

Are you ready for the Standardized Credit Risk Assessments (SCRA) rules under Basel III?

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What is changing?



Basel III standards adoption

Majority of standards already implemented, remaining elements are now agreed and endorsed by the Council

		AR	AU	BR	CA	CN	HK	IN	ID	JP	KR	MX	RU	SA	SG	ZA	CH	TR	GB	US	EU	
Capital	CCyB	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4
	MAR NCCD	1	4	4	4	1	4	2	2	4	2	3	2	4	4	4	4	1	4	4	4	4
	CCP	4	4	4	4	1	4	3	2	4	4	4	2	4	4	4	4	4	4	4	4	4
	EIF	4	4	4	4	1	4	na	na	4	4	2	4	4	4	4	4	4	4	4	2	4
	SA-CCR	4	4	4	4	4	4	3	4	4	4	1	4	4	4	4	4	4	4	4	4	4
	SEC	4	4	4	4	2	4	4	4	4	4	4	4	4	4	4	4	1	4	2	4	4
	TLAC	na	4	4	4	4	4	1	na	4	1	4	4	4	4	4	4	1	4	4	4	4
	CR SA 2023	1	4	4	4	2	2	1	4	3	4	4	2	4	3	2	2	1	2	2	2	2
	CR IRB 2023	na	4	4	4	2	2	na	na	3	4	1	4	4	3	2	2	1	2	na	2	2
	CVA 2023	1	1	1	3	2	2	1	3	3	4	1	1	4	3	2	2	1	2	2	2	2
	MR 2023	1	1	2	3	2	2	2	3	3	4	na	1	4	3	2	2	1	2	2	2	2
	OR 2023	1	4	2	4	2	2	3	4	3	4	4	4	4	3	2	2	1	2	2	2	2
	OF 2023	na	4	1	4	2	2	na	na	3	4	1	4	4	3	2	2	1	2	2	2	2
	RBC 2013	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4

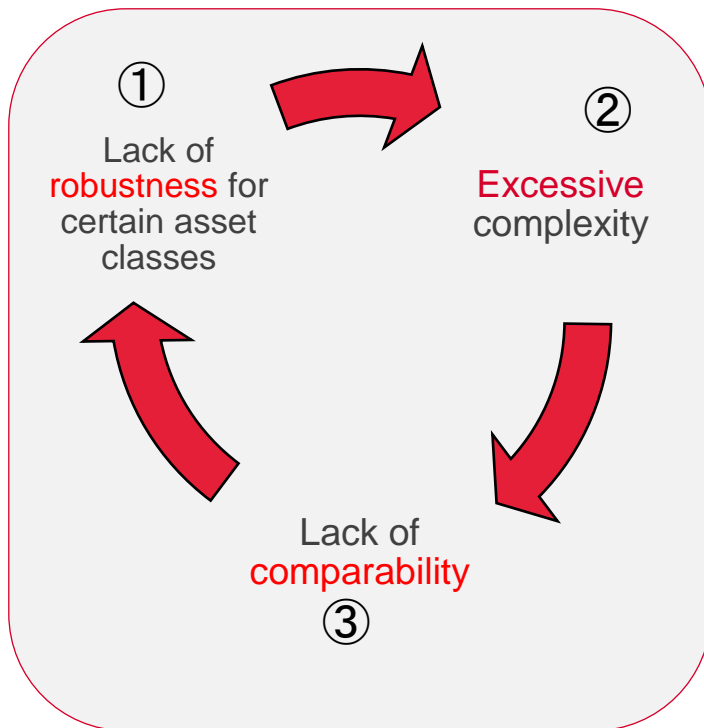


- 1 draft regulation not published
- 2 draft regulation published
- 3 final rule published (not yet implemented by banks)
- 4 final rule in force (published and implemented by banks)
- na not applicable

Source: RCAP on timeliness: Basel III implementation dashboard (bis.org)
 Latest updates on the banking package - European Commission (europa.eu) (as of Sep 2023)

Basel 3.1: Strengthening the Global Banking System through Enhanced Risk-Weighted Assets

