ACCA

The Impact of Basel III: What little we know

The global body for professional accountants

ACCA

The global body for professional accountants

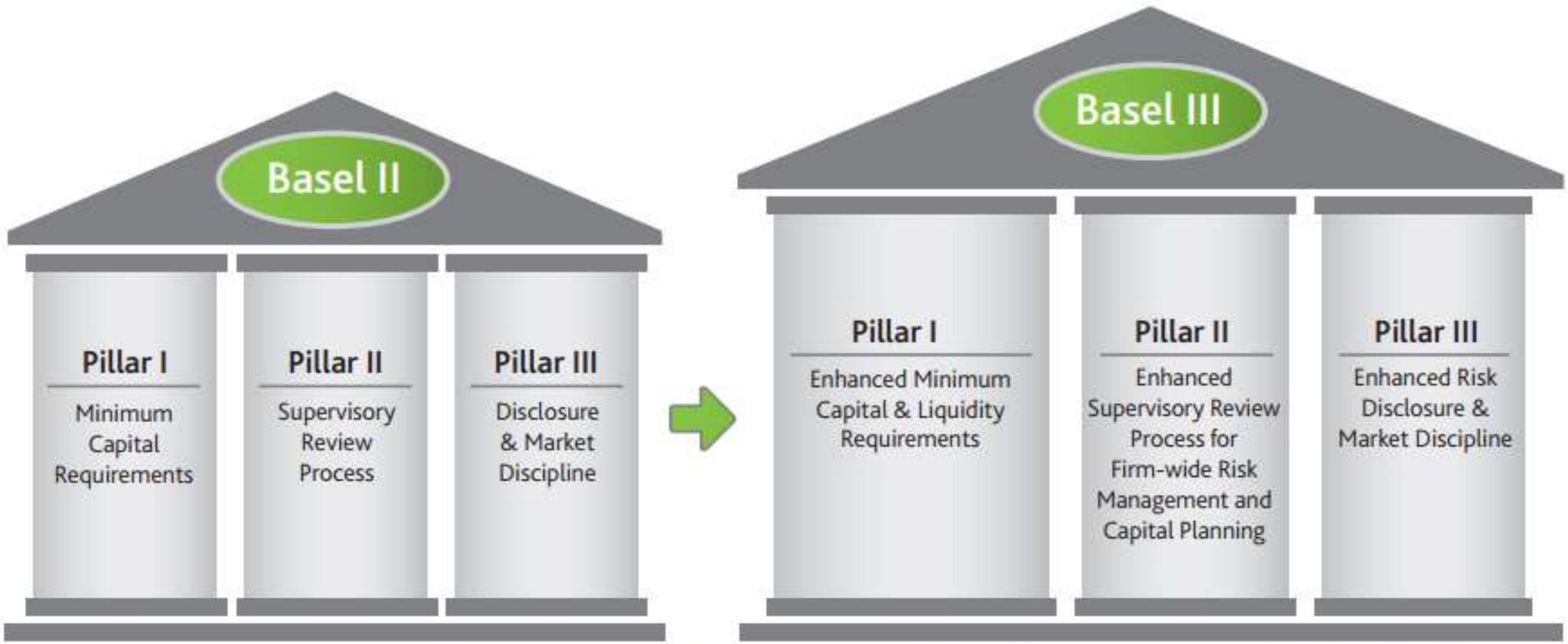
Basel III: the story so far

The post- crisis G-20 consensus:

- Failure of market discipline
- Too little / poor quality capital
- Too much leverage
- Too much short-term funding, reliance on supposedly liquid markets
- Procyclical capital requirements
- Insufficient provision for Too Big To Fail

Basel III: the story so far

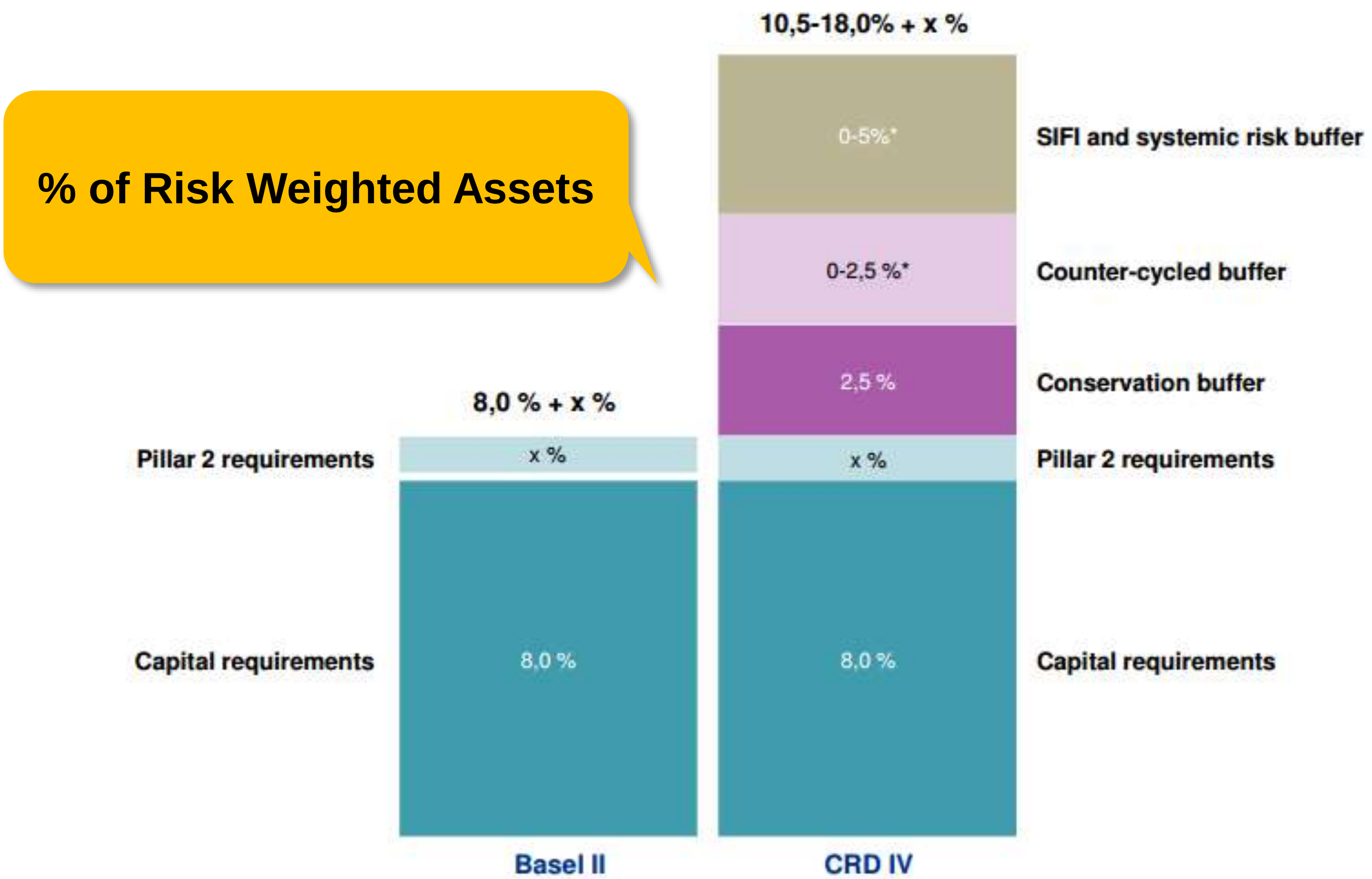
- Sep 2009: G-20 in Pittsburgh call for new capital, liquidity rules by end 2010
- Nov 2010: G-20 endorse the Basel Committee's Basel III proposals in Seoul, seek to enact by end 2012
- Jul 2011: EC unveils CRD IV proposals
- Mar 2013: CRD IV approved by Council, EP. MS to transpose by 2014.
- Jan 2014: Deadline for transposition.
- 2019-22: Full implementation



Basel III strengthens the three Basel II pillars, especially pillar 1 with enhanced minimum capital and liquidity requirements.

