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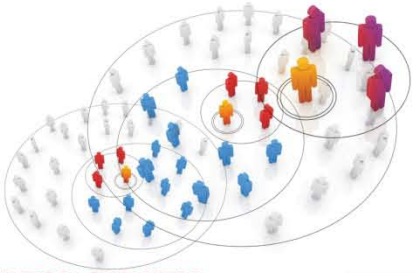

10 – 13 APRIL 2011 • HILTON SYDNEY

Comparison of Basel III Regulatory Regimes Australia, Canada and UK

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Agenda

1. Introduction to Basel III
2. Why comparison between Australia, Canada and UK
3. Key features of Basel III regimes for each country
4. Implications to banks

1. Introduction to Basel III

Introduction to Basel III

- Rationale of Basel III and sequence of events
- Building Blocks of Basel III
- Timeline of Implementation

Rationale to Basel III

- As a consequence of the financial turmoil, a large number of governmental, regulatory and industry organisations are proposing regulations and other means to ‘fix the industry’ and ‘debug the prudential framework’
- The reform targets both micro and macro-economic improvements

Rationale to Basel III

- Bank-level, or micro-prudential, regulation, which will help raise the resilience of individual banking institutions to periods of stress
- Regulation that deals with macro-prudential, system wide risks that can build up across the banking sector as well as the pro-cyclical amplification of these risks over time

Key events leading to Basel III

Regulatory overhaul

Subprime losses

Political pressure

Stakeholders
Investors, Financial Institutions, Regulators, Media, Governments

Financial Turmoil

Analysis of failure

Stabilisation

Massive Intervention

Building Blocks for Basel III

1. Strengthening of Capital Base

- The new framework focus on improvement of quality of Tier 1 with predominant form of Tier 1 must be common shares and retained earnings (4,5%)
- Tier 2 capital being harmonized and simplified; only one class of Tier 2 capital will remain
- Tier 3 capital (currently available to cover market risk requirements) eliminated
- Enhanced disclosures of capital base

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2. Enhancing risk coverage

- The framework introduces a range of measures, which are to be seen in addition to the trading book and securitisation reforms announced in July 2009 .
- Strengthening capital requirements for Counterparty Credit Risk
- Focus is on improvement of capital standards relating to EAD and collateral management in the trading book
- Further, the proposal introduces new rules relating to how to deal with external ratings and credit rating agencies

Building Blocks for Basel III

3. Introduction of an Overall Leverage Ratio

- The framework introduces an overall restriction of leverage (exposure / capital) fixed at 3%
- Aim is to reinforce the risk-based requirements with a simple, non-risk-based "backstop" measure based on gross exposure, and to harmonize the new measure internationally, fully adjusting for material differences in accounting
- The proposal defines in more detail how to deal with derivatives and commitment

4. Dealing with Procyclicality

- Dampen any excess cyclicality of the minimum capital requirement
- Promote more forward looking provisions, in line with the recent IASB proposals
- Introduce conserve capital to build buffers at individual banks and the banking sector that can be used in stress
- Protect the banking sector from periods of excess credit growth through introduction of additional capital buffers in such periods, up to 2.5%

Building Blocks for Basel III

5. Addressing Systemic Risk and Interconnectedness

- Capital incentives for banks to use Central counterparties for OTC derivatives
- Higher capital requirements for trading and derivative activities, complex securitisations and off-balance sheet exposures
- Higher capital requirements for inter-financial sector exposures
- Possible capital and liquidity surcharge for systemically important banks are still under investigation with the FSB

6. Introduction of Global Liquidity Risk Standards

- Capital requirements alone are not sufficient to promote sound risk management and basic principles of liquidity risk management reinforced through robust supervisory standards is of equal importance
- A 30-day liquidity coverage ratio is intended to promote short-term resilience to potential liquidity disruptions
- The second standard is a longer-term structural ratio to address liquidity mismatches, in order to provide incentives for banks to use stable sources to fund their activities.

	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 (including amounts exceeding the limit for DTAs, MSRs and financials)				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%	9.125%	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	

Comparison between Australia, Canada and UK

Why comparison between Australia, Canada and UK

1. Similarities in regulatory environment
2. Learning from supervisory approaches
3. Diversification opportunities for growth
4. Surge in interest in applying for banking licenses in Australia

Why comparison between Australia, Canada and UK

- At least eight foreign banks are applying for Australian banking licenses
- ‘Sound regulatory environment’ called out as a reason.