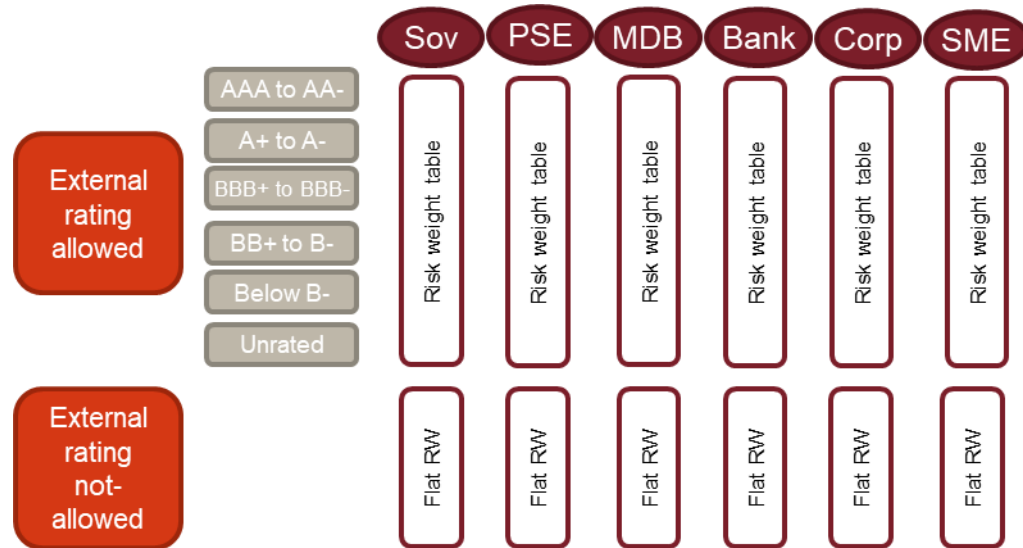
The major weaknesses of IRB approach identified by BSBC:



- ① **Robustness of S&P models**
 - Various qualitative risk drivers in addition to financial data aiming at increasing robustness of the model
 - Robust calibration based on proprietary S&P's global default database dating back to 1981
 - Subject-matter credit expertise for asset classes where statistical modelling is not possible
- ② **Complexity of S&P models**
 - Shadow-rating methodology which reduces complexity
 - Simple, open-form and technology agnostic – easy to implement in client internal system.
- ③ **Comparability of S&P models**
 - Consistent rules on how to assess credit rating
 - Comparability of risk drivers with S&P rated universe

Basel 3.1: Standardized approach – “Due Diligence”

STANDARDISED APPROACH



Due Diligence

- Banks must perform **due diligence** to ensure that the external ratings appropriately reflect the creditworthiness of the counterparties.
- Due diligence analysis must never result in the application of a lower risk weight than that determined by the external rating. (Basel, CRE 20)

Implications for Banks

- ❑ Even if the banks use the external ratings they are obliged to evidence that the ratings are sufficiently conservative for the counterparties they are assessing.
- ❑ Using regulatory risk weights does not replace the need of having an independent risk assessment for internal management and reporting purposes.

What is Standardised Credit Risk Assessment Approach (SCRA) ?

Under Basel III Standardized Approach, bank exposures will be risk-weighted according to the following hierarchy:

- **External Credit Risk Assessment Approach (ECRA)** in jurisdictions that allow the use of external ratings for regulatory purposes.
- **Standardized Credit Risk Assessment Approach (SCRA):** In jurisdictions that do not allow the use of external ratings or for unrated exposures under ECRA.

- Under SCRA, banks have to classify bank exposures into **buckets (i.e., A, B and C)** and assign the corresponding risk weights.
- Banks must perform **due diligence** to ensure that the ‘buckets’ assigned are appropriate and conservative.
- To ensure **consistency and comparability** of banks portfolios under ECRA and SCRA, banks could use internal credit assessment to assign risk buckets independently and transparently.
- Concepts of **ESG**, Transfer & Convertibility risk and implicit Government Support are also introduced to assess banks’ exposures.

Sources and Regulatory references:

- [CRE20 - Standardized approach: individual exposures \(bis.org\)](#)
- [CRE21 - Standardized approach: use of external ratings \(bis.org\)](#)

SCRA under Basel III Standardised approach Definition	SCRA grade	S&P Global Ratings Scale
Counterparty has adequate capacity to meet their financial commitments (including repayments of principal and interest) in a timely manner, for the projected life of the assets or exposures and irrespective of the economic cycles and business conditions.	A	AAA
		AA+
		AA
		AA-
		A+
		A
Counterparty is subject to substantial credit risk, such as repayment capacities that are dependent on stable or favourable economic or business conditions.	B	A-
		BBB+
		BBB
		BBB-
		BB+
		BB
Counterparty has material default risks and limited margins of safety. For these counterparties, adverse business, financial, or economic conditions are very likely to lead, or have led, to an inability to meet their financial commitments.	C	BB-
		B+
		B
		B-
		CCC+
		CCC
		Lower than CCC

What is changing with SCRA in Basel III?