Source: Moody's (2012)

Significant increase in capital requirements



Source: [Schwarz-Petersen (2013)]

Liquidity Coverage Ratio (LCR) (by 2015)

net liquidity outflows during a 30-day stress period
---
stock of ‘high quality’ liquid assets

Net Stable Funding Ratio (NSFR)
(2018, but in observation from 2012)

Net Stable Funding (customer deposits, long-term wholesale funding and equity weighted by liquidity risk)

Assets (weighted by refinancing risk)

Leverage Ratio (LCR) (tracked from 2013, disclosed from 2015)

Tier 1

Total on- and off- balance sheet assets

The Macro Impact Assessments.

The Basel III IA boxed set: estimates

Impact estimate for Basel III	Output loss	Spreads incr.
MAG (Dec 2010)	0.05	<20bps
IMF (Sep 2012)	0.05 to 0.08	28bps
BCBS (Aug 2010)	0.08	66 bps
OECD (Feb 2011)	0.15	53 bps
EC (Jul 2011)	0.16	29 bps
IIF (Sep 2011)	0.70	364 bps

The Basel III IA boxed set: consensus

- Small output loss, peaks in ca. 9yrs
- Lending spreads will rise modestly
- Bank ROE will suffer
- Impact largest in Europe, Japan
- Incremental cost falls if banks learn
- Timing can determine impact
- Synergies between capital and liquidity
- Monetary policy can reduce the impact
- Benefits will outweigh costs

The Basel III IA boxed set: unknowns

- Counterfactuals
- Investors' response and cost of equity
- Liquidity gaps, maturity matching costs
- Banks' own capital targets
- Banks' changing business models
- Monetary policy
- Viability of non-bank channels
- Impact on SMEs

The Basel III IA boxed set: underway

- Reviving securitisation (ACCA 2013)
- ‘Silo-ing’ collateral (Singh 2013)
- Financial disintegration, mostly through liquidity rules (Lehmann et al 2011)

The Micro Impact.

Improve data quality and internal reporting

Re-focus on fee-based services

Withdraw capital-intensive products (overdrafts)

Shorten maturities

Seek collateral and guarantees

Improve loan-loss provisions based on better modelling

Cut costs / remuneration

Impact on SME lending

Avoid SMEs, riskier borrowers

Redirect funds away from trading

Make greater use of covenants

Ration capital

Re-price credit

Take loans off balance sheet / originate to distribute

Attract retail / SME deposits

CRD IV –
What's it good for?.

60% - 300%

of GDP: the typical cost
of a financial crisis

4.6%<3%

Probability of a financial crisis per year,
before and after Basel III

0?

Change in the expected
severity of crises due to Basel III

Source: [BCBS (Aug 2010)]

Risk-weighted assets (RWAs) as % of total assets for major global banks

Source: Slovik (2012)

