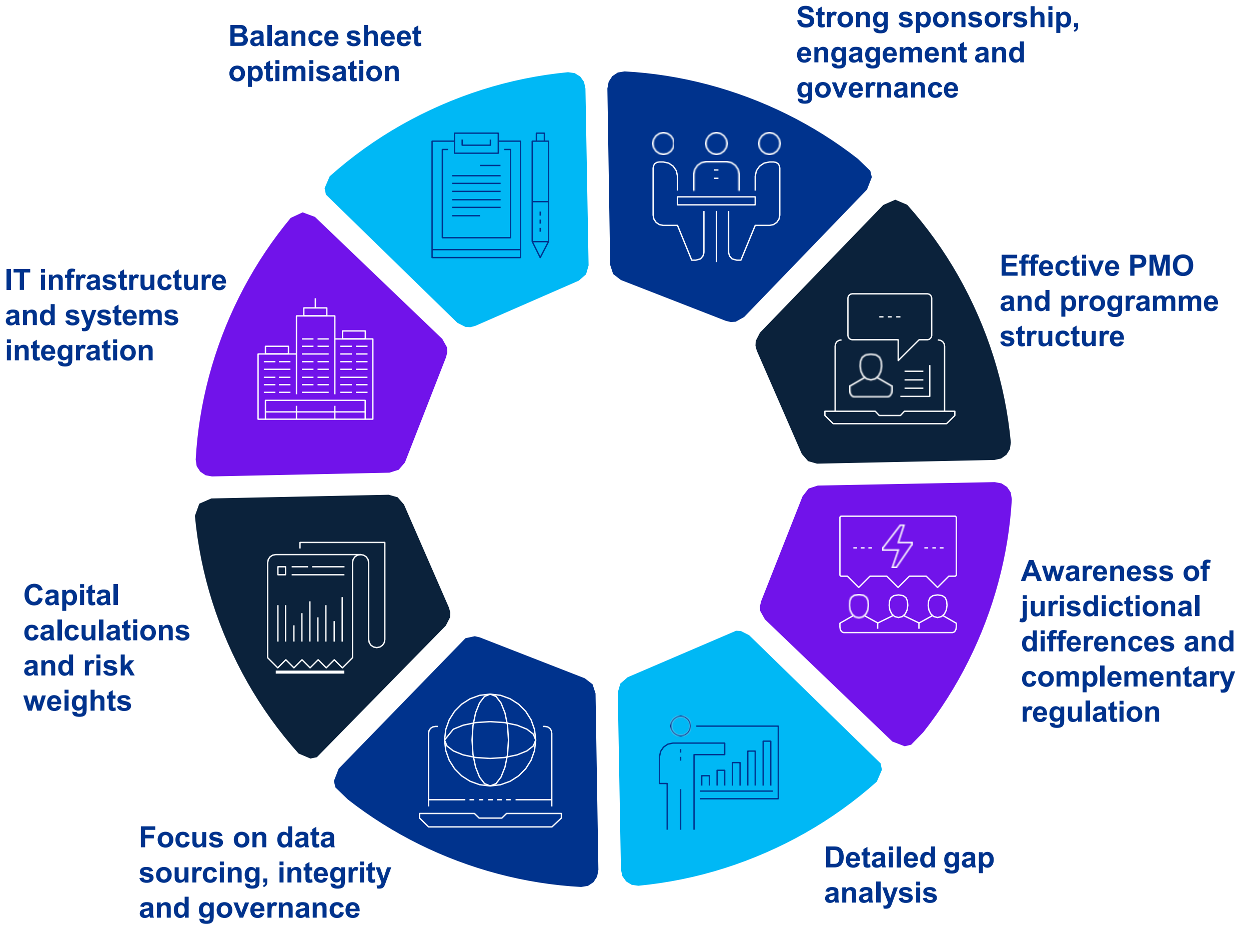
The changes to the Basel rules create significant work for banks. However, this should be considered as an opportunity not only to ensure regulatory compliance but also to consider the capital impacts and how their business should evolve to deliver future profitability.

KPMG Belgium has the skills and expertise to support you through all the stages of this transformative journey. Read on for a summary of our views on the challenges banks will likely face as they look towards implementation and to learn more about potential strategies for successfully navigating the complex Basel 4 requirements.

