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Basel III Post-crisis reforms discussion

A KPMG discussion on the implementation challenges posed by the regulatory reforms, including the need for investment in data, systems, and processes, as well as the introduction of new disclosure requirements.

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Introduction

The global prudential reform agenda continues to prompt significant regulatory developments in banking sectors worldwide. These reforms aim to enhance risk sensitivity and improve the resilience of our banks.

South Africa has committed to full alignment with the outstanding components of these global reforms, referred to as "Basel III post crisis reforms". The most impactful changes became effective on 1 July 2025, which introduce a fundamental shift in how the capital requirements of banks are determined.

We were joined by banking industry leaders for a discussion on the implementation challenges posed by the regulatory reforms, including the need for investment in data, systems, and processes, as well as the introduction of new disclosure requirements.

This event was designed in collaboration with KPMG's Board Leadership Centre as an industry knowledge-sharing forum, enriched with practical insights. Our panel featured leading voices including KPMG's Global Head of Banking Francisco Uria, Olaotse Matshane, the Prudential Authority's Head of Department for Policy, Statistics and Industry Support, who covered why the Basel III post crises reforms were introduced, as well as what the reforms are meant to achieve. She also covered the expected impact at a high level. Together with seasoned KPMG subject matter experts we unpacked Basel III post-crisis reforms.

Basel III Post-crisis reforms: Insights from Olaotse Matshane

Olaotse Matshane, Head of Policy, Statistics, and Industry Support at the Prudential Authority (PA), delivered a comprehensive presentation on South Africa's financial sector regulatory framework, highlighting the legislative structure and the Twin Peaks model of regulation.

The Twin Peaks Model of Financial Regulation

Olaotse began by outlining the Twin Peaks system, which divides financial regulation into two main areas:

1. **Prudential Regulation** – Overseen by the PA located within the South African Reserve Bank (SARB), this peak focuses on the safety and soundness of financial institutions. It includes specific entities previously regulated by the Financial Services Board (FSB) and the Co-operative Banks Development Agency (CBDA).
2. **Market Conduct Regulation** – Overseen by the Financial Sector Conduct Authority (FSCA), this peak ensures fair treatment of financial customers in addition to the oversight of institutions undertaken by the National Credit Regulator (NCR).

She emphasised the need for audit committees to apply equally rigorous approaches to Conduct matters as they do to Prudential matters, noting that many Prudential issues often stem from underlying Conduct-related root causes.

Evolution of the Basel Framework

Olaotse traced the development of international banking standards through the respective Basel Accords:

- **Basel I (1988):** Introduced by the Basel Committee on Banking Supervision (BCBS), it focused on capital adequacy and added a framework for market risk in 1996. The main objective of the framework was to strengthen the soundness and stability of the international banking system; and to ensure comparability and leveling the playing fields between internationally active banks within the banking system.
- **Basel II (2008):** Replaced Basel I with a more risk-sensitive approach, emphasising adequate capital and reserves in relation to credit risk, operational risk, and market risk.

  Basel II included the introduction of the 3 pillars: minimum capital requirements, supervisory review process and minimum disclosure requirements.
- **Post-Global Financial Crisis Reforms:** In response to the 2009 crisis, the G20 launched a coordinated framework for sustainable global growth. The BCBS revised the Basel II framework by means of the Basel 2.5 framework, followed by Basel III and its post-crisis reforms.

Basel III and Beyond

Basel III introduced two major enhancements:

1. **Strengthened Capital Framework**
2. **Global Liquidity Standards**, including:
   - Liquidity Coverage Ratio (LCR)
   - Net Stable Funding Ratio (NSFR)

From 2013 onwards, Basel III reforms predominantly focused on:

- Standardised and internal ratings-based approaches for credit risk
- Operational risk
- Leverage ratio
- Output floor
- Market risk
- Credit Valuation Adjustment (CVA) framework

These reforms were illustrated through key metrics such as the risk-based capital ratio (Regulatory Capital/Risk-Weighted Assets) and the leverage ratio.

During the early stage of the Post Crisis Reforms, the emphasis was placed on the Regulatory Capital (RC) (numerator) held by the banks and with the subsequent Post Crisis Reforms, further emphasis has been placed on the risk weighted assets (RWA) (denominator) to ensure a robust risk-based capital ratio (RBC Ratio commonly referred to as Capital Adequacy Ratio).

$$RBC\ Ratio = \frac{RC}{RWA}$$

Governance and Audit Committees

Olaotse emphasised the critical role of audit committees in maintaining strong governance. Their responsibilities include ensuring compliance, overseeing risk management frameworks, and ensuring the implementation and maintenance of robust internal controls.

