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CBI response to the Basel Committee

Strengthening global capital and liquidity requirements

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CBI supports the objectives of capital reform proposals detailed by the Basel Committee but is concerned that impacts on business and the wider economy are not being adequately considered.

Introduction

The CBI believes that capital reforms are a key element of the regulatory reform agenda being discussed by policy-makers in the wake of the financial crisis.

We believe the key objective of international reform efforts should be the better management of systemic risk and that capital requirements are an important tool in achieving this.

However, as just one element of a wider programme of policy reforms, we are increasingly concerned that no coordinated assessment of the cumulative impacts reforms will have on the ability of financial services to support business has yet been completed.

This briefing aims to provide the Basel Committee with a strategic overview to compliment the detailed technical submissions from individual firms and trade bodies.

Reform agenda

The broad cross section of UK business that the CBI represents recognises that major financial sector reform is essential to restore confidence in the wider economic system.

However of increasing concern is how the detail of reforms being proposed at international, European and national level will impact the role of financial services to the economy.

The calibration and timing of requirements must be consistent with the role we want financial services to perform.

The industry acknowledges that the status quo is not an option. But policy-makers need a clear focus on what reforms are designed to achieve and what mix of proposals will best deliver this.

We believe that the twin objectives must be better management of systemic risk, delivered in a way that is consistent with promoting sustainable economic growth.

In considering reform we believe that the role of supervision needs greater emphasis, especially around risk management rather than the assumption that more regulation is the only answer.

We would also argue that in addressing the issues arising from the financial crisis focus must be given to failings beyond the financial sector including global macro imbalances and the role of central banks.

In assessing proposals we will apply three key principles:

1. They must deliver better management of systemic risk, to reduce the economic impact and exposure of the public purse in the event of financial failure.
2. They must enable financial services to support businesses and consumers. Timed and phased to be consistent and supporting of economic recovery.
3. They must be designed in a way that doesn't distort the level playing field, so as not to damage the UK's standing as a global financial centre.

Global capital and liquidity requirements

The proposals set out in the consultation documents issued by the Basel Committee in December 2009 aim to strengthen global capital and liquidity regulations with the goal of promoting a more resilient banking sector.

The objectives of the Committee to improve the quality, consistency and transparency of the banking sectors capital base and introduce liquidity standards to increase resilience are widely supported across the industry.

However key concerns remain on the details of proposals being put forward.

Key proposals and CBI view

We summarise the key elements of proposals with our concerns over potential impacts:

Raise minimum capital levels, especially for large, internationally active banks.

We are supportive of international standards for improved capital in the banking sector, and agree that the quality, consistency and transparency of capital should be raised. However we believe that level of risk rather than size should be the key determining factor. It should be acknowledged that much has already been done in the UK to increase capital levels.

Increase risk coverage to include counterparty risk exposures resulting from derivatives, repos and securities financing, as well as already announced trading book and securitisation measures.

We support the principle of increased risk coverage by the capital framework but are concerned that without very careful calibration some products and services provided to businesses will become uneconomic. For example derivatives are widely used by business to manage risk, so their repricing will inevitably have substantial impacts on business users.

Businesses will need considerable time to adapt to such changes and the potential impact on the wider economy in terms of levels of investment, overseas activity and jobs could be severe.

Migrate to a Pillar 1 liquidity ratio, harmonised internationally and adjusted for accounting differences

The principle of a leverage ratio is correct but only as a supervisory tool, based on business model and risk, rather than a prescriptive one-size-fits-all measure. It would be a mistake to create an over reliance on standard quantitative measures.

There is widespread concern that the miscalibration of liquidity ratios will lead to a substantial reduction in the availability of finance to business and the economy. Also that they could create inappropriate incentives by encouraging the

use of off balance sheet vehicles and a move towards higher risk assets.

Countercyclical measures to dampen impact of economic shocks

We support the concept of a countercyclical capital framework as a means of preventing further shocks but the detail needs proper calibration and coordination to prevent double-counting in markets already operating some measures.

Minimum liquidity standard for internationally active banks including 30-day liquidity coverage ratio and framework for supervision of liquidity risk

We would call for further research on the impacts of minimum liquidity standards, as there is potential for unintended impacts on economic conditions if liquidity is tied up in the banking system.

Recommendations

We believe that the Basel Committee approach is the correct way to better manage systemic risk in the global financial services system, as reforms must be seen in an international context.

However, we believe the current proposals require further amendments and that the timescales need to be adjusted so that detailed impact assessment work to correctly calibrate measures can be done. Failure to do this risks limiting the ability of banks to maintain services to businesses and so impact economic recovery.

We would also urge that consideration must be given to how improved supervision will play a greater role. In particular we believe addressing failings in risk management should form a substantial part of the coordinated response to the crisis. We don't think too much emphasis on prescriptive rules will address issues of systemic risk.

As previous experience has demonstrated the Basel Committee must be sensitive to the markets reactions to its communications. We would request going forward a no-surprises regime, with a clear and realistic route-map for implementing recommendations as global markets remain fragile and sensitive to shocks.

Concluding remarks

In providing its response to the Basel Committee's consultation on global capital and liquidity requirements the CBI has deliberately steered away from detailed commentary of specific technical proposals. Instead we have sought to emphasise the significant consequences on businesses and the wider economy of proposals being considered for the banking sector. We urge policymakers to take a cumulative view of proposals to prevent unintended consequences on the economy.

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