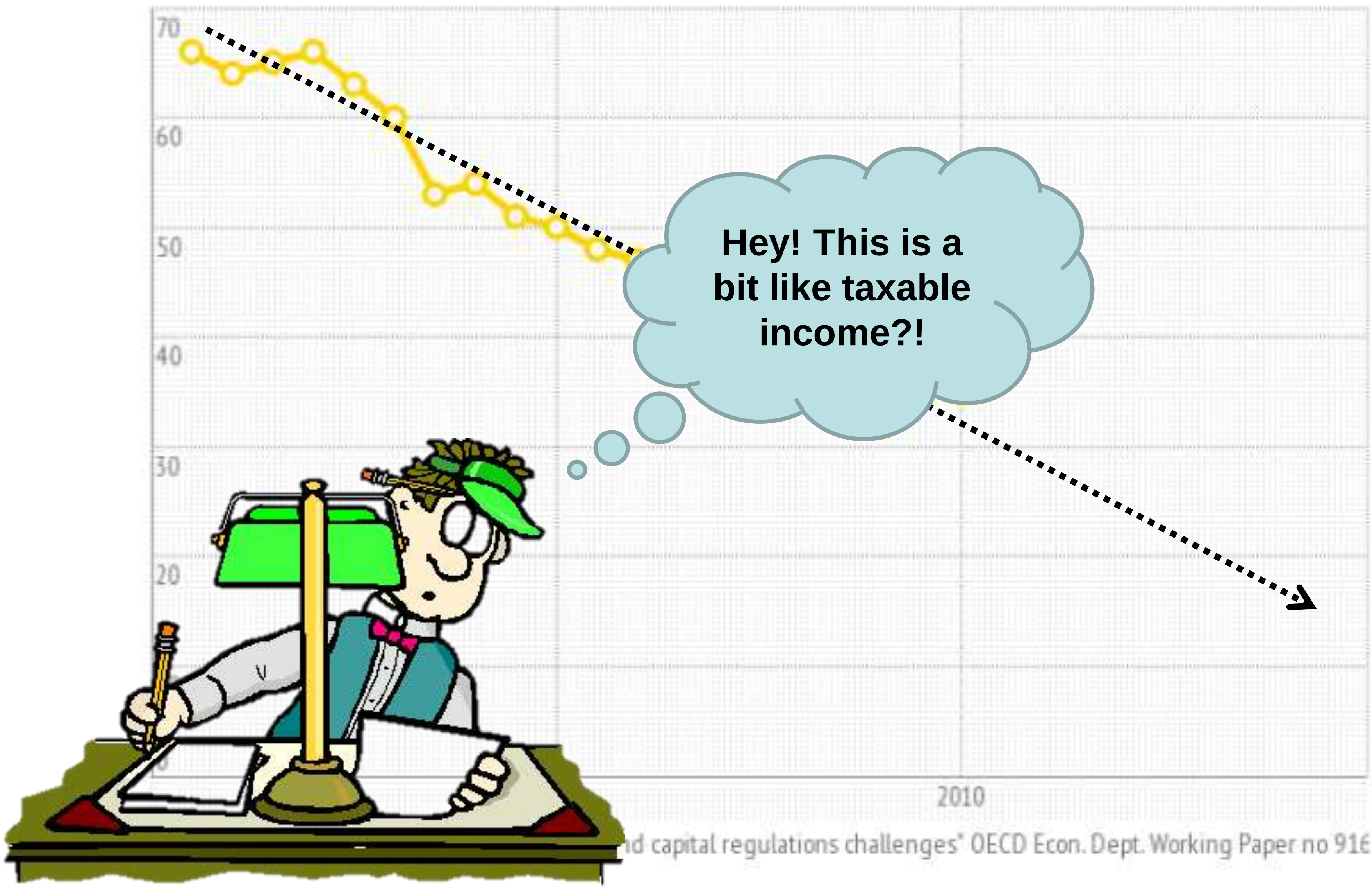
