Criteria | Financial Institutions | Request for Comment:

Request For Comment: Risk-Adjusted Capital Framework Methodology

January 25, 2024

S&P Global Ratings is requesting comments on a proposed revision to the treatment of market risk in its "Risk-Adjusted Capital Framework Methodology" (RACF; published on July 20, 2017) based on emerging Basel III framework changes. These criteria constitute S&P Global Ratings' global framework for evaluating the capital adequacy of banks and certain nonbank financial institutions and financial services companies (including nonoperating holding companies of such groups). In this article, we refer to all these entities collectively as "financial institutions." The current criteria remain in effect until we finalize these proposed criteria.

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KEY CHANGES

Market Risk On Trading Activities

- We're proposing to update the current Paragraphs 111, 114, and 122 of the RACF to address recently implemented Basel III changes for reporting market risk on trading activities.
- The Basel changes include the introduction of the sensitivities-based and simplified standardized approaches, which we propose to address by adding new paragraphs and a table after Table 10.
- We're not proposing any changes to our methodology for prior regulatory approaches, such as Basel 2.5.

Revised Approach For Jurisdictions That Exempt Some Asset Classes From The Regulatory Credit Valuation Adjustment (CVA) Charge

- We propose to apply a multiplier based on the average proportion of nonexempted counterparties from a large sample of banks but to apply a bank-specific multiplier when we believe it could be material to our analysis. This proposal would result in us updating Paragraphs 87 and 88 of the criteria while deleting Paragraph 89.
- We propose to update the current Paragraph 92 to address the recently implemented Basel III fallback approach for computing the regulatory CVA charge.

IMPACT ON OUTSTANDING RATINGS

Any rating impact is highly unlikely if we adopt these proposals. This is because they're targeted to a limited aspect of the RACF (market risk on the trading book and credit valuation adjustment charge) and are not a fundamental change.

WHEN AND HOW TO SUBMIT COMMENTS

S&P Global Ratings is seeking feedback on the proposed criteria by Feb. 26, 2024. We encourage interested market participants to submit their written comments to https://disclosure.spglobal.com/ratings/en/regulatory/ratings-criteria. Comments may also be sent to CriteriaComments@spglobal.com should participants encounter technical difficulties.

PROPOSED METHODOLOGY

87. In jurisdictions that exempt some asset classes from the regulatory CVA charge, we apply--in addition to the multiplier defined above--a second multiplier that aims to ensure a level playing field with banks domiciled in jurisdictions that don't apply the exemptions. This second multiplier is based on the average proportion of nonexempted counterparties from a large sample of banks. The current value of the second multiplier can be found in the related sector and industry variables report (SIVR) and is applicable unless we believe that applying a bank-specific multiplier may be material to our analysis.

88. When we believe that applying a second multiplier based on bank-specific information is material to our analysis, the second multiplier is computed as follows: 1 + (1 + add-on)*(1 – non-exempted counterparties exposures as a % share of total OTC derivatives exposures)/non-exempted counterparties exposures as a % share of total OTC derivatives exposures. This add-on is our estimate of the incremental risks represented by exempted counterparties compared with nonexempted counterparties per unit of OTC derivatives exposures. The current value of the add-on referred to in this paragraph can be found in the SIVR.

92. For entities that don't publish the Basel III regulatory CVA charge (because, for example, they aren't domiciled in Basel III jurisdictions) or apply the fallback approach (a regulatory capital requirement equal to 100% of the bank's capital requirement for counterparty credit risk) in a revised Basel III jurisdiction, but exceed the above thresholds, we compute the RAC CVA charge as a percentage of derivatives receivables (asset side of the balance sheet), with multipliers calibrated on a set of representative banks. We use two multipliers, one for entities in jurisdictions for which derivatives are presented on a gross basis (as in IFRS) and one for entities in jurisdictions for which derivatives are presented on a net basis (as in U.S. GAAP). The current multipliers can be found in the SIVR.

111. RACF is intended to capture market risk on a bank's trading activities and equity investments not accounted for in the trading business. In this section, we define a "Basel 2.5 jurisdiction" as one that has implemented "Revisions to the Basel II market risk framework," Bank for International Settlements (first published in July 2009). A Basel III jurisdiction for this section is defined as one that has implemented "Minimum Capital for Market Risk," Bank for International Settlements (January 2019 (rev. February 2019)).

114. Entities that have regulatory-approved internal market risk models but are not domiciled in Basel 2.5 or Basel III jurisdictions: For banks with value at risk (VaR) models validated for general risk only, we apply a 3.0 multiplier to the regulatory capital requirement figure. This is to align the VaR charge with a one-year horizon and make it consistent with a 99.9% confidence level. The multiplier includes a 50% add-on to account for extreme (fat-tail) events in a hypothetical portfolio consisting of equities, interest rate positions, commodities, and foreign exchange.

New Text To Be Inserted After Table 10

Entities that are domiciled in Basel III jurisdictions, applying the standardized sensitivities approach: We apply a multiplier to the regulatory capital requirement calculated under the sensitivities-based method. This multiplier will be updated as market conditions warrant. It's derived by incorporating assumptions for a typical bank's trading book, applying the Basel framework. The resulting calibration reflects the risk of loss on a bank's trading portfolio to a one-year horizon and a 99.9% confidence level. The current multiplier can be found in the SIVR.

We apply the sensitivities-based method multiplier to the sensitivities-based standardized method regulatory charge and a 1x multiplier to the default risk and residual risk add-on regulatory capital requirements, when the breakout of these components are available. We apply the sensitivities-based multiplier to the balance of the regulatory capital requirement when the breakdown of these components isn't available.

RAC charges for market risk exposure from trading activities--Basel III standardized sensitivities approach

Sensitivities-based method	(Multiplier from the SIVR) times regulatory charge
Default risk	1.0x regulatory charge
Residual add-on	1.0x regulatory charge
Standardized approach when no breakdown by component is available	(Multiplier from the SIVR) times regulatory charge

Entities that are domiciled in Basel III jurisdiction, applying the simplified standardized approach: We apply a 1.2x multiplier to the simplified standardized approach regulatory charge.

122. Entities with no approved market risk internal models for regulatory purposes not in a Basel III regime: We apply a 1.5 multiplier to the regulatory capital requirement figure if it's derived from the Basel standardized approach.

PROPOSED SECTOR AND INDUSTRY VARIABLES

Overview And Scope

This appendix provides proposed sector and industry variables related to our proposed criteria. We intend to incorporate these updates into the existing SIVR following the publication of the final criteria article. For further information about sector and industry variables reports, see "Evolution of the Methodologies Framework: Introducing Sector and Industry Variables Reports," Oct. 1,

2021. We will periodically update these sector and industry variables as market conditions warrant.

Sector And Industry Variables

Basel III sensitivities-based method multiplier

The RACF criteria state that we apply a multiplier to the regulatory capital requirement calculated under the sensitivities-based method, which is derived by incorporating assumptions for a typical bank's trading book, applying the Basel framework and the resulting calibration of the risk of loss on a bank's trading portfolio to a one-year horizon and a 99.9% confidence level. Based on analytical judgement, applying available disclosures from a representative sample of banks with meaningful trading activities, the multiplier applied to the Basel III regulatory sensitivities-based method calculation is 1.7x.

RACF credit valuation adjustment charge in jurisdictions with no exempted counterparties

The RACF criteria target a one-year 99.9% confidence level. For banks applying the revised Basel III standardized or basic approach, we apply a multiplier of 1.6. We apply a multiplier of 1.3 for other banks.

RACF CVA charge when the regulatory CVA charge isn't available or when the revised Basel III fallback approach is applied

In our RACF criteria, we define our approach for entities that meet the materiality thresholds but for which the regulatory CVA charge is not available. We compute the RAC CVA charge as a percentage of derivatives receivables, with percentages calibrated on a set of representative banks. We use two percentages, one for entities in jurisdictions for which derivatives are presented on a gross basis (as in International Financial Reporting Standards; IFRS) and one for entities in jurisdictions for which derivatives are presented on a net basis (as in U.S. generally accepted accounting principles; GAAP). The current values of the two multipliers are:

- 11% of derivatives receivables for entities reporting under U.S. GAAP or equivalent and
- 2% of derivatives receivables for entities reporting under IFRS or equivalent.

RELATED PUBLICATIONS

Criteria To Be Partly Superseded

- Risk-Adjusted Capital Framework Methodology (Paragraphs 87, 88, 89, 92, 111, 114, and 122), July 20, 2017

Related Criteria

- Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- Financial Institutions Rating Methodology, Dec. 9, 2021

Related Sector And Industry Variables Report

- Sector And Industry Variables: Risk-Adjusted Capital Framework Methodology, March 31, 2023

Related Research

- What's Behind The Proposal To Update Our Risk-Adjusted Capital Framework Methodology?, Jan. 25, 2024

This report does not constitute a rating action.

This article is proposed Criteria. Criteria are the published analytic framework for determining Credit Ratings. Criteria include fundamental factors, analytical principles, methodologies, and /or key assumptions that we use in the ratings process to produce our Credit Ratings. Criteria, like our Credit Ratings, are forward-looking in nature. Criteria are intended to help users of our Credit Ratings understand how S&P Global Ratings analysts generally approach the analysis of Issuers or Issues in a given sector. Criteria include those material methodological elements identified by S&P Global Ratings as being relevant to credit analysis. However, S&P Global Ratings recognizes that there are many unique factors / facts and circumstances that may potentially apply to the analysis of a given Issuer or Issue. Accordingly, S&P Global Ratings Criteria is not designed to provide an exhaustive list of all factors applied in our rating analyses. Analysts exercise analytic judgement in the application of Criteria through the Rating Committee process to arrive at rating determinations.

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