

How do you capitalize on capital regulations?

Global Basel 3 Reforms Survey 2021



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Executive summary



The Basel 3 Reforms: progress, but at different speeds

Much has happened on the regulatory agenda since our last global survey on the Basel 3 Reforms. Not least, there have been numerous pandemic-related developments. Among them, the Basel Committee on Banking Supervision (BCBS) announced a revised deadline of 1 January 2023 for implementation of the reforms, so banks have had to adjust their sights to this new date. In addition, the pandemic has brought inevitable disruption to banks' preparations.

So our EY team thought it was a good time to take the market's pulse and find out where the top global banks are on their journeys toward the new capital regime.

With less than two years to go to the BCBS deadline, we have uncovered significant differences in firms' levels of preparedness. These vary from examples of mature, well-structured change programs that are most of the way through a clear, multiyear delivery track, to banks that seem to have hardly started.

EY's analysis shows that progress is highly size dependent, as larger firms understandably need more time to deploy changes of the magnitude and complexity of the Reforms. Progress also varies by region, suggesting that levels of regulatory focus and prioritization play a part in banks' responses.

Although this is a regulatory-driven change, business and commercial impacts continue to top banks' priorities. The vast majority of respondents continue to view the Reforms as an opportunity to change their business operations more fundamentally and deliver additional business transformation.

Capital impacts, and their potential to alter current market and commercial dynamics, are also top of mind. Progress in this area is clear, with most banks now well advanced in their planning for, and implementation of, commercial and capital mitigation strategies. Our teams expect this to be an area of continued evolution and growing focus during 2021.

But the path to 2023 is unlikely to be a smooth one, and banks continue to grapple with both internal and external challenges. Operationally, data continues to be banks' number one concern, ahead even of system and operating model changes. Externally, there continues to be considerable uncertainty about ongoing pandemic-related disruption, as well as the potential for further change in the regulatory timetable across jurisdictions. Notwithstanding this, most banks are currently reporting confidence in their ability to deliver on plans and meet the deadline, with only a few reporting delays at this stage. This is certainly an area to watch.

Looking ahead, banks will have to continue to balance a relentless focus on operational implementation with astute commercial decisions and an ability to respond with agility to regulatory and environmental developments. None of this will be easy.

To discuss our insights on the Basel 3 Reforms, including how your institution compares with the results in the survey, please speak to the survey team or to your local EY contact.

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The Basel 3 Reforms are clearly one of the most significant regulatory changes banks face. Dealing with the economic fallout from the pandemic at the same time will be a real test of banks' capabilities and strategic focus, not least as the pressures on capital increase.



Jan Bellens
Global Sector Leader, Banking & Capital Markets

At a glance

Overall readiness

Across the industry, there are big differences in the levels of preparedness for the Reforms. Global systemically important banks (G-SIBs) are ahead of domestic systemically important banks (D-SIBs). Regionally, banks headquartered in Asia are behind other regions.

Capital changes

The majority of respondents see capital requirements increasing over most risk types. But only a quarter have either already disclosed capital impacts or are planning to do so in the next 12 months.

Mitigating commercial impacts

There is a better understanding of the strategic and commercial impacts of the Basel 3 Reforms. **Half** of respondents have identified or are carrying out mitigation, compared with **37%** in last year's survey.

Business transformation

Although this is a regulatory-driven change, the majority (**82%**) of respondents are extending the scope of delivery to transform related aspects of business, either significantly or incrementally.

Meeting the deadline

Two-thirds of banks are highly confident of being able to deliver by the regulatory deadline in less than two years. A minority (**20%**) are reporting delays, and a few (**7%**) are assuming a later deadline.

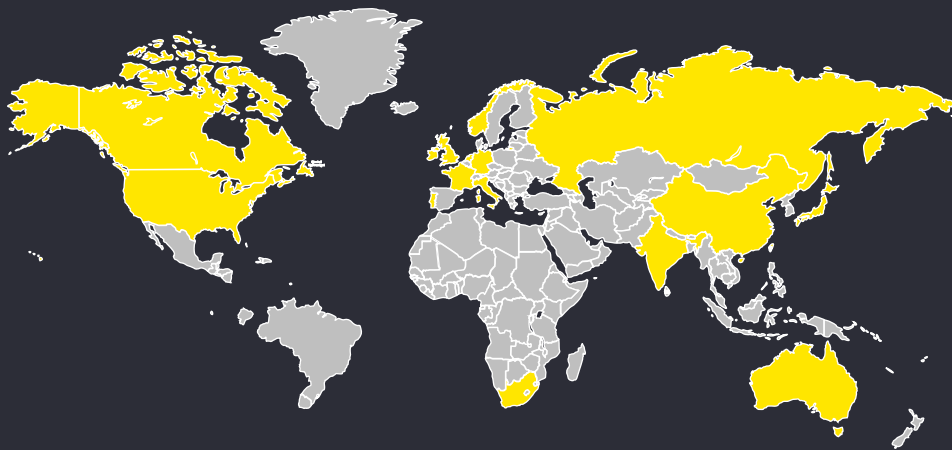
Delivery challenges

Data quality and availability continues to be the **#1** challenge in delivering the Reforms. The delivery of a risk-weighted assets (RWA) control framework ranks much higher as a challenge this year (**#4** versus **#7**).

Participant profile

To provide a global picture of Basel 3 Reform readiness, we aimed this survey at the top 100 banks around the world. We received survey responses from 45 firms, headquartered in 19 jurisdictions. Of the respondents:

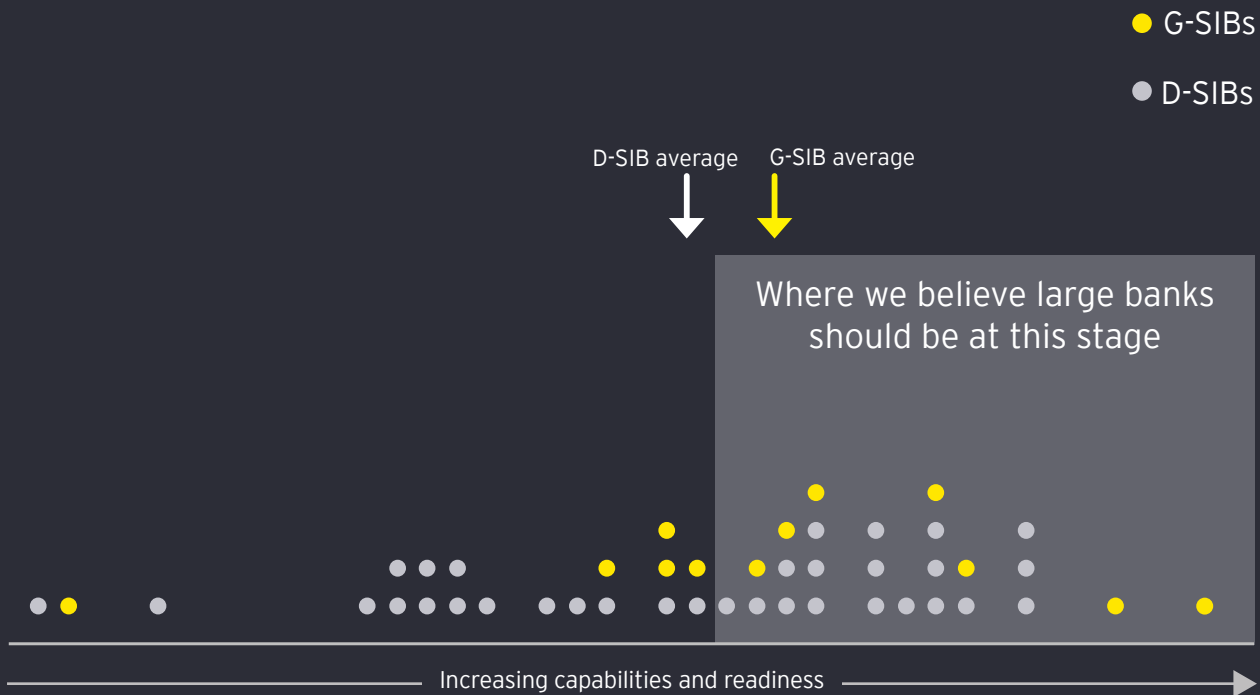
- ▶ Over a quarter are G-SIBs and the remainder are D-SIBs.
- ▶ Regionally, 42% are headquartered in Asia-Pacific, 45% in EMEIA and 13% in the Americas.