Potential impact on the RWA and Capital for exposures to Banks and Securities Firms

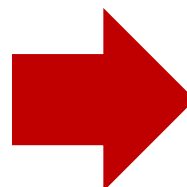
Basel II SA Two Options with External Ratings

Option 1

Credit assessment of Sovereign	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk weight under Option 1	20%	50%	100%	100%	150%	100%

Option 2

Credit assessment of Banks	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk weight under Option 2	20%	50%	50%	100%	150%	50%
Risk weight for short-term claims ²² under Option 2	20%	20%	20%	50%	150%	20%



New Basel rules Two Options with External Ratings

RATED BANK EXPOSURE - ECRA

Risk weight table for bank exposures

External Credit Risk Assessment Approach

Table 6

External rating of counterparty	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-
"Base" risk weight	20%	30%	50%	100%	150%
Risk weight for short-term exposures	20%	20%	20%	50%	150%

UNRATED BANK EXPOSURE - SCRA

Risk weight table for bank exposures

Standardised Credit Risk Assessment Approach

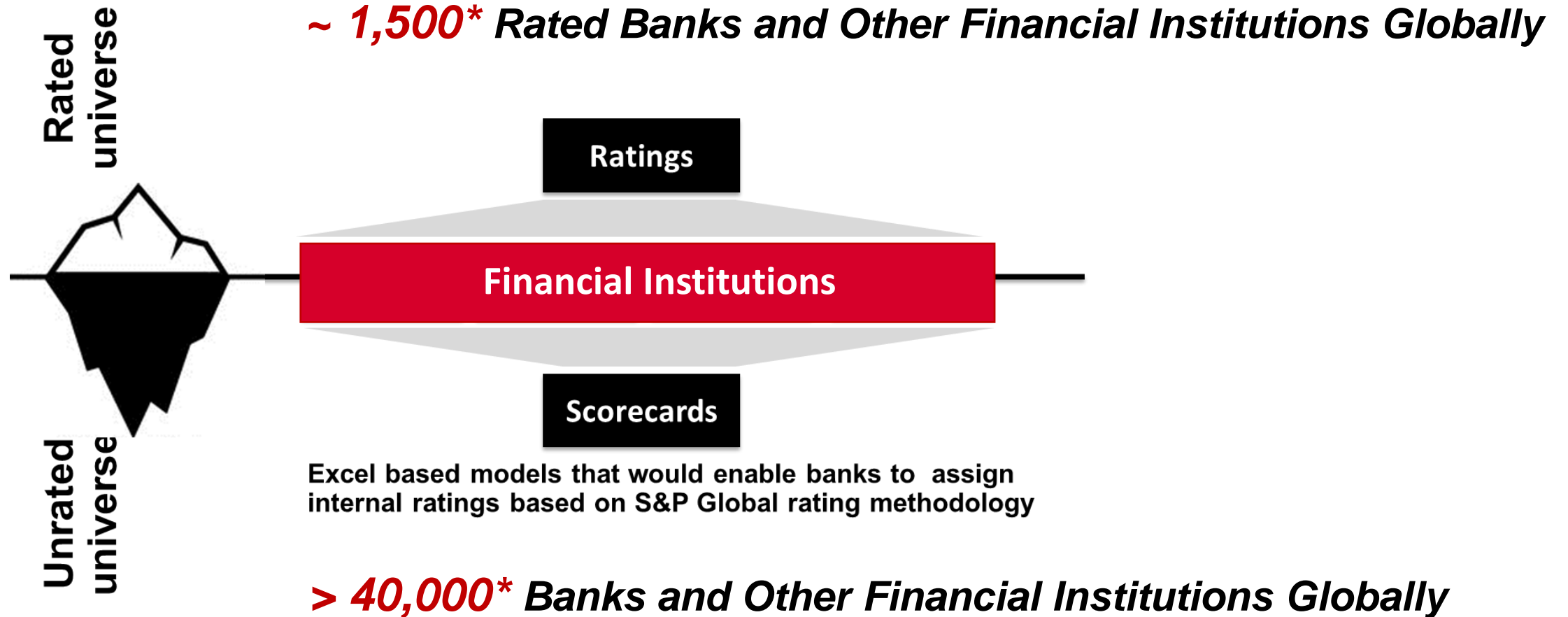
Table 7

Credit risk assessment of counterparty	Grade A	Grade B	Grade C
"Base" risk weight	40%	75%	150%
Risk weight for short-term exposures	20%	50%	150%

Under the SCRA, exposures to banks without an external credit rating may receive a risk weight of 30%, provided that the counterparty bank has a Common Equity Tier 1 ratio that meets or exceeds 14% and a Tier 1 leverage ratio that meets or exceeds 5%. The counterparty bank must also satisfy all the requirements for Grade A classification.

