

WSBI and ESBG



**“The impact of Basel III to SME lending”**

**FEE Round Table**

**Access to Finance for SMEs and the  
Economic Recovery** - *Challenges and Creative  
Solutions*

**13 October 2010**



**WSBI**



**ESBG**

# Overview

- 1) Status quo of prudential regulation
- 2) Steps towards 'Basel III' (and 'CRD IV')
- 3) Key features of 'Basel III' and implications for lending to SMEs

# Who does ESBG represent?

- ESBG (European Savings Banks Group) is an international banking association that represents a large part of the European retail banking sector:
  - 29 members from 26 countries, comprising approximately 880 individual savings and retail banks
  - These institutions operate 84,000 branches and employ 925,000 people
  - Total assets of ESBG members amounted to €6,062 billion (January 2008)
- ESBG members: different business models and organizational structures; generally traditional approach to retail banking
- ESBG members have in common the '3 R': Retail, Regional, Responsible
- ESBG represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

# 1) Status quo of prudential regulation

- Current regulatory regime: **Basel II** (2004)  
(EU implementation via **Capital Requirements Directive** (CRD, 2006))
- Basel II replaced Basel I (1988)

<b>1988: Basel I</b>	<b>2004: Basel II</b>
Focus on Single Measure (Capital)	Three Pillars
One Size Fits All	Menu of Approaches
Broad Brush	Greater Risk Sensitivity

# 1) Status quo of prudential regulation (Basel II)

## Capital Adequacy

$$\frac{\text{Total Capital}}{(\text{Market Risk} + \text{Credit Risk} + \text{Operational Risk})} \geq 8\%$$

### PILLAR 1

**Minimum  
Capital  
Requirements**

**Rules  
To Calculate  
Required Capital**

### PILLAR 2

**Supervisory  
Review  
Process**

**Increased  
Supervisory  
Power**

### PILLAR 3

**Market  
Discipline  
Requirements**

**Increased  
Disclosure  
Requirements**

## 2) Steps towards 'Basel III' (and 'CRD IV')

2009: G 20 London and Pittsburgh: cornerstones of global reform, implementation by **2012**

Summer 2010: Proposals: "countercyclical buffers" & "capital loss absorbency" + '**Basel III update**'