- | | |
|----------------|--------------|
| Australia | Netherlands |
| Austria | Norway |
| Canada | Portugal |
| China Mainland | Russia |
| France | South Africa |
| Germany | Switzerland |
| India | Taiwan |
| Ireland | UK |
| Italy | US |
| Japan | |

Overall readiness

Basel 3 Reforms overall readiness indicator



There are huge differences in firms' preparedness for the Basel 3 Reform changes. As in prior years, we have calculated a single "readiness" indicator, based on a composite of the survey responses. This indicator shows where each firm is, relative to others, by aggregating responses to all relevant survey questions. A higher score indicates that a bank has a greater capability and is better prepared.

The results (and our experience) show that differences in readiness arise from:

- ▶ Firms' size and complexity - with larger, more complex firms taking longer to deliver change and therefore needing to be readier earlier. This is borne out by the average score for G-SIBs being higher (at 55%) than the average for D-SIBs (48%).

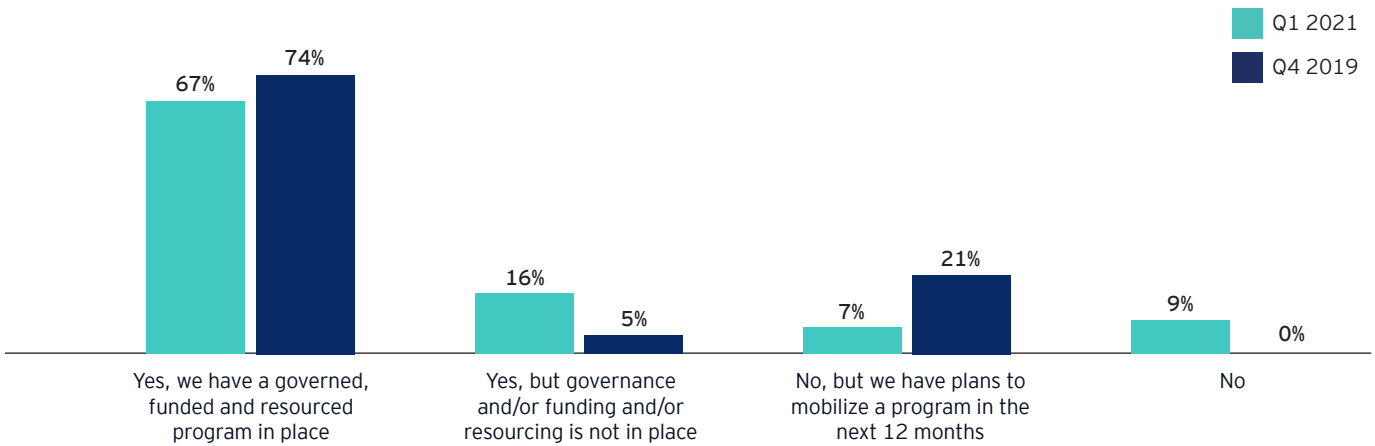
- ▶ The regulatory environment, and differences in regulators' expectations and approaches to prioritization in different jurisdictions - this can be seen in variations in readiness across and within regions. For example, readiness for banks headquartered in EMEIA and the Americas, at 54% and 55% respectively, is higher than for those headquartered in Asia-Pacific (44%).

With less than two years to go to the regulatory deadline, we indicate on the chart a range where EY believes that large banks need to be at this stage, in order to manage delivery risks as we approach the go-live date. Many firms, and the majority of D-SIBs, are not yet within that range, suggesting that the path to success may not be smooth for everyone.

Program governance and mobilization

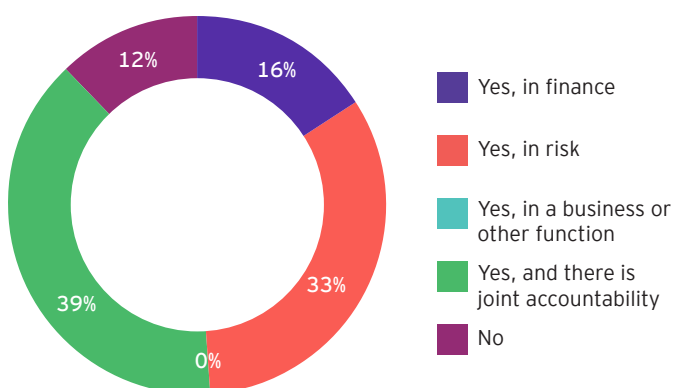


1. Does your firm have a Basel 3 Reforms program in place?



- ▶ In our first survey in 2018, only 14% of respondents had fully set up and funded a delivery program.
- ▶ Now, with less than two years until the regulatory deadline, 83% of respondents have established a Basel 3 Reforms program - marginally more than the last survey (79%).
- ▶ Larger and better-prepared banks are building in time to run and embed changes in parallel. As such, their delivery is already at a relatively mature state of evolution.

2. Does your firm have an identified sponsor or accountable executive for the Basel 3 Reforms?



- ▶ Different governance models have been adopted by firms to oversee and direct the delivery of the Basel 3 Reforms changes. Globally, the dominant approaches see sponsorship by the risk or finance functions, or joint accountability (almost always between risk and finance). Interestingly, leadership from business functions is not evident, potentially indicating that programs were set up to focus on operational delivery rather than capital management.
- ▶ Larger firms tend to favor the joint accountability model more (seen in 55% of G-SIBs, as opposed to 34% for D-SIBs).
- ▶ Significant regional differences are also apparent. For banks in Asia-Pacific, risk tends to be the accountable function (56%); whereas in the Americas, accountability is joint or with finance (50% and 33% respectively), and the dominant model is joint in EMEIA (52%).

