If, like many of our banking clients, you’re scratching your head over the differences among Basel I, II, and III, this research brief offers an ideal starting point.

By summarizing key differences in the three Basel accords, and the business issues banks need to focus on as they strive to achieve compliance with the US Basel III Accord, this brief can help you:

**Identify the additional effort involved** in implementing Basel III’s advanced approaches, compared to that of Basel II

**Implement the standardized approach in Basel III**—significantly more stringent than the standardized approach of Basel II, which is similar to Basel I

All three Basel regulations primarily focus on banks holding adequate capital commensurate with their risk profile. Since the maiden introduction of Basel I in 1988, however, each subsequent regulation has become more risk sensitive.

Introduction of new financial products—whose risks, in hindsight, were never fully understood—and more importantly, the lessons of the financial crisis of 2008–9, have mandated that banks address risks that, either had yet to be identified, or were deemed inconsequential in the past. This has ushered in a sea of challenges for banks in their efforts to remain compliant with the bare minimum regulatory requirements, let alone address Basel III’s industry-leading practices.

Risk assessment methodologies have evolved significantly since the first accord. Yet, even with advancement in risk management, some risks remain difficult to quantify. The industry will continue to seek appropriate techniques in its effort to accurately measure these risks.
Key Aspects and Differences among Basel I, II, and III

BASEL I
Released rule July 1988
Revolutionary, providing a paradigm to
address risk management from a bank’s
capital adequacy perspective
Not as risk sensitive as Basel II and III
Backward looking, focused on existing
assets rather than the future composition of
a bank’s portfolio
Credit risk only—no other risk types
Fixed, predetermined risk weights for
different asset classes. Example: Cash,
0%; uninsured residential mortgage loans,
50%; corporate loans, 100%
Differentiated assets between banking
and trading books
No advanced measurement of risk,
based upon bank-specific portfolio
Simple tier calculations—tier 1 capital
ratio of 4%, and total capital ratio (tiers 1 and
2) of 8%

BASEL II
Released US rule December 2007
Somewhat forward looking risk-sensitive
approach to capital calculation
Provided smaller banks the option of
adopting the more risk-sensitive advanced
approaches or a less sophisticated
standardized approach, which was modeled
after Basel I
Introduced a three-pillar approach to
risk management:
- Pillar I established minimum regulatory
capital requirements for credit, market,
and operational risks; banks had to
develop their own (internal) models
specific to their portfolios under the
advanced approaches
- Pillar II established principals for
a bank’s Internal Capital Adequacy
Assessment Process (ICAAP), which is
intended to identify additional risks that
are material, but not easily recognized.
Such risks include strategic, reputational,
and liquidity risks. Also established
requirements to strengthen banks’ capital
adequacy by estimating economic capital
to account for unexpected losses
- Pillar III established enhanced reporting
requirements for market disclosure,
such as credit risk exposure in different
rating bands, and credit quality of
securitization holdings
Improved oversight by raising the
bar on supervisory responsibilities and
expectations to normalize the way banks
reported risk identification, measurement
and management, as well as capital
management practices

BASEL III
Released US rule July 2013, with
phased-in implementation by 2019
Emphasis on reducing systemic risk
by minimizing procyclical and promoting
countercyclical via capital conservation
and countercyclical buffers—building up
capital in good economic times to use it in
tough times, for example
Forward looking, addresses risks
relevant to bank-specific portfolios and the
macroeconomic environment
Mandates requirements for:
- Higher minimum capital
- Higher quality capital
Introduces leverage ratios, with the intent
of improving financial system resilience, by
limiting a banking organization’s leverage
Introduces liquidity risk: 30-day liquidity
coverage ratio (LCR), one-year net stable
funding ratio (NSFR), and liquidity monitoring
tools (only the LCR has been introduced in
the US)
Mandates:
- Enhanced disclosure requirements
- Interaction between LCR and the
provision of central bank facilities
Revises Basel II methodologies for
securitizations
Enhances risk coverage by quantifying
counterparty risk, credit value adjustments,
and wrong way risk
More conservative market risk
requirements
Increases the standardized approach
risk sensitivity for:
- Residential mortgages
- Certain commercial credit facilities
- Exposures that are 90 days past due
- Exposures to foreign banks, public sector
entities, and sovereigns
Stricter data governance and data
requirements

---

About the Authors

Dr. Varun Agarwal is a principal within the risk and compliance practice of Capgemini Financial Services. He has more than 19 years of experience in areas that span from enterprise risk management, credit, market, and country risk management; financial modeling and valuation; and international financial markets research and analyses.

Prior to Capgemini, Varun worked in the risk strategy area of HSBC. Previously, he has also worked in the global business consulting practice at IBM, the capital markets group of Deloitte & Touche, and at JP Morgan Chase in its global risk management area.

Varun has presented at numerous industry and trade conferences at both national and regional levels. His academic background includes a PhD in financial economics, an MS in quantitative economics and a bachelor’s degree in engineering.

Miles Ravitz is a senior consultant within the risk and compliance practice of Capgemini Financial Services. He has more than 10 years of experience in areas that span from risk regulation, enterprise risk management, credit risk, market risk, model validation, financial markets, and financial technology.

As a consultant, Miles has worked exclusively for banking clients. However, prior to joining Capgemini, he held a variety of roles at the New York Mercantile Exchange, worked as an adjunct professor, and also enjoyed a stint in financial technology. His academic background includes a master’s degree in financial engineering.

Get started today by visiting us at www.capgemini.com/risk
or contacting us at riskmgmt@capgemini.com.

---

The information contained in this document is proprietary. ©2014 Capgemini. All rights reserved. Rightshore® is a trademark belonging to Capgemini.

www.capgemini.com