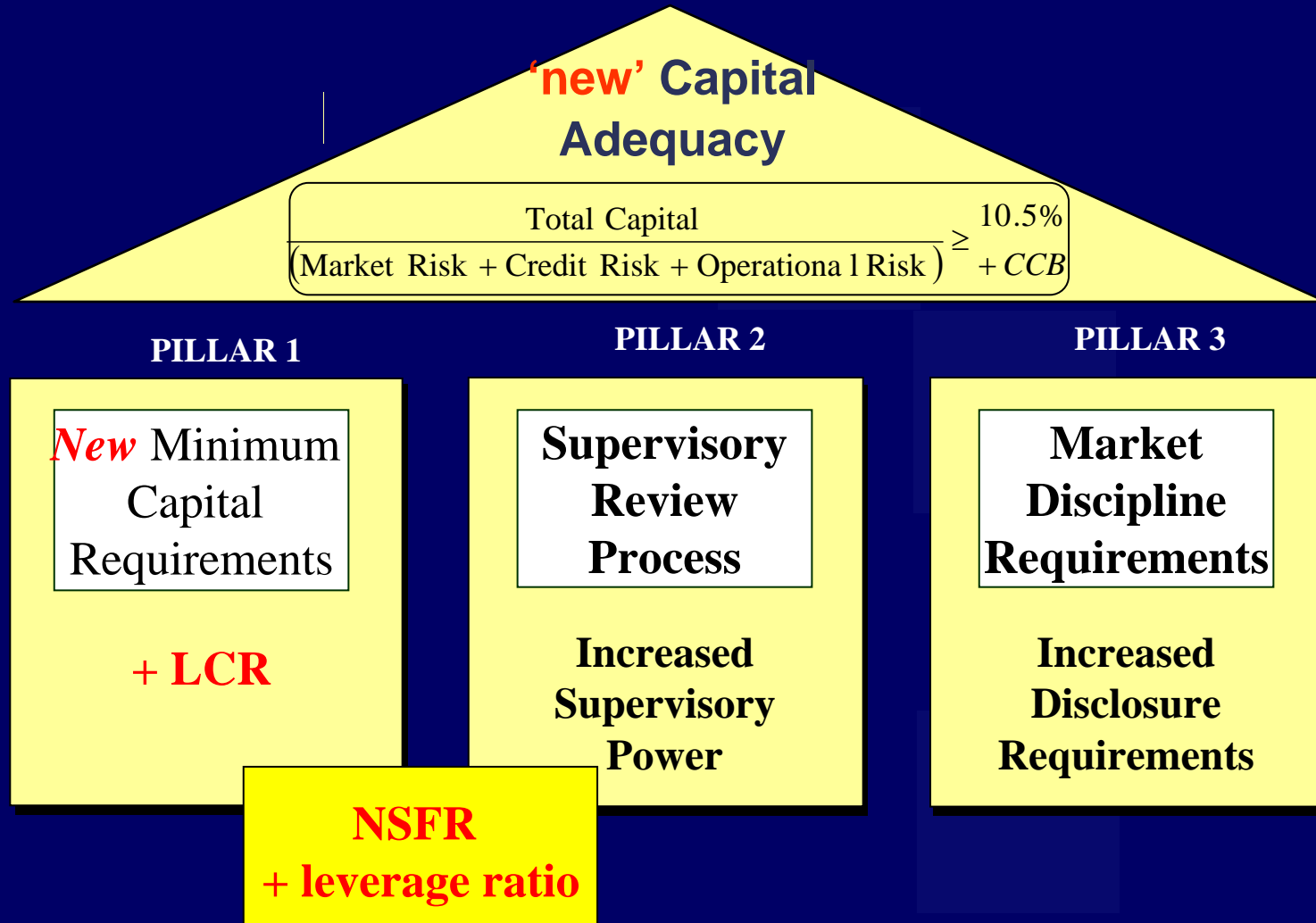
November 2010: G 20 to agree with '**finalized Basel III**' + on SIFIS



December 2009: '**Basel III**' proposals and consultation

12<sup>th</sup> September 2010: Announcement of '**Basel III capital requirements**' and '**Basel III timetable**'

## 2) Steps towards 'Basel III' (and 'CRD IV')



## 2) Steps towards 'Basel III' (and 'CRD IV')

**EU Commitment: implementation of 'Basel III' in the EU by 2012**

→ **revision of the Capital Requirements Directive (i.e. 'CRD IV')**

*So far:*

- **February 2010: European Commission (DG MARKT) initialises work:**
  - **'CRD IV' consultation: 'Basel III' (December 2009 version) + consultation on addressing systemically important financial institutions + steps towards a Single Rulebook**
- **September 2010: European Parliament (ECON) adopts own initiative Report on 'Basel III'/'CRD IV', Rapporteur MEP O. Karas (EPP/Austria)**

*Upcoming:*

- **End 2010: EC consultations on countercyclical capital buffers and SIFIs**
- **Early 2011: Legislative proposal for 'CRD IV'!**



### 3) Key features of 'Basel III' and impact on lending to SMEs

Note: Basel Committee 'target group': large internationally active banks

From a (traditional) retail banking perspective and with view to SME lending: which proposals matter the most?