Global Implementation Gaps

Despite progress, major jurisdictions like the United States of America, United Kingdom, and European Union have yet to implement revised market risk and CVA frameworks. This regulatory lag creates uncertainty and may result in lower capital requirements being held in certain jurisdictions, affecting global comparability. South Africa's PA views these delays as increasing vulnerability in international markets. Reasons for South Africa to implement at this stage is South Africa's positioning in the G20 compared to the above countries, therefore the PA opted for timely adoption to protect our banks and increase investor confidence.

South Africa's Alignment with Basel III

South Africa has fully aligned with the revised Basel framework as of 1 July 2025. This alignment:

- Supports the real economy by ensuring banks are well-capitalised
- Enhances the global competitiveness of South African banks
- Promotes confidence in the financial sector

The BCBS's Regulatory Consistency Assessment Programme (RCAP) found South Africa compliant across all four areas assessed to date, with the Net Stable Funding Ratio (NSFR) rated as "largely compliant"—expected to be fully compliant by 2028.

The changes implemented in the updated Basel framework will improve the treatment of credit risk in South Africa in the following manner:

- Provide for a more detailed risk weighting approach as opposed to a flat risk weight in selected cases
- Reducing the reliance on external credit ratings, requiring banks to conduct sufficient due diligence when using these external credit ratings
- For IRB Banks the introduction of constraints on the risk parameters used within specific risk estimates.

The Post Crisis Reforms also attempt to streamline the treatment of operational risk by replacing the previous 4-approach framework with a single revised standardised approach. The main objective is to make it easier to compare Risk Weighted Assets across banks by removing the option to use multiple approaches and the option to use internal models.

Quantitative Impact Survey (QIS)

The QIS aims to assess the impact of Basel III post-crisis reforms on South African banks. It focuses on six key areas (1. Operational Risk, 2. Credit Risk, 3. Market Risk, 4. Credit Valuation Adjustment (CVA), 5. Leverage Ratio and 6. Output Floor) introduced as part of the reforms, covering banks conducting business in South Africa.

The Importance of Conduct Risk

In closing, Olaotse highlighted the significance of conduct risk. She stressed that conduct issues are intertwined with prudential matters, influencing South Africa's reputation and investor confidence. Understanding the revised Basel framework is essential, but so is acting with integrity and fulfilling fiduciary duties.

Panel Discussion Highlights: Navigating Challenges in Financial Sector Regulation

During a dynamic Q&A session with the panel, key issues affecting the financial sector were explored, ranging from operational risks and data quality, to regulatory compliance and talent retention. Below are the main insights shared:

1. Industry Challenges: Areas that may require technical interpretation guidance from the PA noted thus far

Panelists acknowledged a noticeable increase in technical interpretive matters, particularly in **credit risk capital requirement and modelling**. A significant area of improvement lies in integrating **IFRS 9** into capital models. Even when banks operate with dual model sets, this integration helps identify gaps and enhances overall risk management.

This spike in technical interpretive matters is largely attributed to the vastness and complexity of the new regulatory requirements. To address this, a structured roadmap has been introduced to help banking institutions reduce findings and improve governance around model development and implementation.

From an operational risk perspective, the one size fits all results in inconsistent (disproportionate) regulatory requirements in a few isolated cases for banks with unique business models.

The PA is open to strategic engagement around how banks are managing risk which may have an impact in the application of some of their capital requirements.

2. Talent Retention and Capacity Constraints

The PA clarified that public consultation is a legal requirement before an amendment to a regulatory framework is approved for implementation. The current roadmap outlines clear timelines, and banks are encouraged to use these consultation platforms to voice concerns—especially if internal capacity constraints or staffing challenges may affect compliance.

A major driver of capacity issues is **data management**. As banks move toward greater automation, the demand for data specialists has surged, highlighting the need for strategic workforce planning.

As it relates to model redevelopment, there is heighted capacity demands as it relates to banks' submission for internal model approvals to the PA, also taking into account skills and experience, and the volume of submission from the banks at the same time.

3. Increased Capital Requirements and Broader Impacts

Operational risk remains a focal point, but model risk committees are increasingly identifying **new and emerging risks**. Governance standards have risen, requiring more time and resources to manage these complexities.

Historically, the Basel framework aimed to level the playing field and enhance comparability. However, the global financial crisis exposed weaknesses in existing models, among others, eroding investor confidence and prompting government intervention. To avoid future bailouts, regulators have strengthened oversight, requiring banks to regularly stress test their models and maintain robust capital buffers.