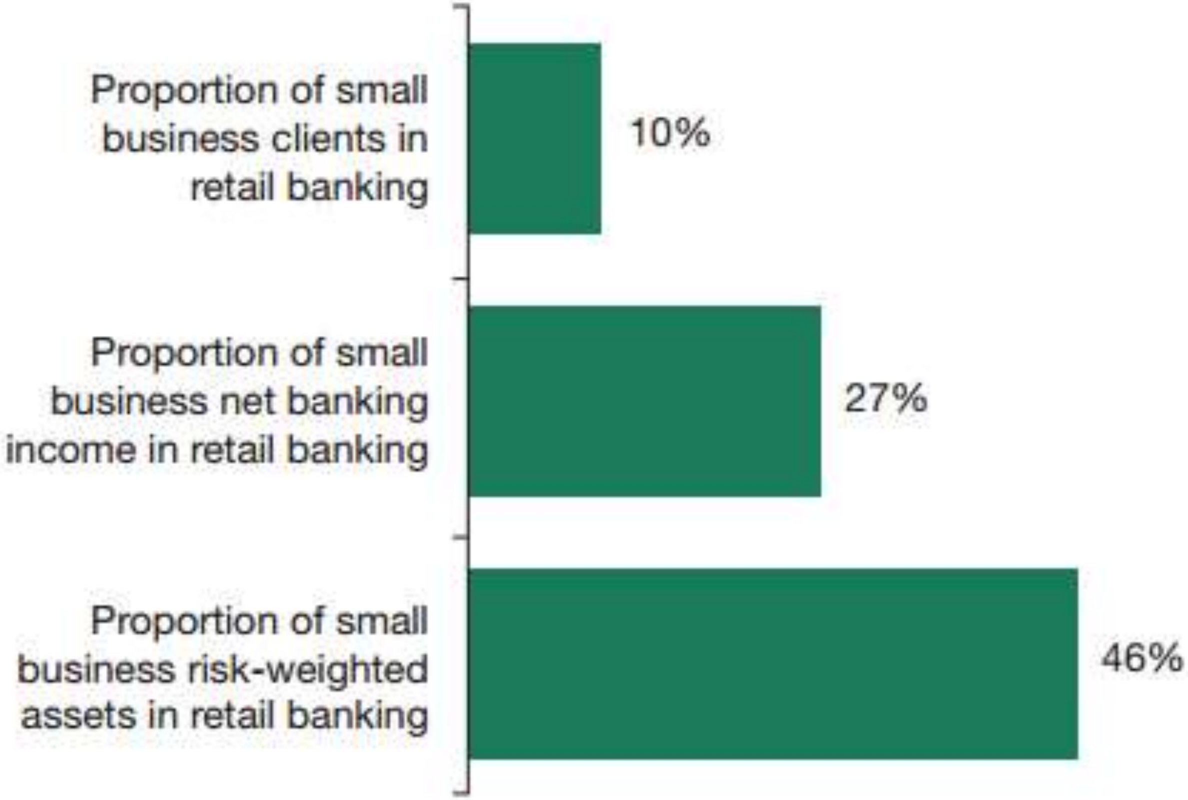


