Thought leadership

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Three Calculations to Crack for Basel III Compliance
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Basel III set out to strengthen bank capital requirements and manage liquidity risk as a result of the financial crisis. While initially the framework only applied to European banks, it was acknowledged by the U.S. Federal Reserve and expanded to all U.S. institutions with $50B in assets.

Given the incremental scope of the regulation and reporting requirements, in 2015 and 2016 global banks began their initial liquidity and LCR calculations only to find Basel III demands stronger data management and governance and an infusion of AI to get to the increasingly accurate and predictable data. Therefore, in 2017 financial institutions will need to focus on these three areas to get ahead of their Basel III calculations.

1) BCBS 248

Sound Liquidity Management Supervision - BCBS 248 sets new global standards around sound liquidity management and supervision for intra-day liquidity. This calculation requires banks to understand their liquidity across multiple asset classes and products without a consolidated place to analyze the data in real-time. This is incredibly difficult to accomplish even for centralized risk systems and relies heavily on real-time data impacted by a multitude of factors. Therefore, financial institutions are looking for ways to automate the calculations and infuse AI and machine learning into these calculations for more predictable intra-day liquidity calculations.

2) LCR Requirements

The liquidity coverage ratio (LCR) requirement builds on intra-day liquidity calculations by setting specific standards for financial institutions regarding the ratio of cash buffers they need to keep on hand in proportion to their liquidity in order to have adequate buffers under systemic stress. The minimum LCR specified by Basel III varies from 60% in 2015 to 100% in 2019; therefore, over the next two years, financial institutions will need to work toward a 100% liquidity coverage ratio and having enough buffer to offset 100% of their liquidity risk. Given cash is costly to hold, firms need to be able to predict how much they need accurately making calculating intra-day liquidity in combination with their LCR requirements two tough problems to solve.

3) BCBS 239

Where BCBS 248 and LCR Requirements call for detailed calculations, Basel III’s BCBS 239 sets out risk data aggregation and reporting best practices. Industry bodies such as the EDM Council have put forward best practice frameworks like the Data Management Capability Model (DCAM). For financial institutions to be able to make credit and liquidity calculations with any confidence, measuring their data management capabilities maturity could be an indicative metric as to the overall health of these data initiatives.

Financial institutions will need to find a fine balance between liquidity risk and managing their margins closely enough to keep enough cash on hand at all times, while also not too much that it impacts their revenues or ability to do business. A thorough assessment of data management capabilities combined with deep data analysis can help organizations find the right balance between risk and reward.