Rated vs Unrated World – Banks

Scorecards allow to manage unrated exposures using a consistent “risk language”



* Banks and credit institutions, including operating subsidiaries. Source: CapIQ Pro

Regulatory Definition of Grades (A, B, and C)

A

- Adequate capacity to meet financial commitments
- Meets or exceeds the published minimum regulatory requirements and buffers
- No adverse audit opinion or substantial doubt about the ability to continue as a going concern within the previous 12 months

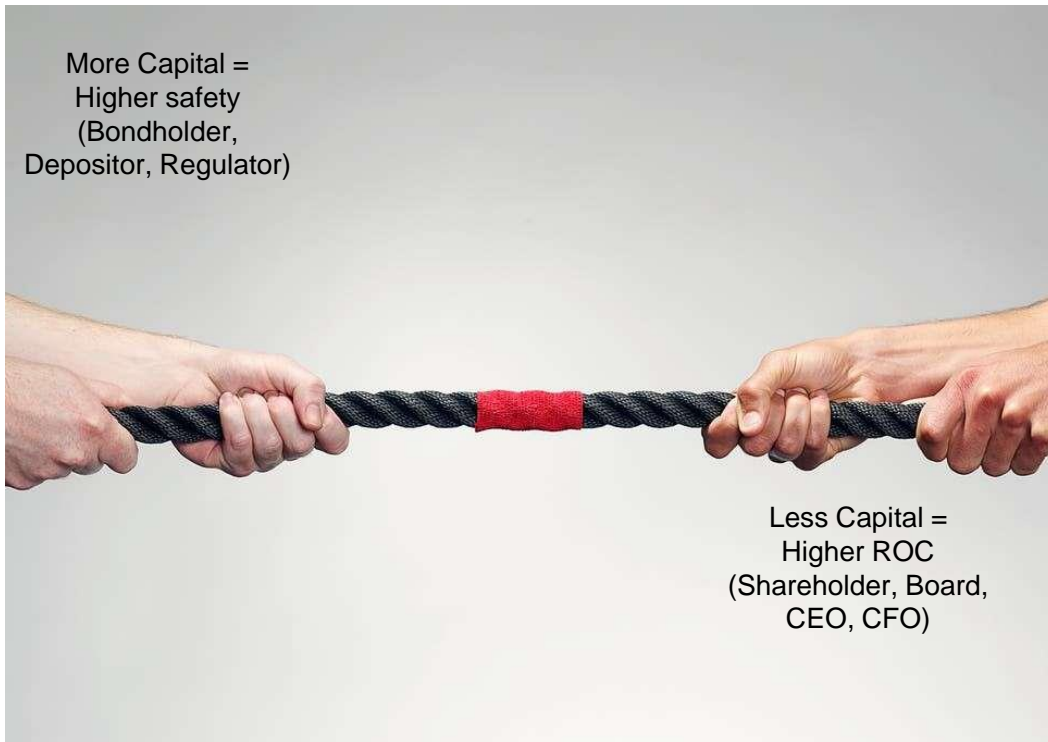
B

- Subject to substantial credit risk
- Meets or exceeds the published minimum regulatory requirements
- No adverse audit opinion or substantial doubt about the counterparty bank's ability to continue as a going concern within the previous 12 months

C

- Material default risks and limited margins of safety
- Adverse business, financial, or economic conditions are very likely to lead or have led to an inability to meet their financial commitments
- Adverse audit opinion or expressed substantial doubt about the counterparty bank's ability to continue as a going concern within the previous 12 months

Why this change matters?



- Revised SA is a more risk sensitive approach
- To reduce the variability of capital levels across IRB Banks, regulators are introducing capital floors based on SA (subject to transition period)
- Overall capital levels are expected to increase with the revised rules
- SCRA will also potentially impact the capital floor for IRB Banks as the floor will be based on the SA.

Implementation Challenges



Practical Implementation Challenges

	Determining “capacity to meet financial commitments”
	Requires credit risk assessment experience of financial institutions and a methodology guideline to follow
	Consider parental support or intervention, however, exclude sovereign support
	Foreign currency/transfer and convertibility risk considerations
	Checks for country- and bank-specific minimum regulatory capital and buffer requirements
	Necessary financial statement and regulatory capital data are spread across many sources and require regular updates
	Climate risk considerations

