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Erste School of Banking and Finance

Group Lecture – Vienna Series – 2012

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Four years after Lehman:
Where do we stand in banking regulation?

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November, 12 2012, Event Center, Vienna

Several Crisis as Trigger for Regulatory Change

2007:US-Subprime Crisis

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2008: Global Financial Crisis

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2009: Global Recession

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2010-?: Soverign Debt Crisis

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G-20 Summit, Washington, November 2008:

All financial markets, products and participants should be regulated or subject to oversight:

Arguments for Regulation

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Correction of market failures

due to

- competitive distortions,
- Internalize externalities,
  e.g. with repsect to systemic risk, too-big-to-fail
- asymmetric information,
  e.g. consumer protection with respect to complex financial products and
- production of public goods.

General Pinciples of Financial Sector Regulation

1. Financial stability should be increased!

2. Benefits of regulation should exceed cost!

„Old World“ of Financial Stability

- Basel II (better risk management)
- Supervision based on systemically importance,
- Deposit guarantee schemes to prevent bank-runs
- Central banks as lender of last resort to prevent liquidity crisis.

„New World“ of Financial Stability: A Little Bit More Complex!

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- FSB (G-20) agenda
  - Building resilient financial institutions – Basel III
  - Ending to-big-too fail (resolution and G-SIFIs)
  - Strengthening oversight and regulation of the shadow banking sector
  - Creating core markets by OTC reform
- Correction of adverse incentive structures (salaries of bank managers, securitization, rating agencies)
- Separation of retail and investment banking (Volcker,Vickers, Liikanen)
- National efforts: e.g. OeNB sustainability package for CESEE
- Banking levies, financial transaction taxes
- Central banks as liquidity provider + supervisors (micro- and macro-prudential supervision)

Transition to Basel III

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	2011	2012	2013	2014	2015	2016	2017	2018	As of 1/1/2019
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 deduction 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				Intro. min. standard				
Net stable funding ratio		Observation period begins						Intro. min. standard	

\)* Phase-in arrangement (shading indicates transition periods) (all dates are as of 1 January)

Global Systemically Important Banks*)

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Last Update: FSB November 2012

Bucket (capital add-on)		G-SIBs in alphabetical order within each bucket
5	(3,5%)	empty
4	(2,5%)	Citigroup, Deutsche Bank, HSBC, JP Morgan Chase
3	(2,0%)	Barclays, BNP Paribas
2	(1,5%)	Bank of America ,Bank of New York Mellon, Credit Suisse, Goldman Sachs, Mitsubishi UFJ FG , Morgan Stanley Royal Bank of Scotland, UBS
1	(1,0%)	Bank of China , BBVA, Groupe BPCE, Group Crédit Agricole, ING Bank, Mizuho FG, Nordea, Santander, Société Générale, Standard Chartered, State Street, Sumitomo Mitsui FG, Unicredit Group, Wells Fargo

*) Additional loss absorbency requirements for G-SIBs will be phased in starting from 2016, initially for those banks identified as G-SIBs in November 2014.

The Liikanen Report: Neither Fish Nor Fowl

1. Ringfencing of trading:
   if trading assets exceed €100 bn or 15-25 % of total assets

   But: trading entity and “retail bank” remain parts of the same banking group!