Considerations for a successful Basel 4 implementation

Banks have significant work to do to ensure timely compliance with the Basel 4 requirements. This includes, but is not limited to:

- Standing up and executing a strategic implementation program
- Performing gap analysis assessments against the new rules
- Data sourcing for new attributes required for real estate, unrated corporates and institutions
- Reviewing and updating existing policy interpretations
- Identifying and making necessary changes to operating models
- Building and implementing RWA calculators for the new standardised approaches for credit, market and operational risk
- Building the standardised floor calculation for Internal Ratings Based (IRB) banks
- Submitting model applications or re-applications to continue using IMA and IRB approaches
- Re-visiting impacts with front office and educating board and executive management



Implementation considerations

Basel 4 will fundamentally change the way in which banks need to manage their balance sheets, presenting opportunities to:

- Drive efficiencies through improved capital deployment
- Increase balance sheet velocity
- Enhance earnings / deployment of capital and return on capital
- More dynamically manage risk appetite
- Reduce balance sheet volatility and stress impact
- Create optionality / recovery actions in stress

Asset origination and distribution economics will change as a result of the output floor. Effective balance sheet management requires banks to look for divergence between the regulatory capital assumed risk and the market assumed risk.

The output floor and adjustments to the standardised and IRB approaches will create a dislocation between these assumed risk metrics, that may benefit from an increase in structural distribution mechanisms; for example, through the use of Significant Risk Transfers (SRTs).

Banks in the EU have been tracking the strategic impact on capital ratios since the Basel Committee first published its final reforms, through exercises such as the quantitative impact studies (QIS), and have established implementation programmes for components such as SA-CCR and FRTB. However, most large banks only set up holistic Basel 4 programmes in Q4 2022 and some smaller firms have not yet commenced the necessary impact analysis even today.

Compared to their other European peers, Belgian banks need to deal with an extra challenge when preparing for the implementation of Basel 4, namely the ineligibility of the mortgage mandates as collateral under the Standardised Approach for credit risk, which may have significant impact on their capital requirements if no timely mitigating actions are taken.

Belgian banks need to make a firm decision right now, whether to fundamentally amend their lending practices, shifting from partly mortgage mandate-based lending to requesting full coverage with mortgage subscription.

Although various transitional measures will still provide some temporary relief, such as:

- an overall capital requirements cap (125% of the unfloored capital requirements) and reduced output floor factors until the end of 2029,
- preferential risk-weights for certain parts of the exposures secured by residential real estate properties until the end of 2032 (gradually phasing out from 2029 until 2032),
- preferential risk-weights for exposures to unrated corporates until the end of 2032,…

banks – in order to ensure that their capital position remains well managed – must use this period strategically, for example they need to refine their existing policies and practices, adjust their operating models, and make good use of the balance sheet optimization opportunities.

How can KPMG help?

KPMG professionals can support you through the various stages of your Basel 4 implementation:

Global view and local expertise

KPMG firms' global network of Basel subject matter experts can help ensure you have the latest perspectives on regulatory and technical mandates. We can also bring insights on how jurisdictional difference are being managed at global and cross border firms.

Regulatory follow-up

KPMG tracks, curates and distributes regulatory content to help you stay on top of the ever-changing regulatory landscape. We can also provide insights from KPMG firms' regulatory specialists on key developments and customised horizon scanning reports.

Policy interpretation

We can review your existing policy interpretations against the new requirements and assess the impact the changes will have on your capital requirements.

We have insights into how other firms are interpreting the new requirements and are planning to address data gaps.

Where interpretations are required, we can draft governance documents to support your decision-making.

Impact assessment and rule decomposition

We can perform a line-by-line impact assessment leveraging our prepared decompositions. This method ensures full traceability back to the regulatory text.

Programme management office (PMO) support

We can perform central programme management office functions, coordinating resources across teams, helping to manage risks and dependencies and assisting with proactive engagement with the necessary stakeholders.

Technology implementation support

KPMG professionals can help with your technology implementation, including:

- Drafting user stories and functional specifications
- Data derivation from existing inventory of systems
- User Acceptance Testing (UAT) and implementation planning
- The development of reporting.

Assessing data requirements

We can perform the data discovery process for new attributes and document the data lineage for these in line with market leading practice. Through our work we will improve data governance through providing full data traceability which will deliver benefits if future changes are required.

Capital impacts and balance sheet optimisation

KPMG specialists can help you to understand the capital impact of Basel 4 on your business and identify opportunities to optimise your strategy and balance sheet, to drive enhanced returns.