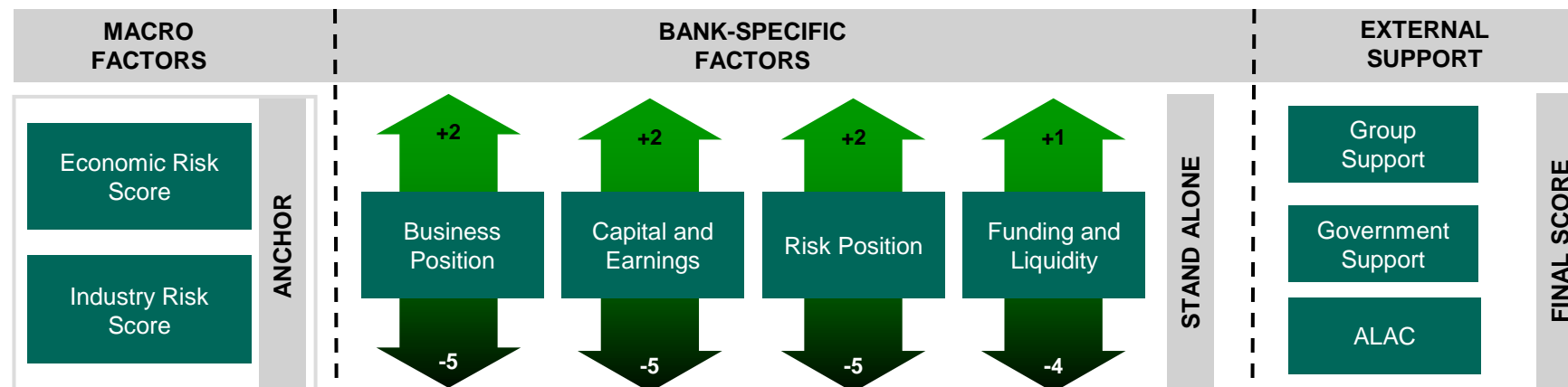
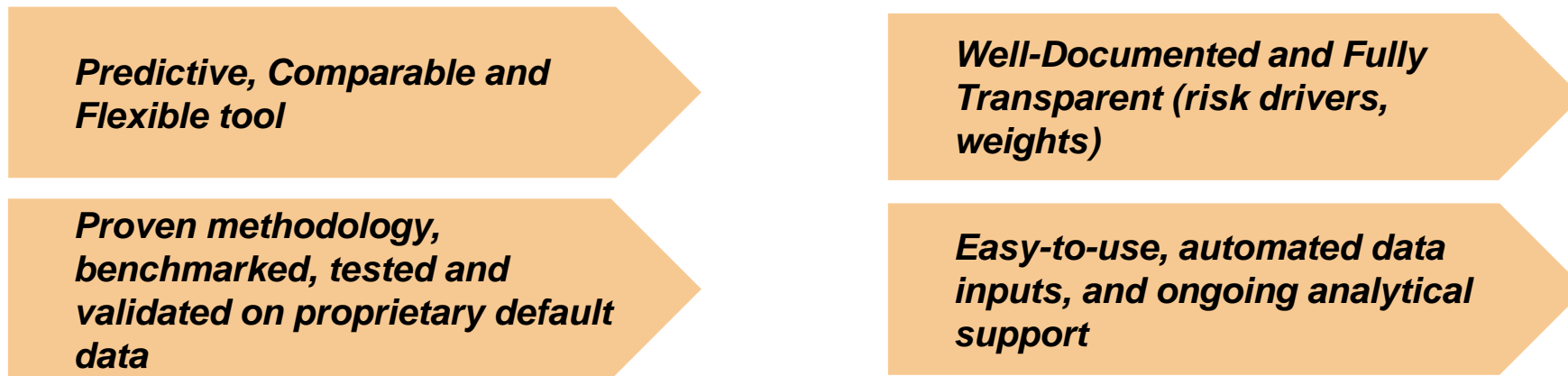
How to solve for SCRA?



Determining the cut off points based on “capacity”

SCORECARDS: provide credit and risk management professionals with essential tools to identify and manage potential default risks.

