Incremental Risk Charge

The incremental risk charge is a regulatory requirement from the Basel Committee in response to the financial crisis. It supplements existing Value-at-Risk and captures the loss due to default and migration events at a **99.9%** confidence level over a **one-year** capital horizon.

The liquidity of a position is explicitly modeled in INCREMENTAL RISK CHARGE through liquidity horizon and constant level of risk. The constant level of risk is a new concept in INCREMENTAL RISK CHARGE. It assumes banks hold portfolio constant over a liquidity horizon.

At the beginning of the next horizon, they rebalance any default, downgraded, or upgraded positions and roll over any matured trades. This presentation describes methodology and implementation details of INCREMENTAL RISK CHARGE.

INCREMENTAL RISK CHARGE Main Features

- Liquidity: The liquidity of position is explicitly modeled in INCREMENTAL RISK CHARGE through liquidity horizon and constant level of risk.
- Constant level of risk: assumption
  - Hold portfolio constant over liquidity horizon
  - Rebalance any default, downgraded, or upgraded positions at the beginning of each liquidity horizon
  - Roll over any matured positions at the beginning of each horizon
- Default and migration: banks need to simulate default and migration for one-year horizon.
- Concentration: it measures the degree of a portfolio diversification. For example, if a significant number of issuers belong to a certain category, the portfolio is a concentrated one.

Reference:

https://finpricing.com/lib/EqConvertible.html