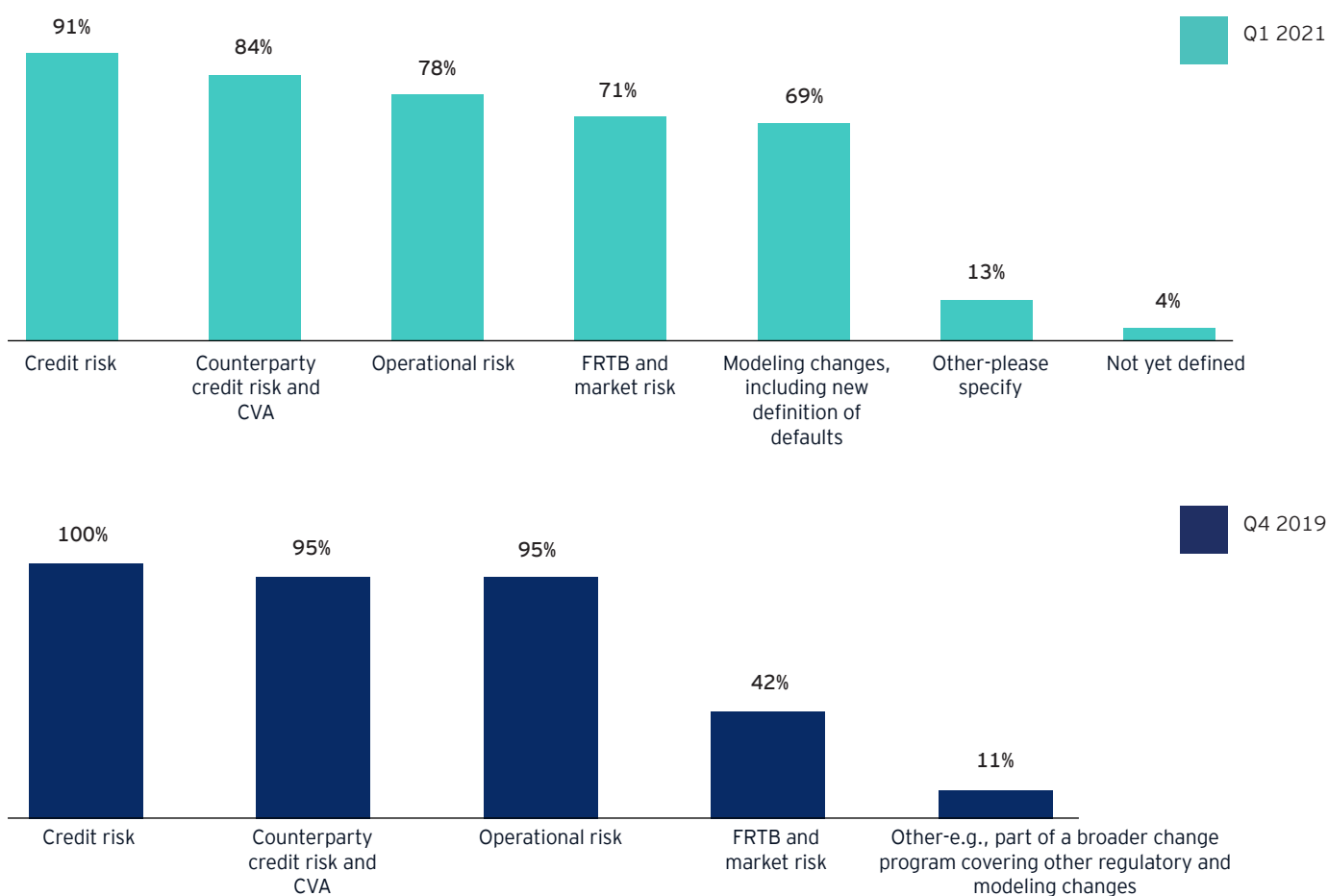
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We found that the risk and finance functions are typically shouldering much of the burden of implementation. This may be sensible, but banks following this model must connect implementation to the frontline business, as all parts of the bank will need to understand and act on the capital impacts. This connectivity will also help migrate programs into business as usual (BAU) smoothly.



Sonja Koerner
EMEIA Financial Services Prudential Solutions Leader

3. Which areas are included in the scope of your Basel 3 Reforms program? (Please select all that apply)

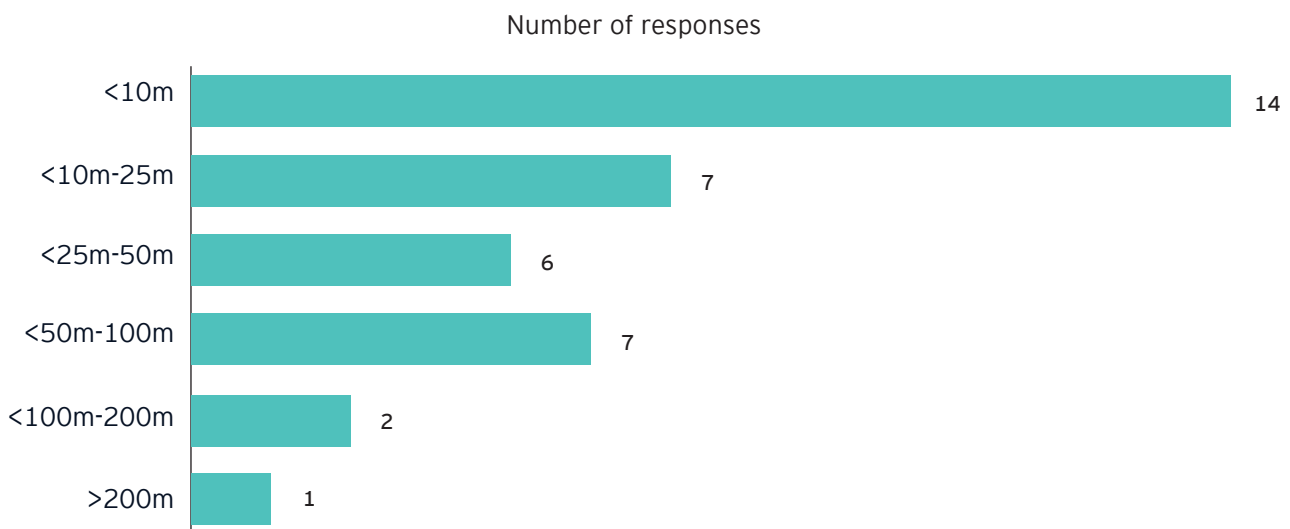


- ▶ Basel 3 Reforms delivery programs are typically set up with slightly different scopes.
- ▶ Core areas include the changes to credit, counterparty and operational risk.
- ▶ Two-thirds (69%) of banks are including modelling changes and enhancements in their scope of delivery; some of these are closely related to, but not strictly part of the Basel 3 Reforms regulatory package.
- ▶ There has been a significant increase since the last survey in the number of respondents who are reporting Fundamental Review of the Trading Book (FRTB) and market risk in their scope of delivery. Our analysis suggests that individual banks are not changing their approaches - the largest global banks still tend to maintain a separate program - so we see this as a factor of the different population of respondents in the current survey results.