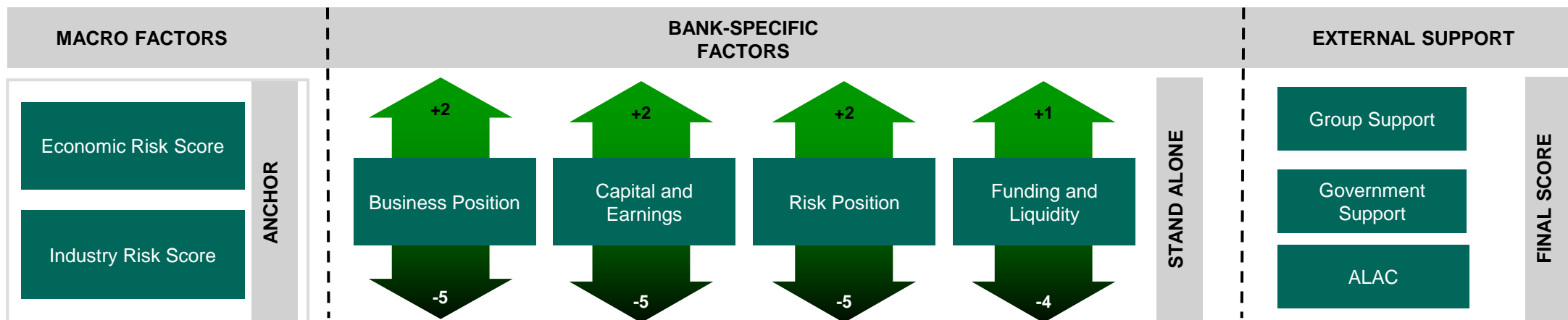
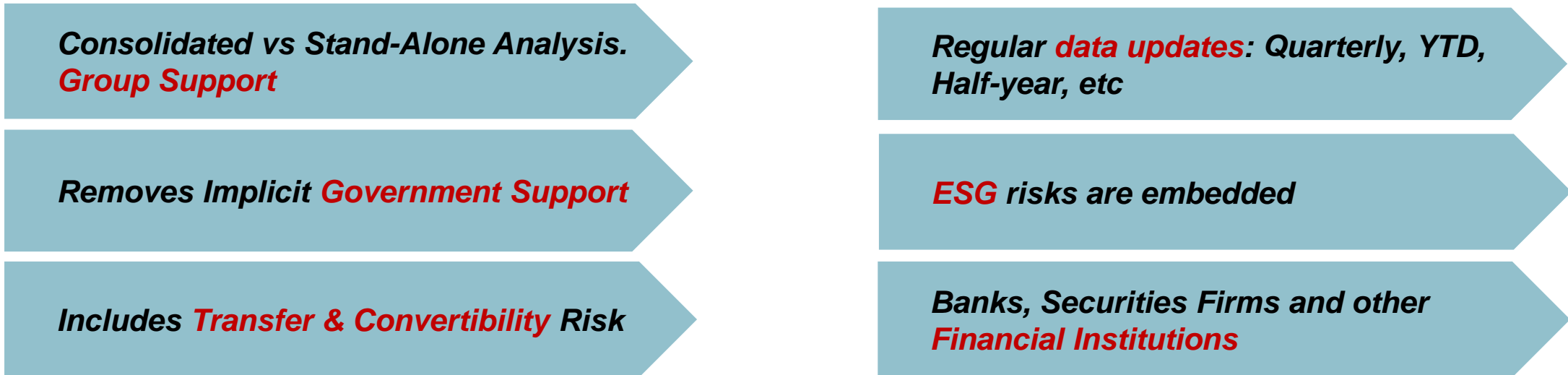
Enable the **due diligence process**, ensuring consistency and comparability.



Source: S&P Global Market Intelligence, for illustrative purposes only.

Step 1: Determining the cut off points based on “capacity”

How Scorecard is tackling some of the key hurdles of SCRA requirements:



Step 2: Scores mapped to grades

Numeric scale	Letter-grade scale
1	aaa
1.5	aa+
2	aa
2.5	aa-
3	a+
3.5	a
4	a-
4.5	bbb+
5	bbb
5.5	bbb-
6	bb+
6.5	bb
7	bb-
7.5	b+
8	b
8.5	b-
9	ccc+
9.5	ccc
10	ccc-



A	Counterparty bank has adequate capacity to meet their financial commitments for the projected life of the assets or exposures irrespective of the economic cycles and business conditions.
B	Counterparty bank is subject to substantial credit risk , such as repayment capacities are dependent on stable or favorable economic or business conditions.
C	Counterparty bank has material default risks and limited margins of safety. For these counterparties, adverse business, financial, or economic conditions are very likely to lead, or have led, to an inability to meet their financial commitments.