- 1) Definition of capital
- 2) Liquidity requirements
- 3) Leverage ratio
- 4) Countercyclical measures

# 3) Key features of 'Basel III' and impact on lending to SMEs

## 1 - Capital:

- ❑ December 2009: much **stricter definition of capital** aimed at improving the quality and consistency of the **common equity element of Tier 1 capital**
- ❑ July 2010 agreement: Retention of most of the definition of capital proposals

## Quantitative requirements

- ❑ Total minimum requirements remain at 8%, within which
  - Tier 1: at least: **4.5 %** of 'new' core Tier 1 capital (common equity) + **1.5%** (non-core Tier 1) +
  - Remainder **2%** Tier 2 capital
- ❑ Additional requirement to hold a capital conservation buffer in form of common equity of **2.5%** to withstand future periods of stress

- ***Hence: Total common equity requirements increased to 7% and total required capital increased to 10.5% (inc. non-core Tier 1 + Tier 2 capital)***
- Additional requirement to build a counter-cyclical buffer (0%-2.5%) will be implemented according to national circumstances.

## Timetable:

- **1 Jan. 2013 - 1 Jan. 2015:** Phasing in of minimum common equity and Tier 1 requirements.
- **1 Jan. 2016 – End 2018:** Phasing in of capital conservation buffer (will become fully effective on 1 Jan. 2019).

# 3) Key features of 'Basel III' and impact on lending to SMEs

## 2 - Leverage ratio

- **Envisaged:** 3% minimum Tier 1 leverage ratio in Pillar 1 (**i.e. Assets  $\leq$  33.33 x Tier 1 Capital**)
  - Uniform conversion factors for off-balance sheet items;
  - netting of derivatives (consistent conversion into 'loan equivalent' amount);
  - calculation on a quarterly basis.
- *Time table:*
- transition and assessment period:
  - Supervisory monitoring from January 2011;
  - 'parallel run period' from 2013 onwards;
  - bank level disclosure from 2015;
  - Final adjustments first half of 2017.
- Migration to Pillar 1 treatment foreseen for January 2018

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## 3 - Liquidity: 2 new regulatory standards (short run and long run)

### ii) Liquidity Coverage Ratio (LCR)

Stock of high quality liquid assets  $\geq$  'Stressed' net cash outflows (30-day period)

□ Stock of high quality liquid assets ('buffer')  $\approx$

cash, central bank reserves, sovereign debt & other public sector debt (best quality)

*and, at a maximum of 40%*

sovereign debt & other public sector debt (lesser quality), good quality corporate bonds (non-financials) and covered bonds (not self-issued) [15% haircut]

□ Net cash outflows: outflows – inflows expected for stress scenario

*Note: some recalibration since December 2009 proposals!*

*Timetable:*

□ Observation period from 2011 onwards

□ **Introduction as a minimum standard in January 2015**

# 3) Key features of 'Basel III' and impact on lending to SMEs

## ii) Net Stable Funding Ratio (NSFR):

Available amount of stable funding (ASF) > Required amount of stable funding (RSF) over 12 months stress scenario