2. Resolution management

3. Build-up of new bail-in instruments

4. More robust risk-weights

5. Further improvement of corporate governance

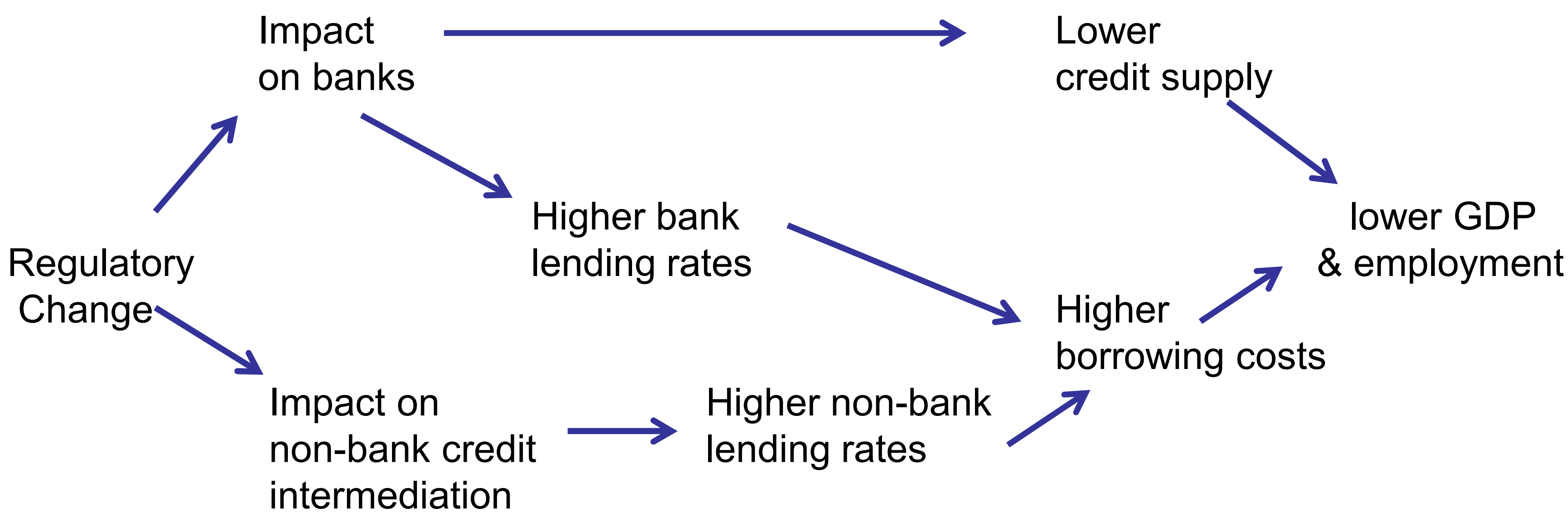
EU Banking Union: Will Take Time

1. Centralised EU banking supervision under the guidance of the ECB (likely start January 2014) with opt-ins for EU members outside the euroarea

2. EU bank resolution (and recapitalisation) mechanism – probably via ESM, framework for recovery and resolution of CI and IFI

3. Pooled deposit guarantee fund: opposition of Savings and Cooperative Banks in Germany and Austria.

Transmission Channels of New Regulations on Real Economy



Source: IIF, 2012

Impact of Regulatory Change (1)

(differences between base and central regulatory change scenario)

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	2011-2015	2011-2020
Real lending rates (basis points)		
US	468	243
Euroarea	291	328
Japan	202	181
G-3 (GDP-weighted)	356	265
Core-Tier 1 capital , (US$ bn,)		
US	161	70
Euroarea	695	386
Japan	166	173
G-3	1022	629

Source: Institute of International Finance, Washington, September 2011

Impact of Regulatory Change (2)

(differences between base and central regulatory change scenario)

	2011-2015	2011-2020
Real GDP (cumulative in %, end of period)		
US	-2,7	-1,1
Euroarea	-3,0	-3,9
Japan	-4,0	-3,4
G-3 (GDP-weighted)	-3,0	-2,5
Employment (mio.)		
US	-2,9	0,9
Euroarea	-2,8	-4,0
Japan	-0,5	-0,4
G-3	-6,2	-3,5

Source: Institute of International Finance, Washington, September 2011

Regulators Tend to Underestimate Cost (and Overestimate Benefits)

	Regulators view (BCBS)	Banks view (IIF)
Total Cost	negligible	substantial
real GDP growth	-0,04% per year in long-run (G-20 member states)	-0,6% per year until 2015 (US, Japan, EU)
Employment	negligible	-6.2 mn jobs in G-3 until 2015
Cost/Benefit Analysis	Overall economic benefits surpass costs by far	Economic costs surpasse benefits by far

Bank Lending Under Pressure

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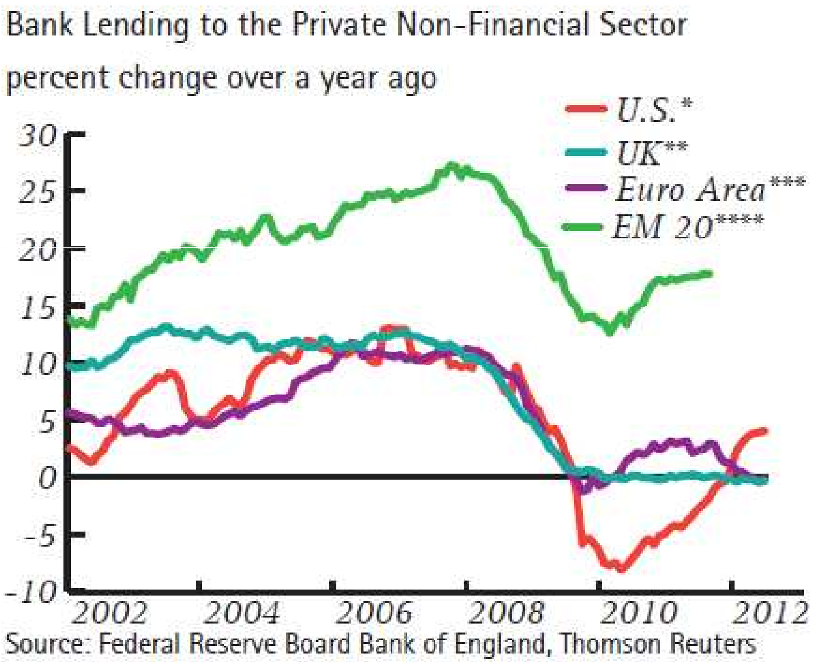

