Christian Noyer: Basel III – CRD4: impact and stakes

Introductory speech by Mr Christian Noyer, Governor of the Bank of France and Chairman of the Board of Directors of the Bank for International Settlements, at the Autorité de contrôle prudentiel (ACP) conference, Paris, 27 June 2012.

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Ladies and gentlemen,

I am delighted to welcome you today to this new conference organised by the Autorité de contrôle prudentiel (ACP). This morning, the conference will be dedicated to the impact and stakes of the Basel III reform and, this afternoon, to the supervision of business practices in banking and insurance. I would like to thank all the participants for the interest they have shown in these crucial exchanges between regulators, supervisors and market participants.

This conference is being held against the backdrop of an economic and financial environment that remains very difficult, characterised in particular in Europe by the ongoing sovereign debt crisis. Many questions surround the future of the European banking system, which has already undergone major transformations in the recent period while significant changes in its prudential framework and the organisation of its supervision are currently being reviewed. Far from putting on the back burner questions concerning Basel III and its application in Europe, that is to say CRD IV and its project to create a "single rule book" for European banks, I believe, on the contrary, these developments underscore the importance of better understanding the current reform and taking time to reflect, in order to ensure that the new framework for banking regulation and the distribution of supervisory responsibilities in Europe will deliver all their expected benefits.

Before leaving you to discuss in greater detail the impact and stakes of the Basel III reform, I would like to make a few remarks on this topic in relation to the current environment.

1. Basel III and CRD IV represent a quantitative and qualitative leap aimed at addressing the shortcomings highlighted by the current financial crisis

First, I believe that it would be useful to rapidly place the Basel III reform in its context, in order to fully understand its scope.

Basel III is first and foremost a response to the financial crisis that started in 2007. This crisis and the subsequent wave of shocks to the banking system have not merely resulted in a temporary loss of output for the major advanced economies. They have also had a lasting impact on employment, industrial production, the confidence of investors and households, and needless to say on public finances, which make crisis exit even more difficult. In response to these developments, the international community adopted in 2009, under the impetus of the G20, an ambitious reform programme including Basel III, which is a key element for the banking sector. Indeed, a banking system that is more robust as a whole and capable of absorbing major shocks is vital to avoid the repetition of such chain reactions in the future. In this respect, despite the delay in the reform agenda in the United States, Europe must clearly press forward: the credibility of our banks and our economies is at stake.

Basel III is naturally based on Basel II which establishes the current capital adequacy rules. However, Basel III goes further than merely changing and updating the existing rules.

– Basel III indeed considerably strengthens the capital requirements that banks must meet, but this reform is more extensive in that it significantly enhances the prudential framework: in addition to capital requirements, it establishes liquidity requirements, and a leverage ratio is set to be introduced in the medium term. From this point of view, Basel III is a far-reaching reform of banking regulation.

– Furthermore, and most importantly, I believe that Basel III is a major step forward in that it leads to a much closer interaction than has been the case to date between the individual supervision of banks, known as microprudential supervision, and the overall supervision of the banking and financial system, or macroprudential supervision. This broader view of banking supervision, taking account of all its facets, translates into a number of provisions and notably introduces additional capital buffers (a capital conservation buffer, a countercyclical buffer and a buffer for systemically important financial institutions) in excess of the regulatory minimum.

Basel III therefore represents a quantitative and also a qualitative leap. Given the magnitude of the changes to be made, Basel III has major repercussions on market participants, who must adapt to this new environment. These repercussions are both anticipated and desirable, but the potentially negative consequences of this reform must be kept to a minimum. In this respect, many associated risks were highlighted during its drafting and even more so recently, due to the current economic and financial difficulties. These included the risk of a rise in the cost of credit or of a credit crunch. Hence, the impact and stakes of Basel III must be carefully analysed and addressed.

2. The difficult economic environment stresses the importance of implementing Basel III in an appropriate manner but does not call into question the rationale of the reform

Without playing down the potential risks associated with the implementation of Basel III, to which the ACP pays close attention, I believe that this reform can be successfully implemented. Allow me to mention some reasons for this conviction and offer some avenues for actions:

– First, French banks, which have complied with Basel 2.5 rules since December 2011, are in a strong position to meet the new capital adequacy requirements when they come into force. Moreover, French banks are ahead of the Basel III schedule. Currently with Core Tier 1 capital ratios of over 9%, the main French groups demonstrate their ability to meet the European Banking Authority deadline of 30 June 2012. They should also fully comply with the new Basel III requirements by 2013.

– The ACP is closely monitoring credit institutions' preparations for Basel III. By doing so, any problems can be identified at an early stage and issues relating to its implementation can be addressed, which I believe is essential for a smooth transition. More generally, in addition to the individual monitoring of banks' preparation, coordination between supervisors and the players concerned is also important to ensure a clear understanding of the rules and identify any questions relating to the reform and their potential consequences. The ACP liaises on a regular basis with the profession on all prudential matters. Indeed, today's conference is a prime illustration of this.

– It is also essential to closely monitor and take into account the impact of the new regulations on the financial system and the economy and to assess the different interactions in order, if necessary, to deal with the unforeseen consequences of Basel III. In this respect, the ACP, which maintains close links to the Banque de France and operates under its aegis, is naturally particularly attentive to and involved in all these matters. This is why we are accompanying the prudential reform with more general and macroeconomic reflections on the financing of the economy, and in particular on credit developments and the relationship between banking regulation and monetary policy. The new liquidity ratios therefore cannot be applied as they stand as they do not take into account all their consequences and interactions beyond the prudential objectives themselves, which include in particular the functioning of the interbank market, the level of intermediation or the conditions of monetary policy implementation. I therefore believe that the work underway on the calibration of these ratios is of the utmost importance in order to properly manage all the consequences of these new rules.

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Before handing the floor to Danièle Nouy, Secretary General of the Autorité de contrôle prudentiel, I would like to conclude with a few words on recent developments in Europe. You are aware of my commitment to full harmonisation in Europe: this “single rule book” is the only way to achieve a truly efficient single market. You are also aware that the negotiations between the European Council and Parliament might reintroduce the national options that the Commission had removed. They may also, under a compromise text, render partly redundant and ineffective the responsibilities of supervisors of home and host countries, as well as those of micro-prudential and macro-prudential supervisors. In this context, I believe that the creation of a banking union is to be supported. It would be a major development for banking supervision in Europe, which would bring numerous benefits and would enable us to efficiently address the current difficulties. Such a development would most likely have very positive consequences in that it would be a step towards greater European harmonisation. Naturally, the benefits of such a reform would be more far-reaching but such questions go beyond the scope of today’s conference. Questions regarding the impact and stakes of Basel III will already give ample food for thought in the rich debates and discussions this morning.

I wish you all a fruitful conference.