KPMG

In the vault with KPMG

Proposed Regulations: Basel III Endgame and the potential impacts to bank tax departments

KPMG's Banking and Capital Markets tax practice discusses the potential impact that proposed Basel III regulations could have on bank tax departments.

Basel III is a regulatory capital framework that aims to ensure that banking organizations maintain certain levels of capital to preserve the health of the global banking system. Recent proposed Basel III regulations (the "NPR") include a number of rule changes. The NPR is intended to provide additional protection for banks from losses and other adverse scenarios. The FDIC has estimated that the NPR would require banks to increase capital by approximately 16 percent. One of the proposed changes would align the regulatory capital calculation across large banking organizations.

The NPR could have a significant impact to the tax components of the regulatory capital calculation for Category III and IV banks (generally banks with assets between $100 billion and $700 billion and less than $75 billion in cross-jurisdictional activity). The changes would require Category III and IV banks to include aspects of accumulated other comprehensive income (AOCI) in regulatory capital, net of the related deferred tax impact. The associated deferred tax asset (DTA)[1] or liability (DTL) would then be included in the "tax netting calculation." This could have adverse impacts to regulatory capital, as it could potentially increase the amount of DTAs that need to be subtracted from regulatory capital. Under the current rules, these banks are able to "opt-out" from including AOCI and the related deferred tax impact in capital.

In addition, Category III and IV banks would be required to deduct from capital, certain temporary DTAs that exceed 10% of Common Equity Tier 1 ("CET1"). There could be an additional deduction from capital to the extent the sum of remaining temporary DTAs and other "threshold" items[2] collectively exceed 15 percent of CET1. The current rule for Category III and IV banks require a deduction for these temporary DTAs to the extent they exceed 25 percent of CET1. This change could have a significant impact to regulatory capital, as DTAs would likely increase significantly as a result of including AOCI deferred tax items in the tax netting calculation.

Bank tax departments that could be impacted by these potential changes should start early to model out the potential implications and may want to consider tax accounting method changes that could mitigate the adverse impacts of the proposed regulations. KPMG has software that can help automate the calculations and quickly compare and contrast results across scenarios.

The NPR is open for comment through November 30th, 2023. If finalized in current form, the rules would be effective July 1, 2025 and certain items would be subject to a three-year phase-in period.

[1] "Very generaly, DTAs are netted against DTLs using a prescribed methodology, and the net result is compared against various rules to determine whether adjustments need to be made to regulatory capital."

[2] "Threshold items" generally include mortgage servicing rights, significant unconsolidated investments, and certain temporary DTAs.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia