Basel Committee
on Banking Supervision

Basel Framework frequently asked questions

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The Basel Framework: frequently asked questions

Introduction

The Basel Framework[1] is the full set of standards of the Basel Committee on Banking Supervision, which is the primary global standard setter for the prudential regulation of banks. To help promote consistent interpretation of the framework the Basel Committee periodically publishes the answers to frequently asked questions (FAQs). This document sets out a number of FAQs that the Committee has agreed to add to the Basel Framework. They cover a range of issues relating to the reform of benchmark reference rates and clarifications relating to the standardised approach to operational risk.

1. Definition of capital

Paragraphs to which the FAQ relates: CAP10.11 & CAP10.16

Regarding the reform of benchmark reference rates, will amendments to the contractual terms of capital instruments that are undertaken to prepare for the transition to the new benchmark rates result in a reassessment of their eligibility as regulatory capital?

Amendments to the contractual terms of capital instruments could potentially trigger a reassessment of their eligibility as regulatory capital in some jurisdictions. A reassessment could result in an existing capital instrument being treated as a new instrument. This in turn could result in breaching the minimum maturity and call date requirements. Similarly, existing capital instruments issued under Basel II that are being phased out could also fail to meet eligibility requirements if they are treated as new instruments. The Committee confirms that amendments to capital instruments pursued solely for the purpose of implementing benchmark rate reforms will not result in them being treated as new instruments for the purpose of assessing the minimum maturity and call date requirements or affect their eligibility for transitional arrangements of Basel III.

2. Market risk

Paragraph to which the FAQ relates: MAR31.13 (2023 version)

Regarding the reform of benchmark reference rates, what guidance can the Committee provide on the count of real price observations for the risk factor eligibility test (RFET)?

Risk factors must have sufficient market liquidity, evidenced by records of trades, to be eligible for modelling. The replacement of risk factors due to benchmark rate reform could raise particular challenges for the count of real price observations for the risk factor eligibility test (RFET). Hence, when conducting the RFET for a new benchmark rate, banks can count both: (i) real price observations of the old benchmark rate (that has been replaced by the new benchmark rate) from before the discontinuation of the old benchmark rate; and (ii) real price observations of the new benchmark rate, until one year after the discontinuation of the old benchmark rate (eg in the UK, LIBOR discontinuation is expected to be 31 December 2021). In this context, discontinuation includes cessation of the old benchmark rate or an event

[1] www.bis.org/basel_framework/

whereby the old benchmark rate is deemed by its regulator to no longer be representative of the underlying market.

Paragraph to which the FAQ relates: MAR33.5 (2023 version)

Regarding the reform of benchmark reference rates, what guidance can the Committee provide on the calculation of expected shortfall (ES) if the new benchmark rate was not available during a stress period for the purposes of MAR33?

If the new benchmark rate is currently eligible for modelling according to MAR31 but was not available during the stress period, it may pose a challenge to banks calculating the expected shortfall (ES) for the current and stress period per MAR33. To address this, if the new benchmark rate is eligible for modelling according to MAR31 but was not available during the stress period, banks may use:

(i) for the current period, the new benchmark rate in the full set of risk factors ($ES_{F,C}$) and in the reduced set of risk factors ($ES_{R,C}$); and

(ii) for the stress period, the old benchmark rate in the reduced set of risk factors ($ES_{R,S}$).

This interpretation does not annul the specification in MAR33.5(2) that the reduced set is subject to supervisory approval and must meet the data quality requirements.

3. Counterparty credit risk

Paragraphs to which the FAQ relates: CRE52.51 (2019 & 2023 versions) & CRE53.24 (2019 & 2023 versions)

Regarding the reform of benchmark reference rates, does the extended margin period of risk in CRE52.51(2) (SA-CCR) and CRE53.24(2) (IMM) apply if the new benchmark rate experiences transitional illiquidity?

Until one year after the discontinuation of an old benchmark rate, any transitional illiquidity of collateral and OTC derivatives that reference the relevant new benchmark rate should not trigger the extended margin period of risk in CRE52.51(2) for SA-CCR and CRE53.24(2) for the IMM.

4. Liquidity

Paragraph to which the FAQ relates: LCR30.1 (2019 version)

Regarding the reform of benchmark reference rates, what guidance can the Committee provide on the assessment of eligibility of instruments as HQLA?