Global banks queue up for entry

Source: Australian Financial Review, 11 March 2011

Key features to Basel III

Basel III in Australia – Key features

- APRA Prudential Standards to be developed over 2011 and 2012 via industry consultation
- APRA had clearly stated that Basel III proposal represents minimum standards with no scope for national discretion
- Where Australia is above minimum standards, APRA will consider whether there is valid reasons to change policy settings

Basel III in Australia – Key features

- Australian banks are considered to be well capitalised and will be able to meet the Basel III requirements without difficulty.
- Key implication regarding the industry's ability to meet the liquidity risk requirements going forward.

Basel III in Australia – Key features

- Liquidity Coverage Ratio and requirements
- Definition of Level 1 and Level 2 assets
- Australia's unique position
- Committed secured liquidity facility with the RBA

Basel III in Canada – Key features

- A new capital guideline, reporting requirements, and possible disclosure guidance that implement Basel III in place before the end of calendar 2012, for implementation in the first fiscal quarter in 2013
- OSFI publicly stated they will require implementation of Basel III requirements on a shorter timeline that other G20 countries. They will be revising existing capital adequacy and liquidity requirements and publishing directives on Basel III in the near future.

Basel III in Canada – Key features

- Canadian banks in many cases already meet or exceed the Tier 1 capital level requirements of Basel III and well as the leverage ratio requirements.
- Migration from current Assets to Capital Multiple (ACM) to the Basel III leverage ratio.

Basel III in Canada – Key features

- The main challenge for Canadian banks:
  - Implementation of the liquidity requirements
  - Treatment of non-qualifying capital instruments under Basel III. Expected implication is to redeem, replace or run off more than C$70 billion in non-common capital by 2023.
  - Non-viability contingent capital (NVCC)

Basel III in the UK – Key features

- Same features and timeline of implementation for the UK as compared to Australia and Canada.
- The required Tier 1 capital ratio is widely expected to be higher than Basel III requirements. Tripling of current core capital has been suggested.
- Has already required UK banks to increase their capital holdings to around 10 percent after the GFC.

Basel III in the UK – Key features

- Measures to safeguard systematically important financial institutions (SIFIs) to be finalised later in the year by the Financial Stability Board – capital surcharges expected
- Regulation around the internal structure of complex cross border trading banks
- Breaking up the biggest banks not ruled out as a consideration
- Address the potential risks in the shadow banking
- Liquidity requirements

Implications to Banks

Why is Basel III a significant challenge?

- There will be some major infrastructure work, but less overall than was required to prepare for Basel II.
- There will be more strategic requirements (e.g. around business model) to assist in evaluating capital and business unit alternatives

Why is Basel III a significant challenge?

- Extent of the impact vary based on:
  - Business mix
  - strength of and depth of risk management and measurement practices
  - Existing capital structures
  - Available liquidity cushions

Transitional implications

- Optimise capital and strategically and effectively allocate capital
- Safely grow capital (in order to avoid a liquidity crunch)
- Balance regulatory requirements with business opportunities and maintenance of customer confidence
- This may include evaluation of business requirements for capital and strategic decisioning for business units (grow/acquire/exit/dispose of/merge)

Transitional implications

- Efficiently and effectively adjust policies and procedures to be aligned with the new guidance
- Develop an improved risk measurement system to calculate capital and liquidity requirements
- Refine measurement of risk adjusted performance

Potential responses

1. Governance

- Analyse the organisation's vulnerability to the measures set out in Basel III
- Themes of board independence and oversight effectiveness, gravity of risk management function in the organisation and reduction of corporate complexity as main features of future debate

2. Capital Management

Regulatory Capital

- Analyse the impacts of the new definitions of Tier 1 and Tier 2 capital and new deduction requirements
- Banks need to run a test calculation what the implementation of the new rules would mean

Leverage Ratio

- Banks should calculate their current leverage ratio under the new rules and monitor the calibration efforts of the BCBS closely

Capital Buffers

- Banks should analyze if they are operating in environments of excessive credit growth and prepare for additional capital requirements for such business activities

Potential responses

3. Risk Management

- Risk Management of treasury and trading departments should be reviewed and the impact of the new regulations on capital requirements analysed
- Credit risk management departments need to analyze the impact of the new requirements for the use of external ratings and credit value adjustments (CVA)

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4. Liquidity Management

Liquidity Risk Management

- LRM should be reviewed, as part of pillar 2 process, and strengthened in accordance with the BCBS basic principles
- Meaningful stress tests should be designed and implemented

Liquidity Ratios

- Banks should perform a pro forma calculation of the new liquidity ratios and assess the impact on business activities

Potential responses

5. Provisioning

- Banks should perform quantitative impact analysis of the expected loss methodology and monitor closely the latest developments on this front
- The level of granularity depends on the available data. Data gaps should be analysed

6. Business / Operating model adjustment

- Optimise mix of products, customers and geographies
- Cost and pricing
- Alternate risk transfer strategies to be examined

Further questions?

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