Figure 2 **Weight of the small business market in retail banking**

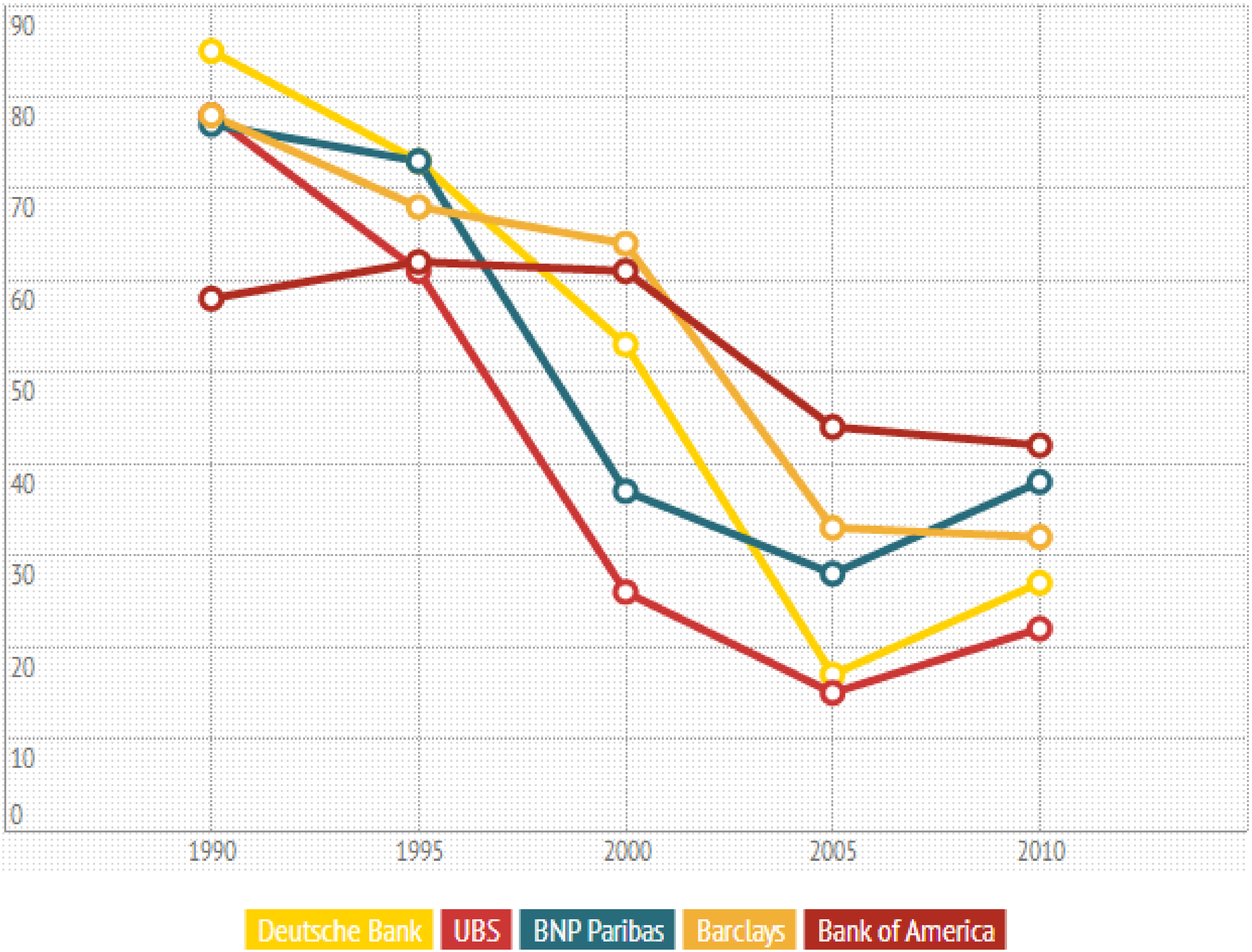


Source: Capgemini analysis from bank interviews, 2010.

[Capgemini (2010)](#)

