A quick manual to Basel IV and CRR III for IRB banks

Due to the **complexity** and **time-consuming nature** of the implementation process, concerns are already being raised about the abilities of banks to meet the new regulatory requirements. For EU banks, the **CRR III binding deadline is in January 2025**. For many non-EU countries, the deadlines **for Basel IV implementation are generally set for 2025 or 2026**.

The regulation introduces **changes applicable to IRB model calculations and scope** as well as is **requiring** the institutions using the IRB approach **to also implement the standardised approach**. The RWA derived from the standardised model will serve as an **output floor for the IRB RWA. Hence, the output floor effectively limits the capital benefit from internal models**, while at the same time introducing **an additional optimisation constraint for IRB modellers**.

How will banks be impacted?

Strategic decisions on IRB usage
Banks will have to make strategic decisions about the (partial) scope of internal models for credit and market risk.

Phased-in regulatory compliance for Capital Requirements
Capital charges will be gradually phased in during a five-year transitional period.

New reporting duties
Current reporting duties are revised and new ESG, covered bonds, and shadow banking disclosures are added.

Stronger enforcement tools
The package provides stronger enforcement tools for supervisors overseeing EU banks.

How can PwC help you?

Impact study

Our team can conduct a comprehensive impact study in order to help you:

- Quantify the **impact of CRR III** on your bank
- Identify the **potential additional data required** for the new RWA calculation
- Identify **key impacted areas** and define **future capitalisation strategies**

Implementation process

We can support you in end-to-end CRR III implementation by covering the following key aspects of the process:

Gap analysis
- Methodological
- Technological
- Data availability

Setup of new data architecture for the purposes of CRR III requirements

Alignment of **internal policies** and **methodologies**

Implementation of **parallel run** to systems and processes

Integration of the **new risk-weighing calculations** into the internal and external risk reporting

Quality assurance

We can review the implementation of CRR III requirements in your systems, focussing on:

- Correct classification of exposure
- Correct assignment of risk weight
- Reperformance of SA-CR model in our own tool
- Strategic assessment of IRB models on portfolio level
- Optimisation of collateral allocation

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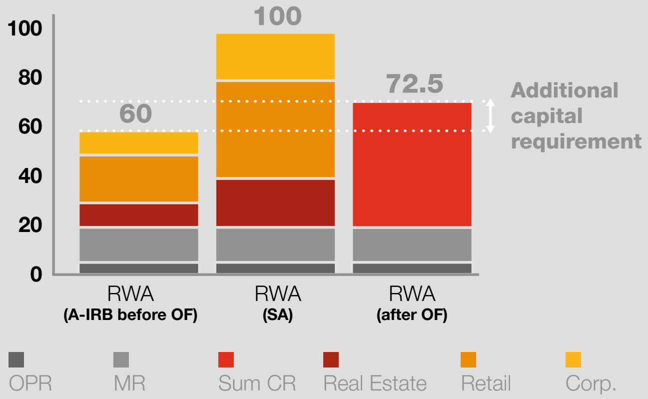
Key changes in the credit risk IRB approach

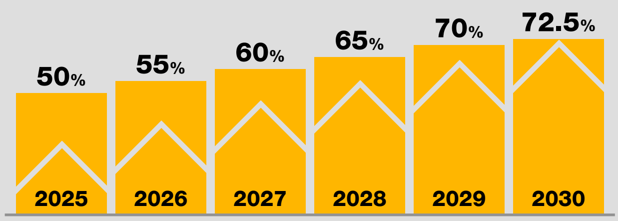
1 Calculation of output floors (OF)

The output floors (OFs) limit the RWA reduction that can be achieved using internal models to 72.5% of the value resulting from standardised approaches. This forces banks to implement standardised approaches in an optimised way and make strategic decisions about the (partial) scope of Internal Models for credit risks.

Illustrative example of the OFs application for a bank with A-IRB for credit risk



The OFs will be increasing over five years, reaching 72.5% in 2030:



In order to spread the impact of the OFs application over time, CRR III introduces **transitional rules** for assigning preferential risk weights for **unrated corporates** (with PD ≤ 0.5%) and **exposures secured by mortgages on residential property** (up to 55% as well as 80% of the property value).

2 Change of scope

- Elimination of the IRB for equity investments
- Elimination of the Advanced IRB for banks/other financial institutions, insurance companies and corporates (turnover > €500 million).
- New exposure class for regional governments and local authorities as well as public sector entities (PSE-RGLA)

3 IRB roll-out and permanent partial use

- Adoption of the IRB approaches for one exposure class by banks is no longer conditioned to the fact that all the exposure classes should be treated under the IRB approach
- Banks are allowed to revert from the IRB to the SA-CR approach for any exposure class until 31 December 2027

4 Risk parameters for A-IRB

- For corporate and retail, new PD input floor of 0.05%, LGD input floors based on the adjusted F-IRB methodology, CCF for revolving products of 50%
- Redefinition of "commitment"
- For specialised lending, transitional factor for the LGD floor

5 Risk parameters for F-IRB

- PD input floor: 0.05%
- New LGD calculation formula with LGD volatility adjustments of 40% or 100%
- New LGD values for the LGD senior unsecured banks 45%, Corporates 40%, LGD secured 0%, 20% or 25%

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