Delivery



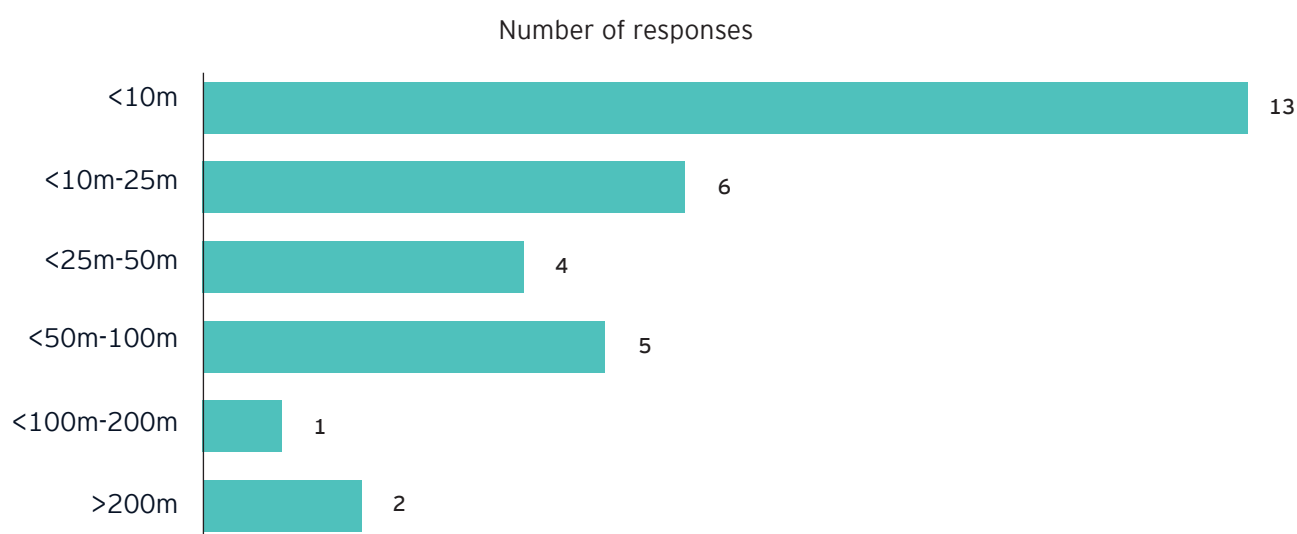
4. How much do you estimate delivering the Basel 3 Reforms will cost? (Covers end-to-end delivery to go live, but excludes FRTB)



US\$

- ▶ The average spend on the Basel 3 Reform changes, excluding FRTB, is around US \$40m-50m. But this masks significant disparity in spend levels.
- ▶ Most obviously, larger firms are spending more to deliver the Basel 3 Reform changes. The average spend for G-SIBs is US \$70m-80m, and for D-SIBs is US \$30m-40m. Those reporting spends of less than US \$10m are typically smaller, simpler, domestic banks, or the few that have not set up a program yet.
- ▶ Spend is also affected by the different scopes of each bank's program and the approach to delivering incremental change (see questions 3 and 6).

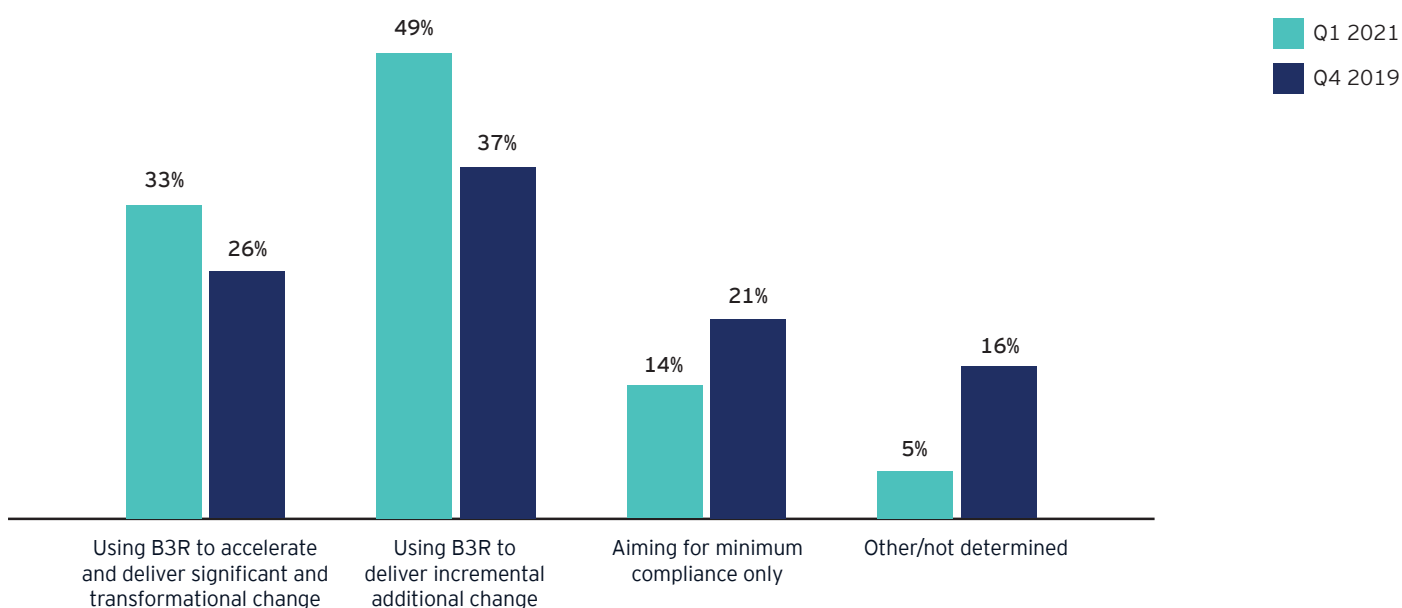
5. How much do you estimate delivering the FRTB element of the Basel 3 Reforms will cost? (Covers end-to-end delivery to go live)



US\$

- ▶ Banks are typically spending around the same again on the FRTB changes.
- ▶ The cost disparity between banks is even more pronounced when it comes to FRTB. G-SIBs, which typically have larger trading books, are committing over US \$100m on average. Some are using FRTB as an opportunity to overhaul their market risk infrastructure, which can drive costs even higher.
- ▶ D-SIBs, typically with smaller trading books, are committing significantly less - their average is US \$20-\$30m.

6. How would you characterize your delivery objectives?



- ▶ The majority of respondents are using the Basel 3 Reforms as an opportunity to deliver business benefits, and are extending the scope of delivery to enhance related aspects of business.
- ▶ Interestingly, this attitude is more pronounced in the current survey. Over four fifths are looking to deliver incremental or transformational change, compared to two thirds in the last survey.
- ▶ This view is also more pronounced in larger banks. Nine tenths of G-SIB respondents are using the Basel 3 Reforms to deliver additional change or accelerate transformational change, compared with eight tenths of D-SIBs.