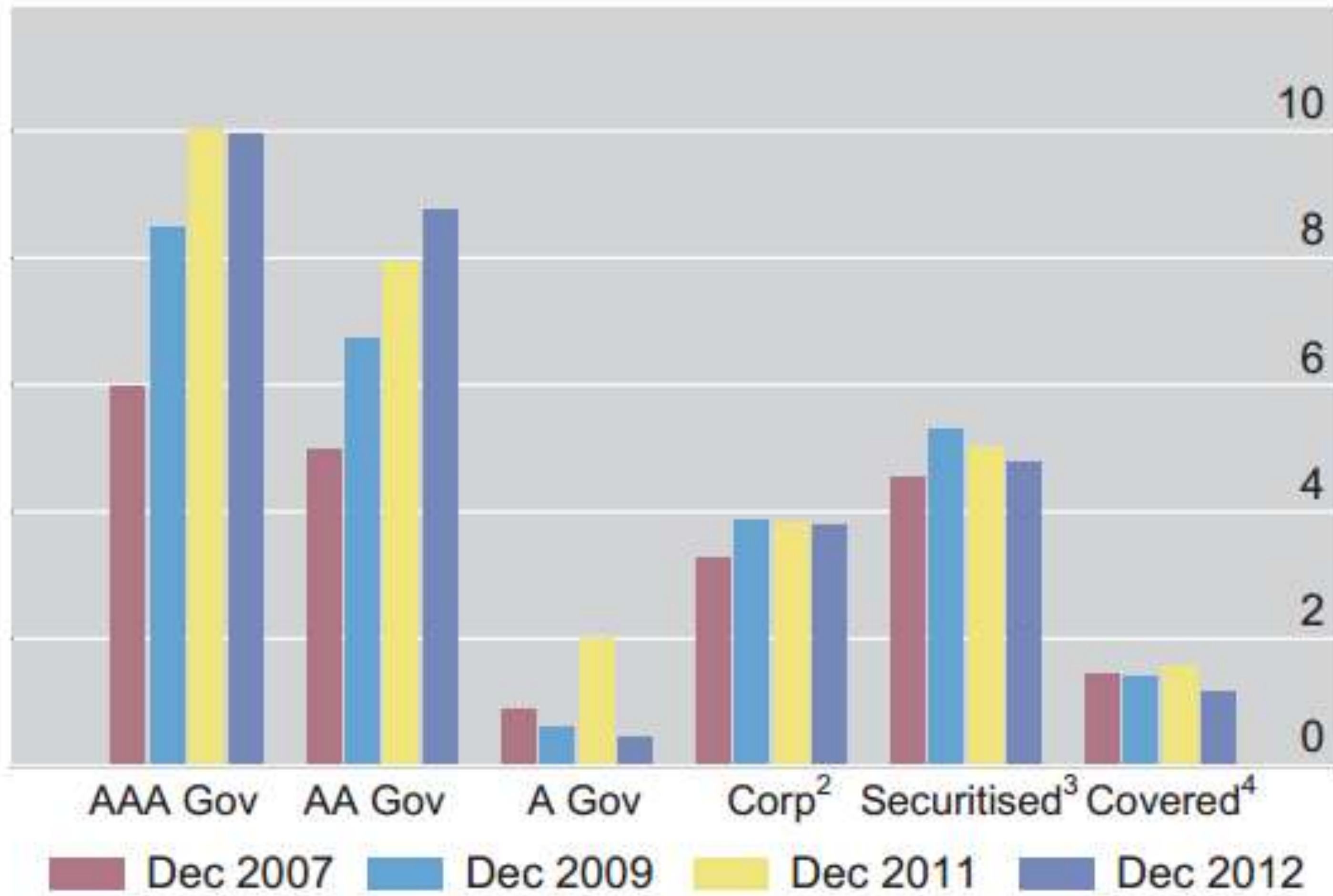
Loans as a % of total assets

Source: Slovik (2012)



Meanwhile, on a balance sheet near you…

Outstanding amounts by asset class[1]