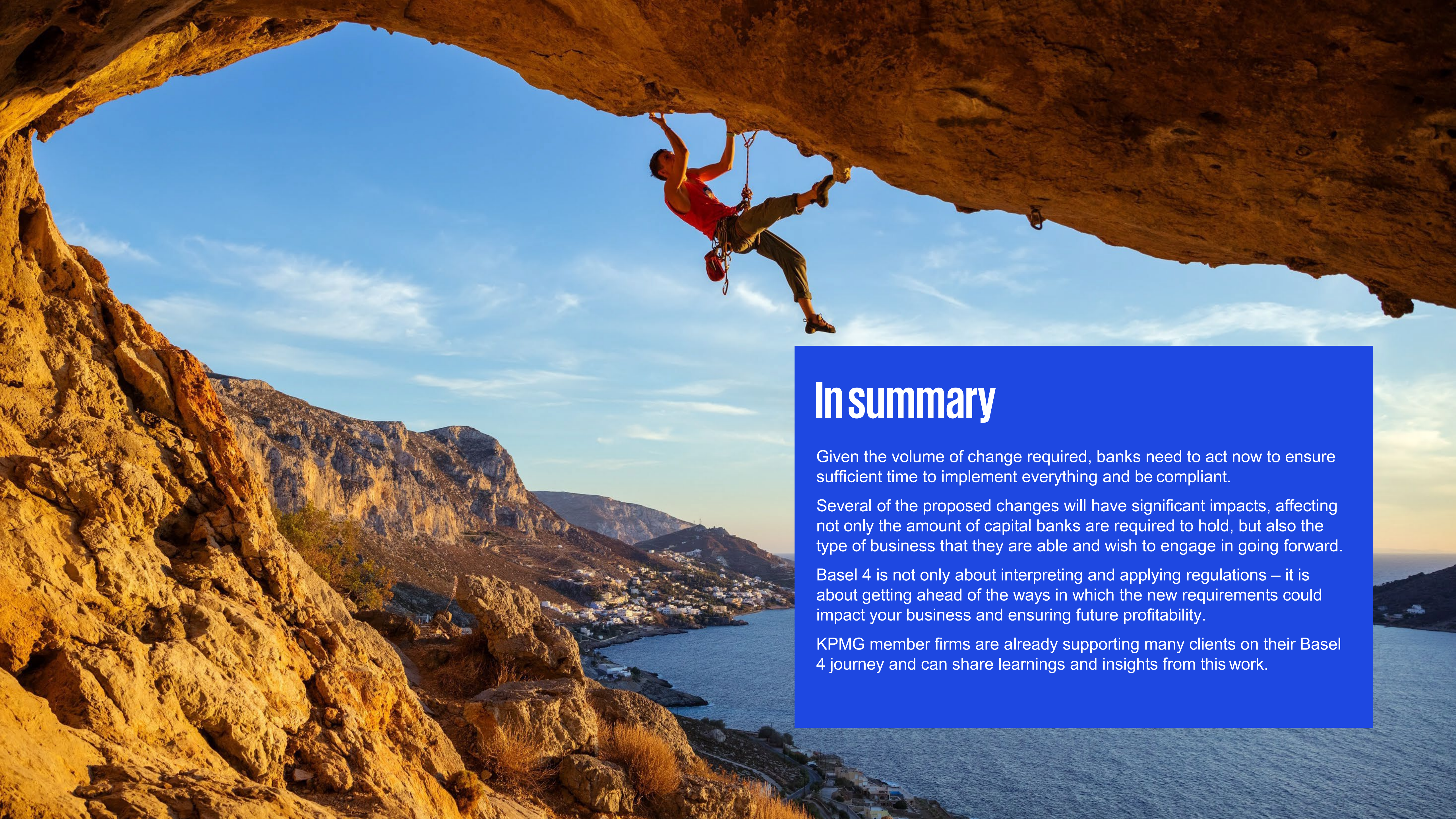
Implementation assurance

Independent review of your implementation approach to help ensure compliance with regulatory requirements including:

- Completeness and traceability back to rules
- Policy
- Governance
- Process and control testing
- User acceptance testing.

Training and upskilling

KPMG professionals can provide "off the shelf" and tailored training to upskill teams across your business on regulatory change, requirements and impacts.



In summary

Given the volume of change required, banks need to act now to ensure sufficient time to implement everything and be compliant.

Several of the proposed changes will have significant impacts, affecting not only the amount of capital banks are required to hold, but also the type of business that they are able and wish to engage in going forward.

Basel 4 is not only about interpreting and applying regulations – it is about getting ahead of the ways in which the new requirements could impact your business and ensuring future profitability.

KPMG member firms are already supporting many clients on their Basel 4 journey and can share learnings and insights from this work.

Contact us

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