BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Press release

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Basel Committee finalises capital treatment for bilateral counterparty credit risk

Today the Basel Committee on Banking Supervision announced that it has completed its review of and finalised the Basel III capital treatment for counterparty credit risk in bilateral trades. The review resulted in a minor modification of the credit valuation adjustment, which is the risk of loss caused by changes in the credit spread of a counterparty due to changes in its credit quality (also referred to as the market value of counterparty credit risk).

Under Basel II, the risk of counterparty default and credit migration risk were addressed but mark-to-market losses due to credit valuation adjustments (CVA) were not. During the financial crisis, however, roughly two-thirds of losses attributed to counterparty credit risk were due to CVA losses and only about one-third were due to actual defaults.

The Basel III framework, published in December 2010, sets out capital rules for CVA risk that include standardised and advanced methods. At the time it issued Basel III, the Committee noted that the level and reasonableness of the standardised CVA risk capital charge was subject to a final impact assessment targeted for completion in the first quarter of 2011.

The impact study has been completed. It showed that the standardised method as originally set out in the December 2010 rules text could be unduly punitive for low-rated counterparties with long maturity transactions. To narrow the gap between the capital required for CCC-rated counterparties under the standardised and the advanced methods, the Basel Committee agreed to reduce the weight applied to CCC-rated counterparties from 18% to 10%.

All other aspects of the regulatory capital treatment for counterparty credit risk and CVA risk remain unchanged from the December 2010 Basel III rules text. Overall, the Committee estimates that, with the addition of the CVA risk capital charge, the capital requirements for counterparty credit risk under Basel III will double the level required under Basel II (ie when counterparty credit risk was capitalised for default risk only). A revised version of the Basel III capital rules reflecting the CVA modification is now available on the BIS website.

The Committee is in the process of completing its review of capitalisation of bank exposures to central counterparties (CCPs) and expects to finalise its December 2010 proposals before year end.

About the Basel Committee

The **Basel Committee on Banking Supervision** provides a forum for regular cooperation on banking supervisory matters. It seeks to promote and strengthen supervisory and risk management practices globally. The Committee comprises representatives from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

The Committee's Secretariat is based at the Bank for International Settlements in Basel, Switzerland.