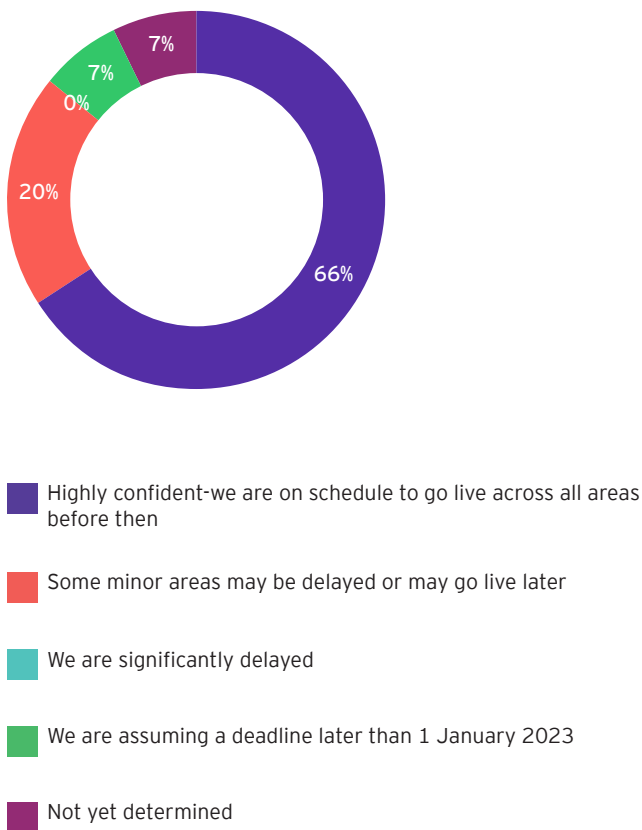
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Banks are under more pressure than ever around capital and regulatory reform. Our survey shows a few banks have approached the Basel 3 Reforms as a compliance exercise. Yet it is pleasing to see most banks deciding to use the changes as an opportunity to rethink and transform their business models. This is considerably more likely to deliver tangible benefits and reflects the reality of banks' strategic challenges and the external environment post-COVID-19.



Federico Guerreri
Global and EMEIA Financial Services Risk Leader

7. How confident are you of being able fully to meet the 1 January 2023 deadline?



- ▶ There are now less than two years to go to the regulatory deadline of 1 January 2023. Currently, the majority of respondents are confident of meeting the deadline or are experiencing only minor delays.
- ▶ No respondents are reporting significant delays yet. However, a small minority (three banks) are assuming a deadline later than 2023.
- ▶ In early 2020, the deadline was pushed back by a year, and we see potential for further delays in the jurisdiction-by-jurisdiction implementation of the Basel 3 Reforms. But, in the absence of announcements to the contrary, maintaining a focus on the Basel deadline remains a prudent approach.



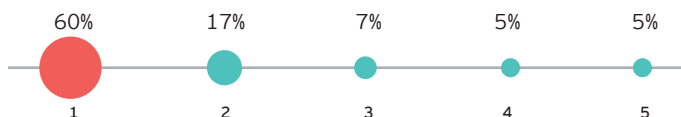
The current levels of confidence expressed by banks in meeting the deadlines needs to be seen in the context of an overall timeline that still feels distant. It will be very interesting to see whether that optimism remains as we near the deadline and execution becomes a reality.



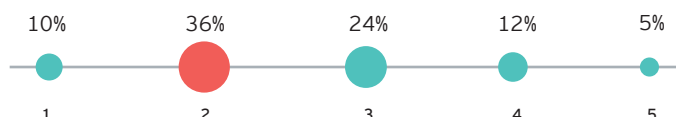
Dan Cooper
UK Banking & Capital Markets Leader

8. What are the most significant challenges your firm faces in delivering the Reforms? (Pick your top five in order of challenge)

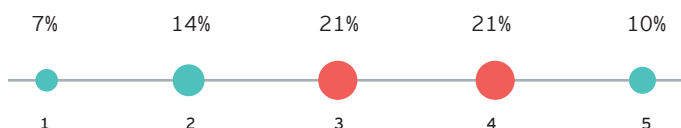
1. The quality and availability of data



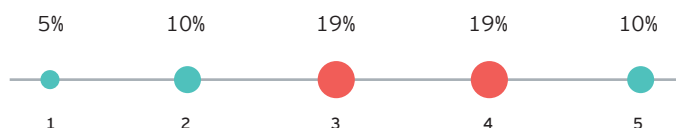
2. The delivery of new/enhanced RWA calculation systems



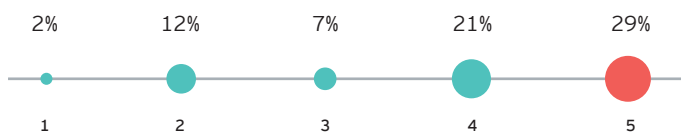
3. Operating model and regulatory reporting changes



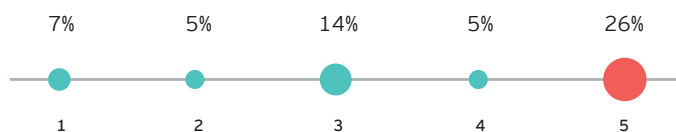
4. The delivery of an RWA control framework



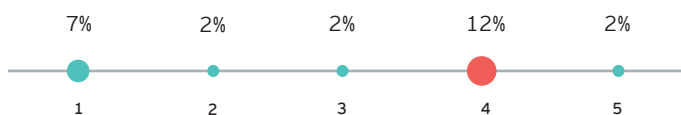
5. Changes to capital forecasting, capital management and stress testing



6. Modeling changes, including new definitions of default



7. The funding of a Basel 3 Reform program



Challenges are shown in order of overall priority
1-Highest overall
7-Lowest overall

● Most common response

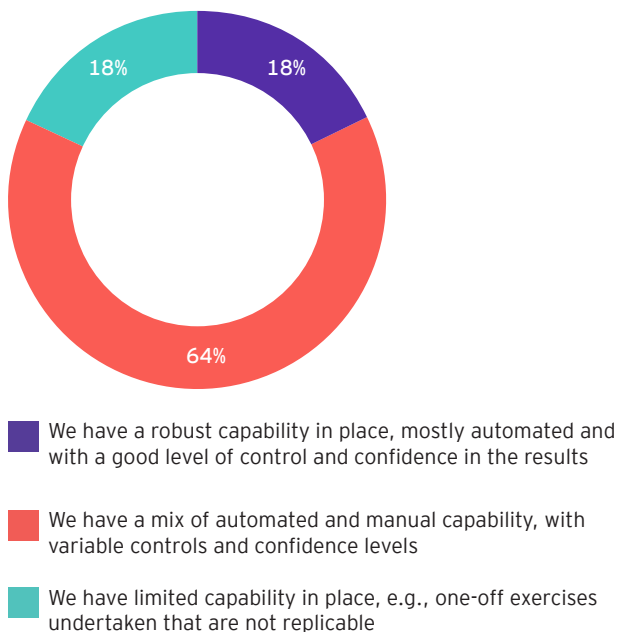
- ▶ For many banks, 2021 is shaping up to be the key delivery year for the Basel 3 Reforms. By now most organizations are in the middle of delivery and therefore aware of the main challenges they face to get their programs across the finishing line.
- ▶ Data continues to be most organizations' number one challenge. This speaks both to new data requirements, as well as to the quality and reliability of data that is coming under increasing scrutiny.

- ▶ The delivery of RWA calculation systems, followed by operating model changes, complete the top three challenges. We see increased awareness of the challenges in defining and maintaining RWA controls (#4 in this survey compared with #7 previously). In contrast, and understandably, program mobilization and funding falls lower in the priority list (#7 down from #3).
- ▶ Other challenges highlighted by respondents include the overhaul of market risk management systems, alignment to other change programs, and a lack of skilled resources.