Given that banks' balance sheets are funded by **public deposits**, both locally and internationally, enhanced regulation and disclosures (e.g., under IFRS) are essential. This has placed pressure on external auditors to ensure financial statements meet stringent compliance standards.

The South African banking sector is robust and has historically demonstrated resilience during times of crisis, and whilst extensive regulation can complicate compliance, the regulator aims to strike a balance between sufficiently robust **risk management and regulatory complexity**. Achieving this balance improves South Africa's global compliance ratings and enhances its attractiveness to international investors.

4. Data Quality and the PA's Perspective

Data precision and consistency—from source to reporting—remains a challenge. Gaps in this process undermine the reliability of data submitted by banks, which in turn affects regulatory assessments.

The **Internal Capital Adequacy Assessment Process (ICAAP)** plays a crucial role in identifying risks stemming from poor data quality. Inconsistent or inaccurate data compromises one of the Basel framework's core objectives: **comparability**. This underscores the importance of a robust data governance framework.

The PA's response in this instance is to emphasise the importance of adequate capital buffers.

5. Private Credit - Unregulated industry

The PA noted that there is currently no clear definition for **private credit**, particularly among non-bank intermediaries. The authorities rely on standard-setting bodies, such as the **Basel Committee on Banking Supervision (BCBS)**, to monitor developments and establish a framework to manage private credit effectively.

Final Remarks

The panel concluded with a strong message to banks and auditors: **take implementation seriously**. Conduct risk must be considered alongside prudential regulations, as it directly impacts South Africa's reputation and investor confidence.

By ensuring compliance and comparability, South Africa positions itself as a credible and competitive player in the global financial landscape—on par with global institutions.

Session with the Global Head of Banking from KPMG: Francisco Uria Fernandez

The session incorporated a reflection of various meetings with Global heads on banks in various countries highlighting key take aways and action points to incorporate into South Africa and audit. The incorporation of Basel III Post Crisis Reform and the optimism for a stronger banking internal system due to international robust regulations being introduced.

Francisco highlighted that we are in a moment in which the global banks face the risk of prudential regulation fragmentation after the effort that was made as a result of the lessons learned in the global financial crisis.

The current debate on simplification and competitiveness, very strong in the UK and the EU, and the political atmosphere in the US makes it difficult to predict how global regulation is going to evolve, but it would be important to remember that the establishment of global standards responded to strong business reasons and the regulation we have now in force (Basel III) has been able to keep the global banking sector safe and strong in the difficult days of the pandemic and the March 23 crisis, which impacted the part of the US banking system that wasn´t fully subject to Basel III standards.

Francisco stated that in his view, simplification is needed, to avoid unnecessary costs and burdens for the banking sector that could damage or limit its capability to lend and support the real economy but, at the same time, simplification is not deregulation so it is not about deleting tons of regulations but to amend and reform them in order to fulfill their objectives, making it compatible with banking efficiency. What is going on in prudential regulation is even stronger when you look at other parts of the banking regulation such as sustainability and everything related to digital, technology, the big IT providers and the crypto economy, these are treated in a very different way on both sides of the Atlantic. The fragmentation of the regulation and the very different criterion applied by the supervisors add costs and complexity to regulatory compliance by the global banking institutions and this is probably not the way in which regulation should be evolving.

Francisco went on to mention four key messages to go forward:

1. **Growth:** How can the banks increase their geographical presence through organic and directed growth.
2. **Efficiency:** The extensive investment into AI and optimising the quality of data to ensure optimal efficiency within the banking operations.
3. **Profitability:** Finding new innovative models and products to provide for a changing society and ensuring that profits are maximised.
4. **Opportunity:** Described as the consolidation of the 3 points above by finding opportunities and in some cases creating new opportunities which cater to clients' needs.

Francisco also pointed out concerns, with the most significant matters being geopolitical matters such as US trade relations, Israel-Palestine war and other matters that take place within the world as well as the global regulatory system for the banks being highly fragmented due to the differing in strictness in relation to the implementation of Basel III along with the aforementioned facts that the UK, US and EU had not yet fully implemented the Basel III Post-Crisis Reform. Francisco highlighted that within the next couple of years, there is a positive trajectory towards those major markets leaning towards full implementation.

Another important point raised by Francisco related to the Banking industry was the unregulated financial institutions challenging certain functions of the bank. This was met with a comment by Dries Smal who highlighted the need for banks to remain consistent in their robust approach towards regulatory compliance as in the long run, the unregulated financial institutions would be either regulated if they continue to grow to a point where they may potentially impact financial stability or they may be absorbed within the banking system over time. Operating within the regulated bounds, provides enhanced governance and sustainability within the banking industry as a major key stakeholder towards the economy of the country.

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