News Bulletin

June 22, 2011

Basel Committee Revises Basel III on the Capital Treatment for Bilateral Counterparty Credit Risk

On 1 June 2011, the Basel Committee on Banking Supervision (the "BCBS") published a press release[1] announcing that it had finished its review of and finalised the Basel III capital treatment for counterparty credit risk ("CCR") in bilateral trades. Following the review, it has made a minor change to the credit valuation adjustment ("CVA"), being the measure of the risk of loss caused by changes in the credit spread of a counterparty due to changes in its credit quality. The existing Basel II regime addresses counterparty default and credit migration risk but not the risk of mark-to-market losses caused by credit valuation adjustments.

In December 2010, the BCBS published the Basel III rules[2] setting out, amongst other things, capital requirements for CCR exposures, which included capital rules for CVA risk that involved both the standardised and advanced methods. At the time it published the main text of Basel III, the BCBS stated that the level and reasonableness of the standardised CVA risk capital charge was subject to a final impact assessment, which has now been completed. Its review found that the standardised method as set out in the December 2010 rules text could be unduly punitive for low-rated counterparties with long maturity transactions. In order to narrow the gap between the capital required for CCC-rated counterparties under the standardised and the advanced methods, the BCBS has decided to reduce the weight applied to CCC-rated counterparties from 18% to 10%.

The BCBS has issued a revised version of the Basel III capital rules, including the relevant change (in paragraph 104).[3] The BCBS has indicated that all other aspects of the regulatory capital treatment for CCR and CVA risk remain unchanged from the December 2010 text. The press release also states that the BCBS is presently completing its review of the capitalisation of bank exposures to central counterparties and expects to finalise its December 2010 proposals before the end of 2011.

[1] http://www.bis.org/press/p110601.pdf.
[2] http://www.bis.org/publ/bcbs189_dec2010.pdf; see also Morrison & Foerster client alert: Basel III: The (Nearly) Full Picture (December 23, 2010), http://www.mofo.com/files/Uploads/Images/101223-Basel-III-The-Nearly-Full-Picture.pdf.
[3] http://www.bis.org/publ/bcbs189.pdf.

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