Capital impacts

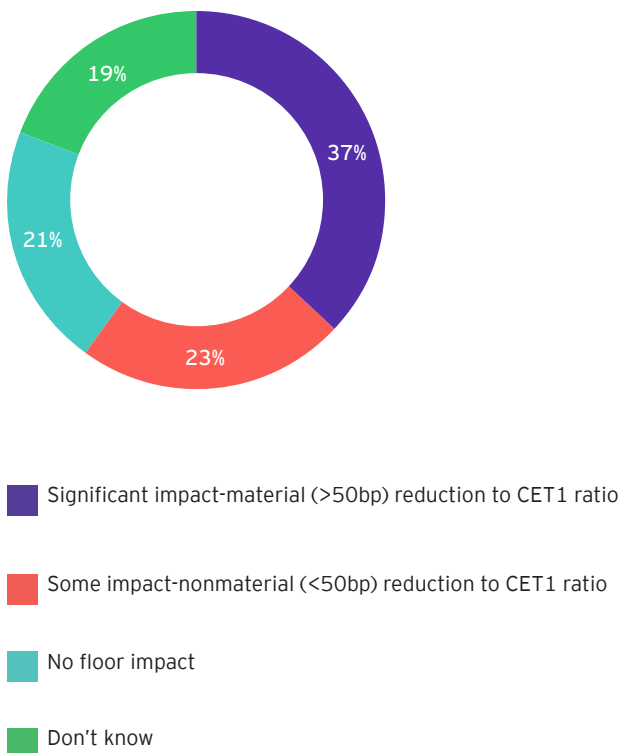


9. What capability do you have in place to estimate and assess the regulatory capital impacts of the Basel 3 Reforms? (Please select the answer that most closely represents your situation)



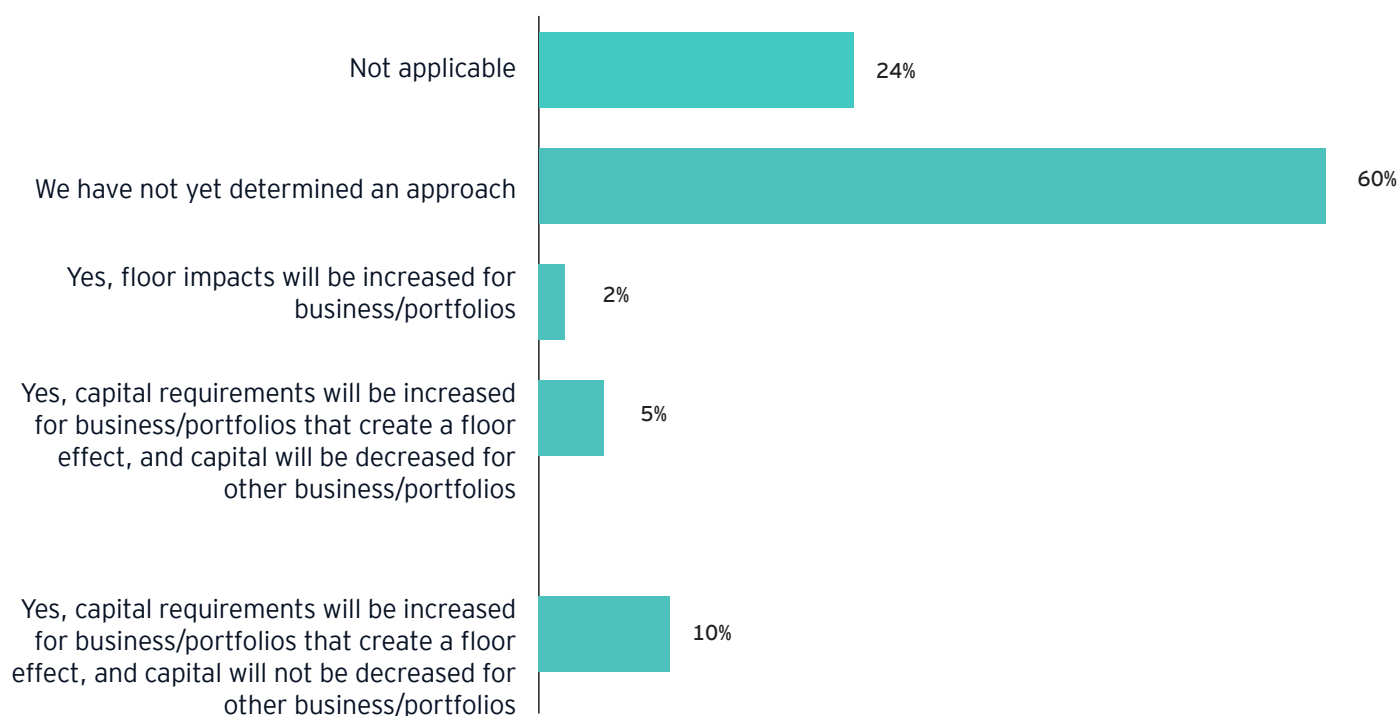
- ▶ The changes to regulatory capital requirements embodied in the Reforms are fast becoming a key area of focus for banks.
- ▶ The baseline for understanding the capital changes is the ability to calculate regulatory capital impacts. The survey shows that around a fifth of banks have a robust capability in place to do this (up from just 5% in Q4 2019).
- ▶ Capabilities vary significantly across the industry: for example, no G-SIBs report having a “limited” capability.
- ▶ Focus on this area is likely to increase in line with a greater desire to mitigate capital impacts and optimize capital consumption.

10. How much of an impact do you see from the overall standardized capital floor?



- ▶ The standardized capital floor (also known as the output floor) is one of the key features introduced in the Reforms.
- ▶ Whether and how the floor impacts an organization is a complex question that is determined by a number of factors. Key among these are portfolio mix and quality, and current regulatory approaches.
- ▶ Most banks (60%) will see a reduction in their Common Equity Tier 1 (CET1) ratio arising from the standardized floor.
- ▶ This is higher among larger firms: for example, the majority (64%) of G-SIB respondents will see a reduction in CET1 of over 50bps.
- ▶ Worryingly, a significant minority of banks (19% overall, but 41% in Asia-Pacific), do not yet know if and how the floor will impact them.