Step 3: Compare bank's regulatory capital to minimum requirements and buffers

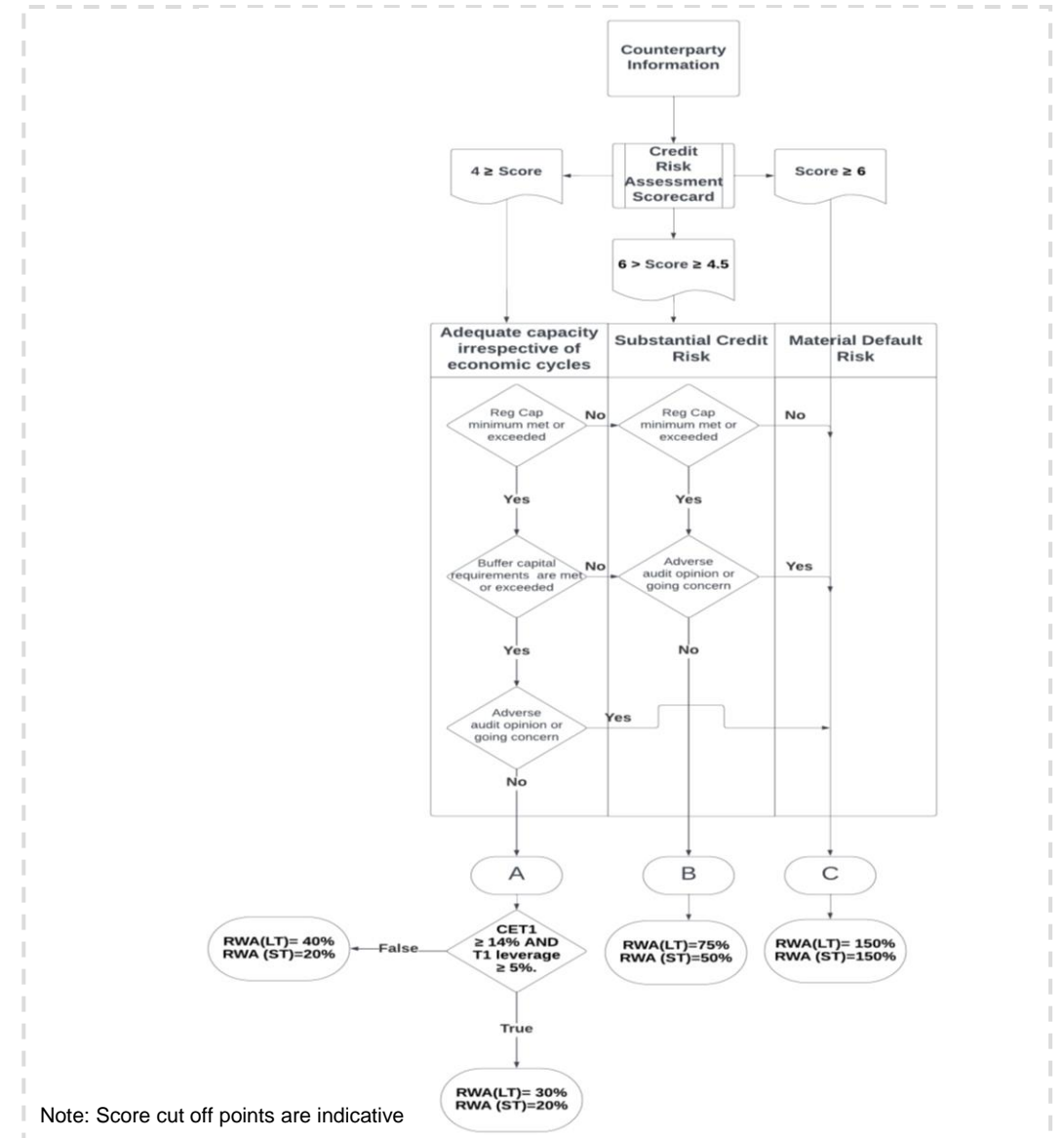
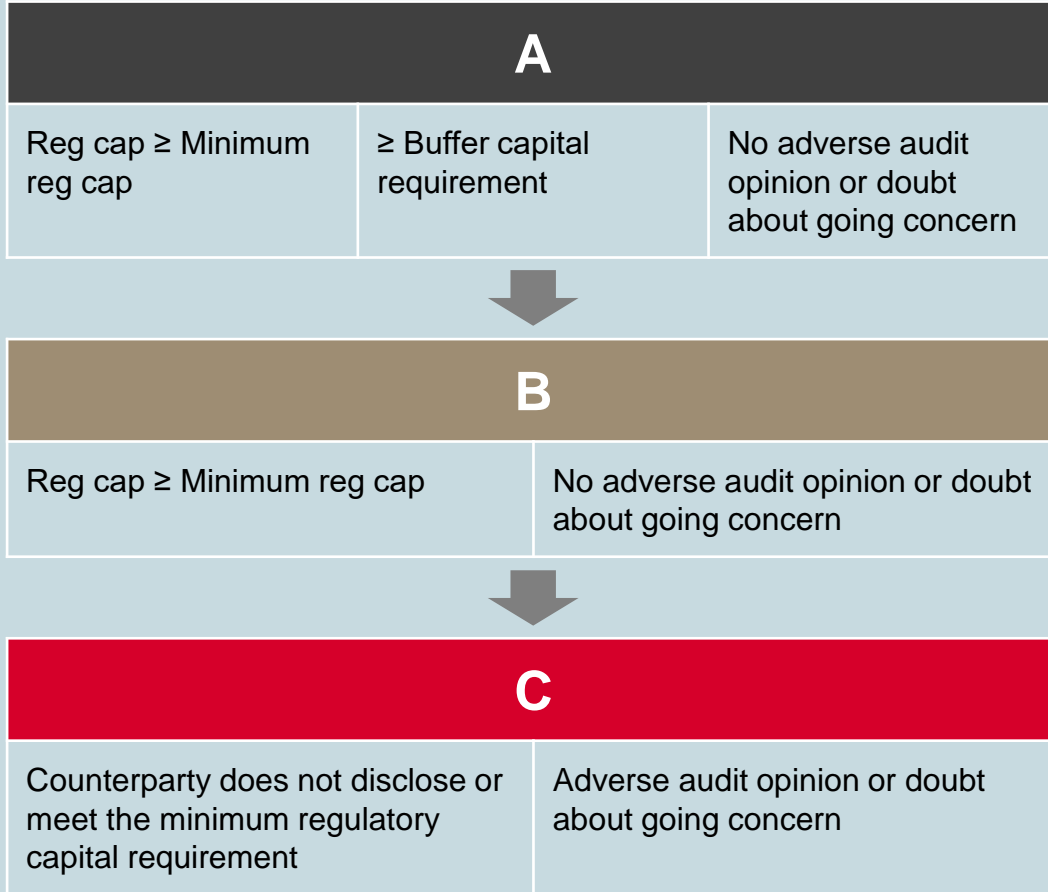
- ✓ Under which jurisdiction is the bank incorporated?
- ✓ Who is the national supervisor?
- ✓ Is the minimum regulatory capital requirement (%) publicly disclosed?
- ✓ What is the minimum regulatory capital requirement?
- ✓ Does the bank meet minimum capital requirement?
- ✓ Is the buffer capital requirement (%) publicly disclosed?
- ✓ What is the buffer capital requirement?
- ✓ Does the bank meet buffer capital requirements?