*Where:*

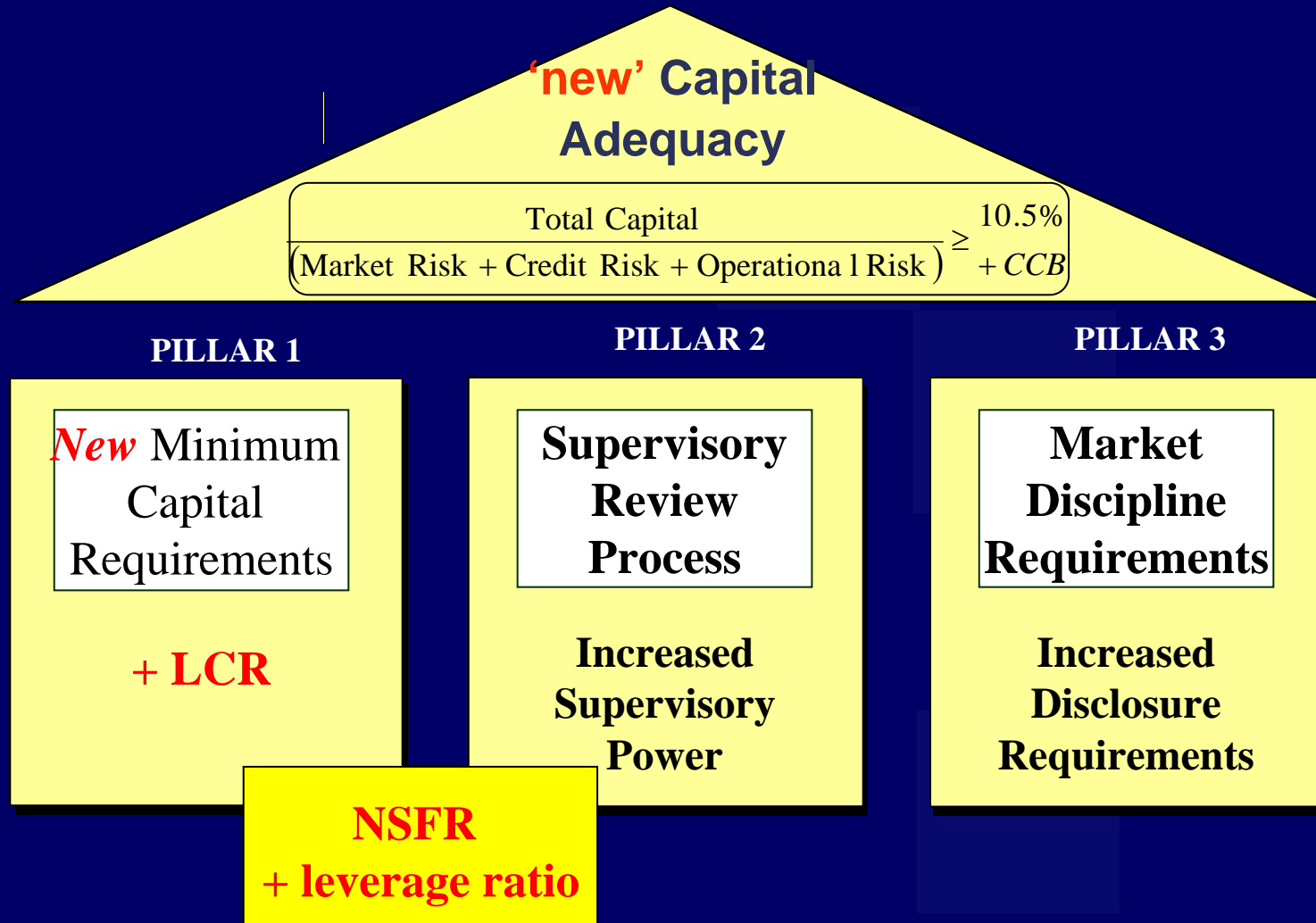
- ASF  $\approx$  capital, preferred stocks ( $m > 1y$ ), borrowing and liabilities ( $m > 1y$ ) + [with haircuts] other retail and wholesale deposits
- Required funding:
  - Low RSF  $\approx$  cash, securities ( $m < 1y$ ), loans to FIs ( $m < 1y$ )
  - High RSF  $\approx$  corporate and covered bonds, equity securities (ratings dependent, with  $m > 1y$ ), loans to retail clients and to non-financial corporate clients (all maturities), gold, all else.

*Note: Revision of December 2009 proposals announced !*

*Timetable:*

- Revised proposals announced for end 2010
- Observation period from 2012 onwards
- **Introduction as a minimum standard in January 2018**

# 3) Key features of 'Basel III' and impact on lending to SMEs



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## Effect on SME lending

- as yet not quantifiable given cumulative effects, unpredictable market developments...
- Depends on:
  - Banks ability to raise sufficient capital to fulfill new requirements
  - Liquidity requirements, where LCR may put stress on liquidity lines to SMEs and 'buffer' may absorb balance sheet capacity, and NSFR (especially if Pillar 1) may put liquidity constraints on illiquid long-term commitments to the real economy (i.e. SMEs)
  - Leverage ratio: introduction as a backstop
  - Countercyclical buffer also can become critical

***Retail banking not in the focus of Basel III – yet:***

***Risk of collateral damages for retail banking activities and SME lending!***



**Thank you very much for your  
attention!**