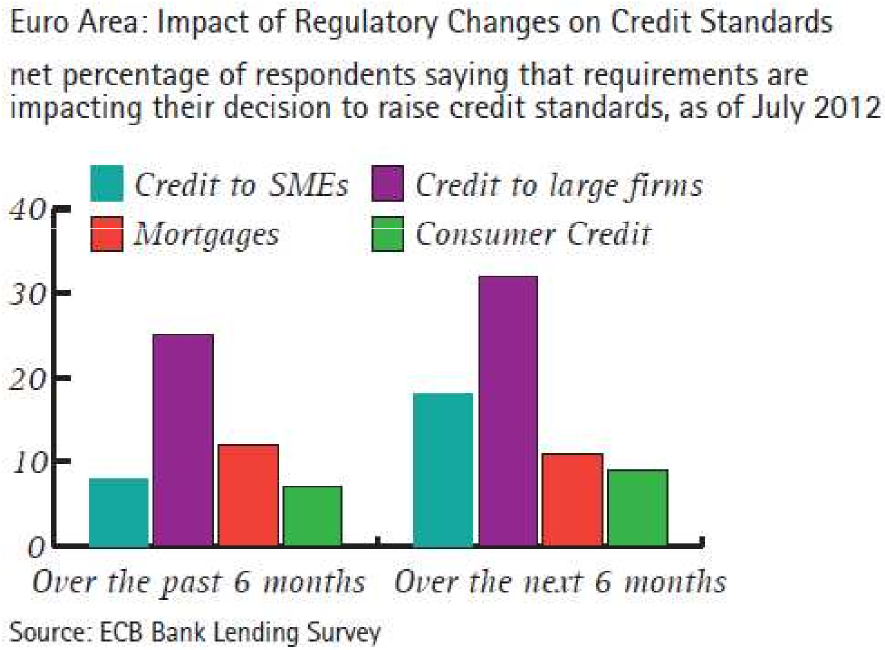

Source: IIF, 2012

More Than 200.000 Jobs Lost

Bloomberg, January 30 2012:

More than 200,000 job cuts were announced in the global financial-services industry last year and many of those will take place this year and next.
Among those chopping heads: Bank of America is cutting 34,075 employees and HSBC Holdings plans to reduce staff by 33,295. Other layoffs are in the works at Citigroup and Northern Trust, which plan about 4,500 layoffs each. That dismal news mirrors dismal fourth-quarter earnings -- thus far one-third of all financial companies have reported numbers and they are down 26 percent from the prior quarter. That's much worse than analyst expectations of a 9 percent decline.

Has New Regulation Increased Financial Stability?

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1. Not yet (see for example IMF Global Financial Stability Report 2012)

2. Supervisors tend to regulate the last crisis. But: Next crisis will be different.

3. Growth of financial regulation has far outpaced that of the financial industry. Armies of supervisors seek to discover risks and neutralize them.

4. Therefore, regulation and supervision gets more and more bulky, frequently based on complex models.

Has New Regulation Increased Financial Stability?

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5. Regulation produces more and more unintended consequences and regulatory arbitrage (regional and shadow banking system).

6. Banking and finance deals with risk (which is quantifiable) but also with uncertainty (which is not quantifiable).

7. Human beings are incapable of listing all possible futures and assigning probabilities to each one. Complex regulations demand too much – therefore, keep them simple. Less is more

8. More and better qualitity of bank capital is necessary, makes financial institutions less vulnerable – Basel III capital

Has New Regulation Increased Financial Stability?

requirements with relatively long transition periods are o.k., many other (intended) regulations (e.g. LCR, NSFR, Liikanen, bank levys, transaction tax aso.) not.

9. Most important, efficient (cross-border) resolution framework and resolution fund to end too-big-to-fail – unfortunately progress moderate.