Summary of SCRA Data Requirements

Auditor Opinion	Other Risk Buffer (%)
Pillar 1 Minimum Requirement (%)	Total CET1 Requirement (%)
Pillar 2 Minimum Requirement (%)	Total Tier 1 Requirement (%)
Capital Conservation Buffer (%)	Total Capital Requirement (%)
Counter Cyclical Buffer (%)	Minimum Basel III Leverage (%)
Systemic Risk Buffer (%)	Minimum TLAC Requirement (%)
Leverage Ratio %	Tier 2 ratio (%)

Step 3: Confirm regulatory capital, buffer compliance, and final grade



Determine Risk-Weighted Assets (RWA) Based on Basel III Guidance

Risk weight table for bank exposures

Standardised Credit Risk Assessment Approach

Table 7

Credit risk assessment of counterparty	Grade A	Grade B	Grade C
“Base” risk weight	40%	75%	150%
Risk weight for short-term exposures	20%	50%	150%

- Additional factors to consider in assigning the RWA:
- Under the SCRA, exposures to banks without an external credit rating may receive a risk weight of 30%, provided that the counterparty bank has a Common Equity Tier 1 ratio that meets or exceeds 14% and a Tier 1 leverage ratio that meets or exceeds 5%. The counterparty bank must also satisfy all the requirements for Grade A classification.
- To reflect transfer and convertibility risk under the SCRA, a risk-weight floor based on the risk weight applicable to exposures to the sovereign of the country where the bank counterparty is incorporated will be applied to the risk weight assigned to bank exposures. The sovereign floor applies when: (i) the exposure is not in the local currency of the jurisdiction of incorporation of the debtor bank; and (ii) for a borrowing booked in a branch of the debtor bank in a foreign jurisdiction, when the exposure is not in the local currency of the jurisdiction in which the branch operates. The sovereign floor will not apply to short-term (i.e. with a maturity below one year) self-liquidating, trade-related contingent items that arise from the movement of goods.

3 key elements required to solve for SCRA



Experienced Analysts

- Credit analysts experienced in assessing the riskiness of banks and similar financial institutions
- Knowledge of nuances when analyzing banks vs NBFIs or securities firms
- Practical knowledge of local regulations and data sources
- Independent, credible, and objective assessment of bank counterparties



Operations and Analytics








- Based on the fundamentals of credit risk principles for financial institutions
- Robust to withstand regulatory scrutiny
- Consistency to assess risk with confidence
- Ease and cost of deployment



Data

- Financial statement data
- Default and recovery data
- Regulatory capital data against supervisory minimum and buffer requirements
- Auditor opinion / going concern / other adverse information necessary for monitoring

An integrated solution to efficiently implement the SCRA approach and determine the appropriate risk weights for the exposures to banks

	Save hours of searching for the annual reports and websites to gather and standardize financial statements and regulatory capital data, monitoring regulations in numerous jurisdictions around the world
	Structured, consistent and coherent approach to assign SCRA grades, based on S&P bank rating methodology, for the due diligence and debt repayment capacity assessment
	The support of experienced credit analysts for regulatory compliance and bank credit risk assessments
	A sound approach for vetting the information necessary to ensure that appropriate capital charges are established.
	A report to support final grade and RWA for the exposure
	Ongoing monitoring of the portfolio on a monthly, quarterly or annual basis
	Optional services for alerts and early warning signals

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