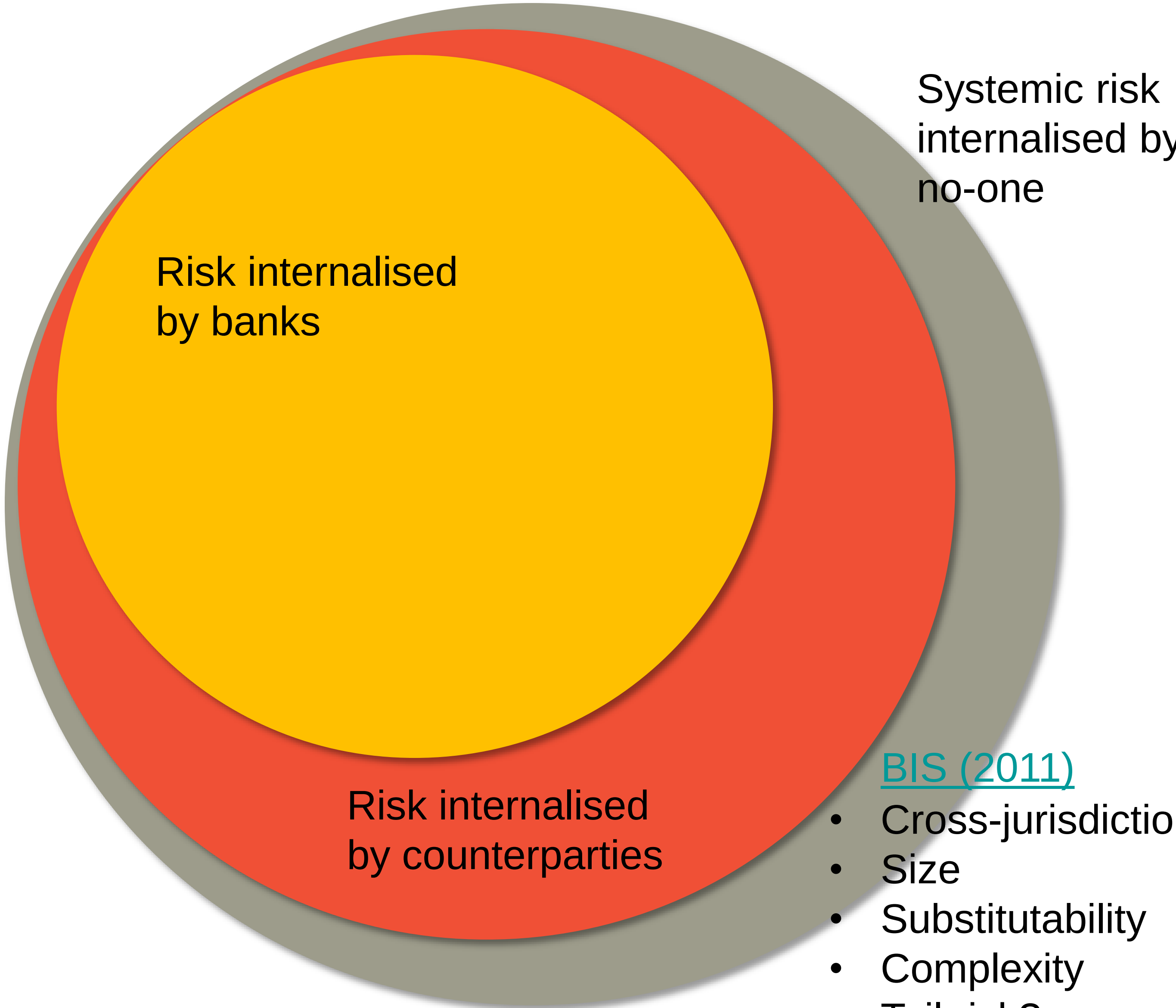


[1] Outstanding amounts with maturity greater than one year. bonds. [4] Global covered bonds.

Source: [BIS (2013)]

“We checked – SMEs *are* riskier.”

Paraphrasing EBA (2012) (a lot)



BIS (2011)

- Cross-jurisdictional activity
- Size
- Substitutability
- Complexity
- Tail risk?

“[T]*he traditional* […]*effects of capital become less powerful* […] *and restrict “skin in the game”* […] *when banks have access to tail risk projects.*

The reason is that tail risk realizations can wipe out almost any level of capital [hence] *a part of the losses is never borne by shareholders.”*

Moreover, […] *higher capital* […] *enables banks to take **higher** tail risk without the fear of breaching the minimal capital requirement in mildly bad (i.e., non-tail) project realizations.*

Perotti et al (2011) (emphasis mine)

What is more dangerous in a systemic way, that which is perceived as risky or that which is perceived as not risky?

Per Kurowski, Former Executive Director at the World Bank

A REFRESHER

- Basel is still not a complete framework; criticism is mainstream – but there's too much political capital invested

- Most impacts will be through changes in banks' *business models*, esp. if banks are given too long to comply.

- Risk weights are deeply problematic, as is the over-reliance on capital.

Thank you!

ACCA