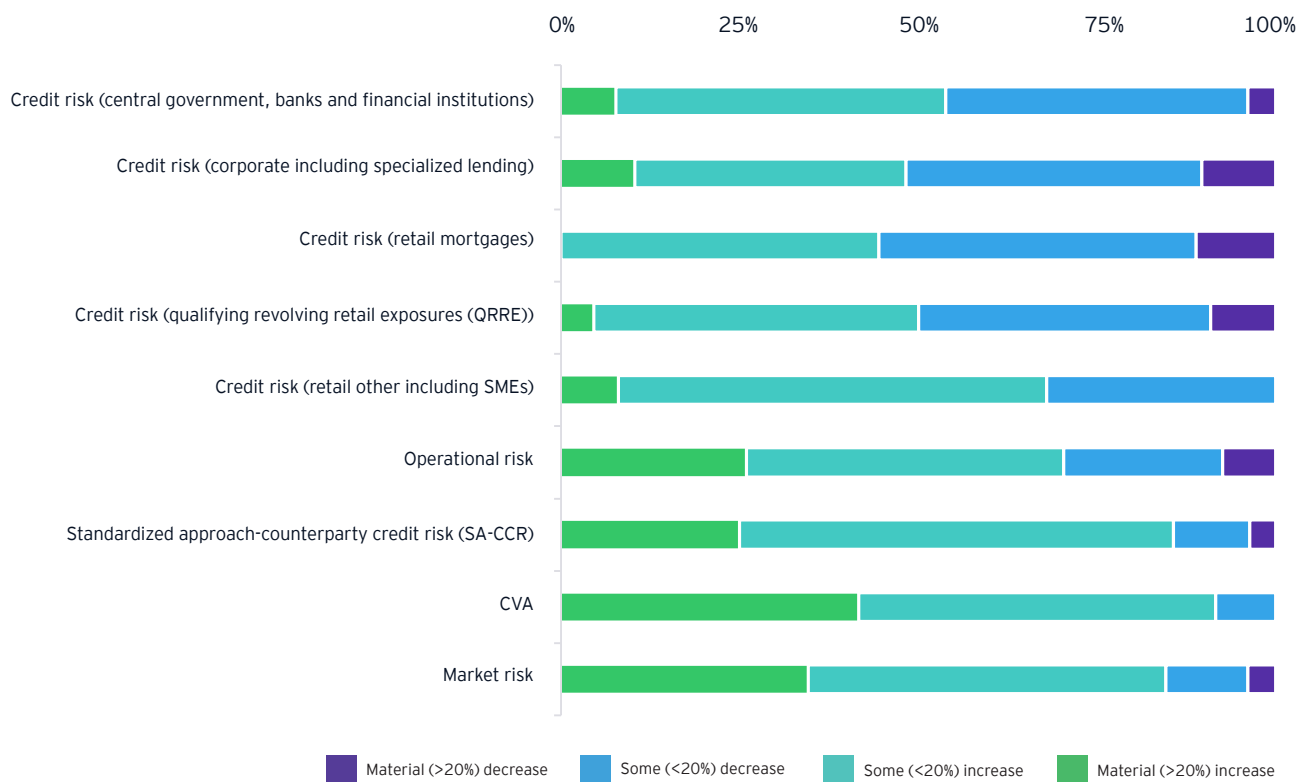
11. Have you determined an approach to allocate the capital impact of the standardized floor?



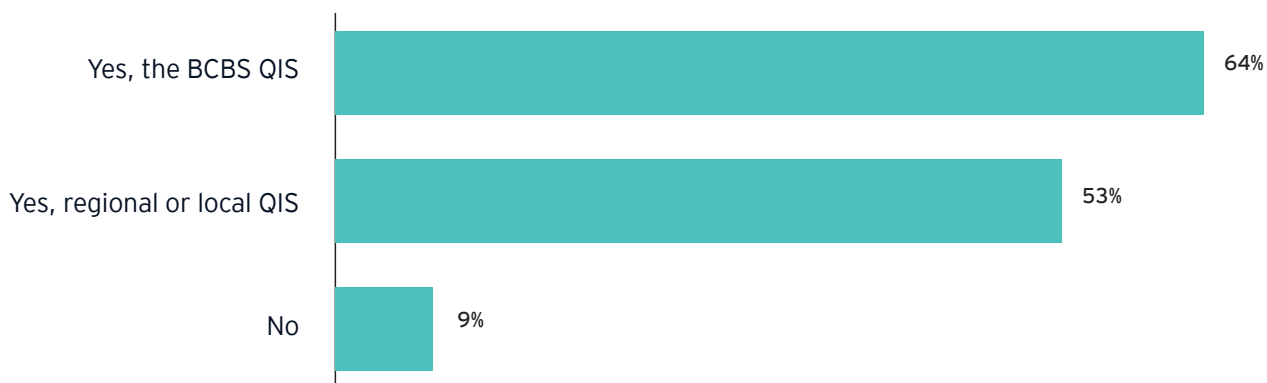
- ▶ Continuing to explore the new standardized capital floor, we asked whether banks have determined an approach to allocate floor impacts to underlying businesses and portfolios. This is a key step in measuring and understanding capital impacts on individual business areas with a group structure. Going forward, we see this as an important component of determining capital consumption, and therefore of influencing behaviors and incentives to mitigate and manage capital.
- ▶ The survey reveals a lack of industry consensus on determining an approach - each potential allocation approach seems to have a small number of adherents. But the overall view from the vast majority of banks is that they have not yet decided how they will do this. This appears to be a gap that needs to be addressed quickly.

12. What areas show the largest capital impact, excluding the standardized capital floor? (Please choose an impact range for each area)

- ▶ Note that this shows capital impacts without including the standardized floor. This is due to the lack of a consistent allocation methodology, as the results of the previous question shows.
- ▶ The EY team's insights into capital impacts across the industry suggest that the changes are complex and interact significantly.
- ▶ There are some risk types (operational, market and counterparty) where most banks see capital increasing. With credit risk, the changes are more nuanced, with increases and decreases more related to portfolio quality and existing approaches.
- ▶ The changes revealed here, when combined with the application of the standardized floor, can alter overall capital requirements considerably. Some firms and business models (e.g., trading book-heavy banks and monoline prime mortgage institutions) are likely to see significant increases in capital requirements.
- ▶ The Reforms certainly change capital weightings and allocations, and bring new challenges and opportunities to manage capital effectively.

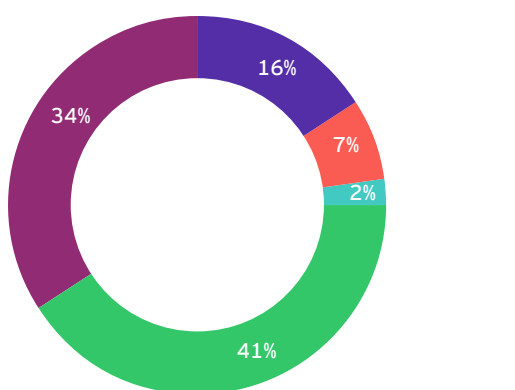







13. Are you participating in external QIS exercises?



- ▶ Given that many jurisdictions are currently discussing and shaping their implementations of the Reforms, regulatory interest in the capital impacts continues to be high.
- ▶ Many regulatory bodies run quantitative studies to assess how the changes are likely to impact the firms they regulate.
- ▶ The vast majority (91%) of the banks in the survey take part in at least one such study and some global banks respond to many.
- ▶ The BCBS runs a quantitative impact study (QIS), as do a number of local regulators, including those in Australia, Canada, China Mainland, Europe, Hong Kong, India, Norway, Russia, South Africa, Switzerland and the UK.
- ▶ Banks also respond to QIS exercises run by trade bodies, including the International Swaps and Derivatives Association (ISDA) and the Association for Financial Markets in Europe (AFME).

14. Do you plan to voluntarily disclose capital impacts externally within the next 12 months?



-  We have already disclosed quantitative metrics
-  Yes, we plan to disclose in the next 12 months, with quantitative metrics
-  Yes, we plan to disclose in the next 12 months, but without quantitative metrics
-  No, we do not plan to disclose impacts in the next 12 months
-  Unsure

- ▶ Despite running capital impact numbers for internal use and for regulators, banks seem to be more reticent about publishing capital impacts to the market.
- ▶ A third (34%) of respondents are not sure whether they will disclose capital impacts in the next year; this is lower than the last survey in Q4 2019 (53%).
- ▶ Among those that have not yet disclosed, the consensus appears not to do so this year.
- ▶ However, there are significant differences between larger and smaller banks, as well as regionally. Larger banks, and those in EMEIA, are leading the way on disclosures.
- ▶ For example, nearly half (46%) of G-SIBs have already disclosed numbers, compared with just 6% of D-SIBs. D-SIBs are also more likely to be planning not to disclose this year (49%, as opposed to 18% of G-SIBs).

