BANK FOR INTERNATIONAL SETTLEMENTS

Building a resilient financial system

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Principles

- Resilience ↔ buffers, solid infrastructure, strengthened resolution
- Regulation is one part of a wider macrofinancial stability framework
- Global system ↔ global rules
- Stay focused on the objectives:
  - Less leverage (= more high-quality capital)
  - Better liquidity management
  - Less moral hazard ↔ market discipline
  - Stronger oversight
  - More transparency

The macrofinancial stability framework

Macroeconomic policies

Monetary policy
- More symmetrical response
- Consider financial stability in setting monetary policy

Fiscal policy
- Sustainable fiscal positions
- Fiscal policy and credit cycles

Other policy areas

Consumer protection

Financial infrastructure

Prudential policies

Macroprudential
- Reduce common exposures and interconnectedness
- Mitigate procyclicality

Microprudential
- Improve risk capture
- Strengthen capital and liquidity buffers
- Enhance transparency

Financial system stability

Risk-taking of institutions

Riskiness of instruments

Resilience of institutions, markets and infrastructure

Enforcement and monitoring

Proactive supervision
- Pillar II
- Supervisory intensity and effectiveness

Market discipline
- Prevent moral hazard
- Transparency
- Accounting rules
- Market integrity

Monitoring systemic risks
- Macroprudential authorities
- Financial stability reports

Bank resolution
- Bankruptcy regimes
- “Living wills”
- Key attributes of effective resolution regimes

International cooperation

- G20
- Other standard setters
- BCBS capital surcharges
- FSB work on procyclicality
- BCBS capital and liquidity standards
- FSB/IMF Early Warnings Exercise
- FSB peer reviews
- Cross-border resolution

Challenges for 2012

- Implementation
- Managing the transition
- Completing the agenda – especially:
  - Liquidity
  - Resolution
  - OTC derivatives
  - Shadow banking
- Stronger oversight
  - Microprudential
  - Macroprudential

The Basel III reform programme – implementation

Enhanced Basel II + Macroprudential overlay = Basel III

Microprudential framework (Enhanced Basel II):

- Increase quantity and quality of capital
- Adequate risk coverage (for trading book, counterparty credit risk, securitisation)
- Enhanced risk management and disclosure
- Global liquidity standards

Macroprudential framework:

- Address stability over time (procyclicality)
    - Countercyclical capital charges
    - Capital conservation rules for stronger capital buffers
    - Dynamic provisioning
- Address stability at each point in time (system-wide approach)
    - Specific treatment for systemically important banks: systemic capital charge
- Leverage ratio

Implementation

- Basel III: more and better capital/liquidity + macroprudential overlay
- Consistency in terms of timing, adoption, enforcement, results
  - Review of risk-weighted assets
- The countercyclical buffer
- The SIFI framework
- Monitoring implementation

→ Basel III is a minimum standard!

Implementation: from Basel II to Basel III

As a percentage of risk-weighted assets	Capital requirements							Additional macroprudential overlay	
	Common equity			Tier 1 capital		Total capital		Counter-cyclical buffer	Additional loss-absorbing capacity for SIFIs
	Minimum	Conservation buffer	Required	Minimum	Required	Minimum	Required	Range	
Basel II	**2**			4		**8**			
Memo:	*Equivalent to around 1% for an average international bank under the new definition*			*Equivalent to around 2% for an average international bank under the new definition*					
Basel III New definition and calibration	**4.5**	2.5	**7.0**	6	8.5	**8**	**10.5**	0–2.5	1–2.5%

10.5% — 15.5%

Implementation: a lengthy phase-in timetable

	2011	2012	2013	2014	2015	2016	2017	2018	As of 1 January 2019
Leverage ratio	Supervisory monitoring		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015				Migration to Pillar 1		
Minimum common equity capital ratio			3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital conservation buffer						0.625%	1.25%	1.875%	2.50%
Minimum common equity plus capital conservation buffer			3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from CET1				20%	40%	60%	80%	100%	100%
Minimum tier 1 capital			4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum total capital			8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum total capital plus conservation buffer			8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Capital instruments that no longer qualify as non-core tier 1 capital or tier 2 capital	Phased out over 10-year horizon beginning 2013								
Liquidity coverage ratio	Observation period begins				Introduce minimum standard				
Net stable funding ratio		Observation period begins						Introduce minimum standard	

Implementation: the Basel III framework

New capital ratios

- Common equity
- Tier 1
- Total capital
- Capital conservation buffer

Raising the quality of capital

- Focus on common equity
- Stricter criteria for Tier 1
- Harmonised deductions from capital

$$\text{Capital ratio} = \frac{\text{Capital}}{\text{Risk-weighted assets}}$$

Enhancing risk coverage

- Securitisation products
- Trading book
- Counterparty credit risk

Macroprudential overlay

Leverage ratio

Mitigating procyclicality

- Countercyclical buffer
- Capital conservation rules

Mitigating systemic risk

- Systemic capital surcharge for SIFIs
- Supervisory intensity and effectiveness
- Infrastructures

Monitoring implementation

- BCBS
  - Progress reports
  - Peer reviews
  - Thematic reviews
    - Risk-weighted assets
- FSB
  - Coordination framework
  - Peer reviews
  - Thematic reviews

Managing the transition

- Do we really want to be doing this when global growth is still weak?
- The Macroeconomic Assessment Group (MAG)
  - Growth impact should be modest
  - Longer transition ↔ lower growth impact
- The Long-term Economic Impact (LEI) study
  - Benefits significantly outweigh costs

Completing the agenda

- Liquidity
- Resolution
- OTC derivatives
- Shadow banking

Completing the agenda: liquidity

- Objectives
  - Increase resilience to liquidity shocks
  - Increase banks' internal recognition of the liquidity risks and encourage appropriate pricing
  - Stability of funding, consistent with assets and business model
  - Reduce dependence on public sector support in times of stress
- What is expected of banks?
  - lengthen term of their funding
  - Improve their risk profiles
- The aim is not simply to hold more liquid assets

Completing the agenda: liquidity ratios

- Liquidity coverage ratio (LCR)

$$\frac{\text{Stock of high-quality liquid assets}}{\text{Net cash outflows over a 30-day period}} \quad > 100\%$$

- Net stable funding ratio (NSFR)

$$\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} \quad > 100\%$$

Completing the agenda: resolution

- Authorities should have broad intervention powers
- Cooperation across agencies and borders
- The key attributes
- Implementation
  - Resolvability assessments
  - Recovery and resolution plans
  - Crisis management groups
  - Cross-border cooperation agreements
- A tight timetable
  - Peer review of implementation by mid-2013
  - Resolvability assessments and RRPs for the largest G-SIBs by end-2012

Completing the agenda: OTC derivatives

- Standardised derivatives should be traded on an exchange and cleared through a CCP
- Derivatives trades to be reported to trade repositories
- Lower capital requirements for centrally cleared instruments
- Safeguards to ensure the robustness of the global clearing architecture
  - Supervisory cooperation
  - Liquidity arrangements for CCPs
  - Fair and open access
  - Resolution

Completing the agenda: shadow banking

- Regular monitoring
- ➢ Three-step approach
  1. Map the overall shadow banking system
  2. Narrow down the focus to potentially risky sectors/activities/instruments
  3. Assess the systemic risk
- ➢ Yearly exercises
- Regulatory responses
  - Interaction with banks
  - Money market funds
  - Securitisation
  - Repo markets
  - Other shadow banking entities

Proactive oversight

- Macroprudential oversight
- Enhanced microprudential supervision