BERMUDA MONETARY AUTHORITY

CONSULTATION PAPER

OUTPUT FLOOR FOR BANKS

CONTENTS

I. INTRODUCTION

1. As part of the finalisation of the Basel III reforms published in December 2017[1], the Basel Committee on Banking Supervision (**"Basel"**) introduced the output floor, which is designed for banks that utilise internal models to calculate their risk weighted assets (**"RWAs"**).

2. The ultimate aim of the output floor is to reduce excessive variability of RWAs and to enhance the comparability of risk weighted capital ratios. The output floor will ensure that a bank's capital requirements derived from the use of internal models do not fall below a certain percentage of capital requirements derived under standardised approaches. The output floor requires that risk-weighted assets must be calculated as the maximum of the bank's initial calculations using all approved approaches and 72.5% of total risk-weighted assets calculated using standardised approaches only.

3. Currently, the Bermuda Monetary Authority (the **"Authority"**) has not approved the use of internal models to measure RWAs and requires that all banks utilise the standardised approaches for credit, market and operational risks. However, the Authority is proposing to adopt this standard to allow for the possibility of this changing in the future.

4. The output floor is to be applied to the following related approaches:

    i. Credit risk: the standardised approach for credit risk;
    ii. Counterparty credit risk: the standardised approach for measuring counterparty credit risk (**"SA-CCR"**);
    iii. Credit valuation adjustment (**"CVA"**) risk: the standardised approach for credit valuation adjustment risk;
    iv. Securitisation framework: based on either (i) the securitisation external ratings-based approach (**"SEC-ERBA"**) or (ii) the securitisation standardised approach (**"SEC-SA"**) and a risk-weight of 1250% where approaches (i) and (ii) cannot be used;
    v. Market risk: the standardised approach for market risk. The SEC-ERBA, SEC-SA or a risk-weight of 1250% must also be used when determining the default risk charge component for securitisations held in the trading book; and
    vi. Operational risk: the standardised approach for operational risk.

[1] See Basel Committee on Banking Supervision "Basel III: Finalising post-crisis reforms" December 2017.

5. The output floor will be calculated as per the following example:

Risk type	Pre-floor RWAs	Standardised RWAs	72.5% of standardised RWAs
Credit risk:	62.0	124.0	89.9
- of which Asset Class A	45.0	80.0	58.0
- of which Asset Class B	5.0	32.0	23.2
- of which Asset Class C (not modelled)	12.0	12.0	8.7
Market risk	2.0	4.0	2.9
Operational risk (not modelled)	12.0	12.0	8.7
Total RWAs[2]	**76.0**	**140.0**	**101.5**

II. DISCLOSURE REQUIREMENTS

6. Banks must publish in Pillar 3 disclosures two sets of risk-weighted capital ratios: (i) ratios that exclude the capital floor in the calculation of RWAs; and (ii) ratios that include the capital floor in the calculation of RWAs. In addition, banks must disclose more granular information related to the calculation of their RWAs under internally-modelled and standardised approaches, which will be set out in forthcoming disclosure templates as part of the Committee's Pillar 3 disclosure framework.

III. TRANSITIONAL ARRANGEMENTS

7. The output floor will be implemented as of 1 January 2023, based on the following calibration phase-in arrangement:

Date	Output floor calibration
1st January 2023	50%
1st January 2024	55%
1st January 2025	60%
1st January 2026	65%
1st January 2027	70%
1st January 2028	72.5%

8. During the phase-in period, the Authority may exercise national discretion to cap the incremental increase in a bank's total RWAs that results from the application of the floor. This transitional cap will be set at 25% of a bank's RWAs before the application of the floor. In the example shown in paragraph 5, the application of this national discretion by the Authority would cap the bank's RWAs to 95 (i.e. a 25% increase of its pre-floor RWAs of 76).

[2] As the floored RWAs (101.5) are higher than the pre-floor RWAs (76) in this example, the bank would use the former to determine the capital requirements.