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We would expect increasing market pressure to disclose as we move nearer the deadline, especially as some of the capital impacts are likely to be significant rather than incremental. Just as important will be banks' ability to explain what mitigating measures they will use, in an environment where efficient use of capital is critical.

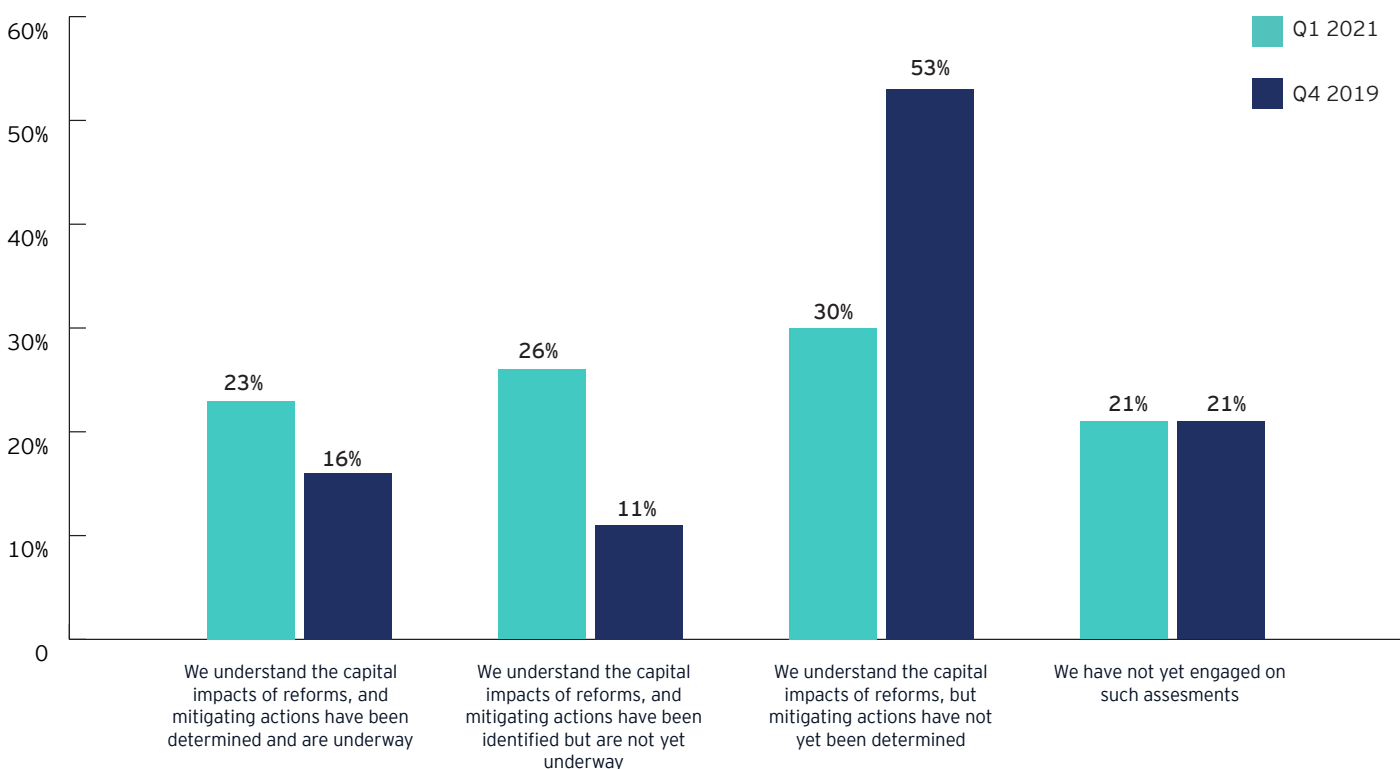


Jared Chebib
Basel 3 Reforms UK Consulting Lead

Strategic and commercial implications



15. What stage do you feel you are at in terms of assessing the strategic and commercial impacts that the Basel 3 Reforms will bring?

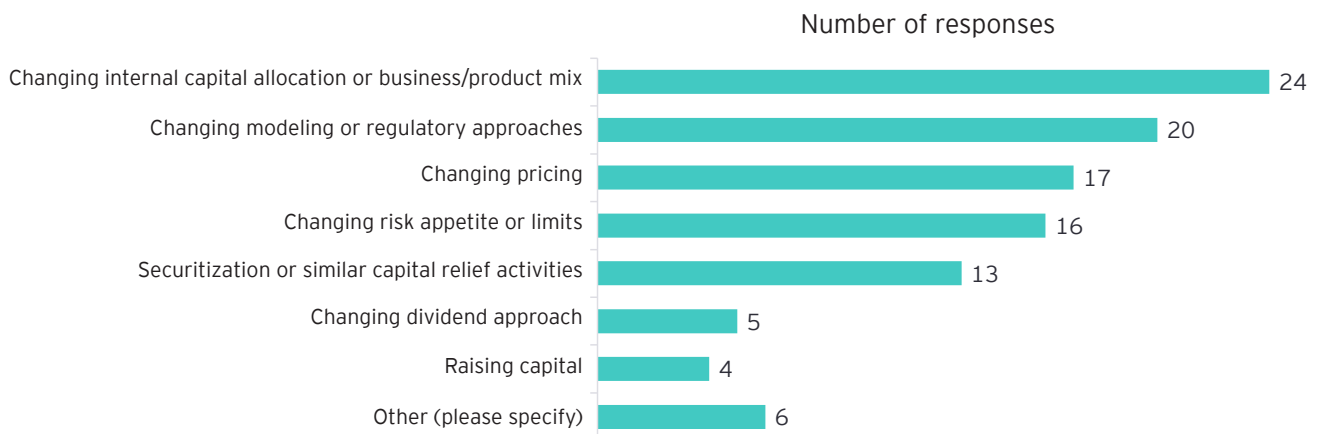


- ▶ The results of the survey bear out EY's view that the last year has seen a significant increase in focus by business lines on the commercial impacts of the Reforms.
- ▶ There has been a clear shift since the last survey that shows more banks identifying and carrying out capital mitigation strategies (49% compared with 27% in Q4 2019). We expect further movement on this

as businesses draw nearer to operating under the Reform's new capital weightings.

- ▶ G-SIBs are marginally ahead of D-SIBs in planning and executing mitigation - 58% of G-SIBs have at least identified mitigating actions, compared with 46% of D-SIBs. Regionally, banks headquartered in the Americas and EMEIA seem to be further down the track than those in Asia.

16. What potential mitigating actions have been identified? (Please select all that apply)



- ▶ As EY's last survey showed, the primary mitigation focus at this stage continues to be on internal actions, such as changing capital allocation or regulatory approaches.
- ▶ We also see changes to the competitive landscape arising from the Reforms. So it is likely that there will be growth opportunities, particularly where banks find themselves at a competitive advantage relative to others due to their capital position.
- ▶ Actions that have a significant external impact (raising capital or changing the dividend) are currently not favored. This is particularly evident among G-SIBs - none identified either of these options as part of their preferred approach.

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The range of mitigating actions speaks to the breadth and complexity of the Reforms' impacts. Choosing the right approaches to mitigation will be a real competitive advantage. It will enable banks to optimize both their business and their financial resources in response to the new capital regime.



Stuart Thomson
UK Financial Services Risk Leader

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