Solely for the purpose of implementing benchmark rate reforms, when a type of instrument that references an interbank offered rate (IBOR) and has historically qualified as eligible HQLA is being replaced with an equivalent type of instrument that references an alternative references rate, supervisors can take into account anticipated increases in the liquidity of the replacement instrument during the transition period when determining whether it qualifies as HQLA.

5. Operational risk

Paragraph to which the FAQ relates: OPE25.30 (2023 version)

Can operational risk losses resulting from the reform of benchmark reference rates be excluded from the operational risk charge based on OPE25.30?

Banks may suffer operational risk losses related to the reform of benchmark reference rates, particularly if they do not adequately prepare for the transition to the new rates. For example, losses may be incurred over an extended period of time if banks fail to identify and remediate relevant legacy contracts prior to the discontinuation of a benchmark rate. Operational risk losses relating to the reform of benchmark reference rates do not fulfil the criteria for exclusion from the calculation of operational risk capital requirements laid out in OPE25.30 (ie characterised as one-off, no longer relevant, no residual exposure). It should, however, be noted that not all costs related to the implementation of benchmark rate reforms represent operational risk losses (eg legal fees to alter contracts to prepare for the new reference rates in accordance with relevant legal rules; or costs related to adjustments to IT systems). To minimise the risk of operational risk losses, banks should consider the effects of benchmark rate reform on their businesses in a timely manner and make the necessary preparations for the transition to the alternative rates. In doing so, they should maintain a close dialogue with their supervisory authorities regarding their plans and transition progress, including any identified impediments.

Paragraph to which the FAQ relates: OPE25.29 (2023 version)

What are the conditions for losses (and recoveries) to be grouped into a single operational loss event?

All operational losses caused by a common underlying trigger or root cause should be grouped into one operational loss event in a bank's operational loss event dataset. Two examples of losses with a common underlying trigger or root cause, which should be grouped into a single loss event:

1. A natural disaster causes losses in multiple locations and/or across an extended time period.
2. A breach of a bank's information security results in the disclosure of confidential customer information. As a result, multiple customers incur fraud-related losses that the bank must reimburse. This is sometimes accompanied by remediation expenses such as credit card re-issue or credit history monitoring services.

Banks should have a clear, well-documented policy for determining the criteria for multiple losses to be grouped into an operational loss event. In addition, processes should be in place to ensure that there is a firm-wide understanding of the loss event grouping policy, that there is appropriate sharing of loss event data across businesses to implement the policy effectively and that there are adequate controls (including independent review) to assess ongoing compliance with the policy.

Paragraph to which the FAQ relates: OPE25.18 (2023 version)

How should the minimum threshold for including a loss event in the Loss Component dataset be applied for events which result in multiple accounting impacts?

Some operational loss events result in multiple accounting impacts, which can be loss impacts or recoveries. To determine whether an operational loss event must be included in the Loss Component calculation dataset, the net loss amount of the event should be calculated by summing all of the event's loss impacts inside the ten-year calculation window and subtracting all recoveries inside the ten-year calculation window. The accounting date of the impacts is used to determine whether they are inside the ten year calculation window. If the event's net total loss amount is equal to or above EUR 20,000 (or equal to or above EUR 100,000 if that national discretion is used), the loss event must be included in the calculation dataset. Note that a loss event may not result in a net loss amount above EUR 20,000 (EUR 100,000) in any individual year and still have to be included in the Loss Component calculation dataset as long as the cumulative impact of the loss event in the ten year window is equal to or above EUR 20,000 (EUR 100,000).

As an example, consider a bank determining its capital requirements using a Loss Component calculation window of 2012 to 2021, and assume this bank is subject to a EUR 20,000 loss threshold. Suppose one loss event results in a loss impact of EUR 16,000 in 2012 and EUR 7,000 in 2013. This loss event must be included in the calculation dataset because its total impact inside the calculation window is EUR 23,000. On the other hand, a loss event that resulted in a loss impact of EUR 1,000,000 in 2010 (outside of the calculation window), a loss impact of EUR 300,000 in 2013 (inside the calculation window), and a recovery of EUR 500,000 in 2015 (inside the calculation window) should not be included in the calculation dataset because its net impact inside the calculation window is negative, and thus less than EUR 20,000.