Basel III

Updates on the current status of regulatory work

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Note: Any opinions expressed are only the presenters’ own and should not be regarded as opinions of the European Central Bank or the Eurosystem.
Outline

1. Leverage ratio
   • Objectives and original proposal (Basel III)
   • Proposed revisions (June 2013 consultative paper)
   • Reactions and open issues

2. Liquidity Coverage Ratio (LCR)
   • Objectives
   • January 2013 revisions
   • On-going work

3. Net Stable Funding Ratio (NSFR)
   • Objectives
   • On-going work
• **2 objectives:** (i) Constrain the build-up of leverage in the banking sector and (ii) reinforce the risk-based requirements with a simple, non-risk based “backstop” measure

• **Design/formula:**

\[
\text{Leverage ratio} = \frac{\text{Capital measure (Tier 1 capital according to the new definition)}}{\text{Exposure measure (on-balance sheet and off-balance sheet items)}}
\]

• **Exposure measure:**

– On-balance sheet items (accounting measure), with specific treatments for

– **Securities and Financing Transactions (SFTs), including repos:**
  Accounting measure of exposure and “Basel II netting”

– **Derivatives:** Accounting measure of exposure + Add-on for potential future exposure (PFE)

– Off-balance sheet items (OBS): Apply credit conversion factors (CCFs)
Leverage Ratio: Proposed revisions (June 2013)

• Consultative document (June 2013): Revised Basel III leverage ratio framework and disclosure requirements

• Revisions to the framework relate primarily to the exposure measure
  – Specification of a broad scope of consolidation for the inclusion of exposures: Exposure measure to be measured consistently with capital
  – Clarification of the general treatment of derivatives and related collateral: Specification of netting rules; no netting of collateral
  – Enhanced treatment of written credit derivatives: To account for notional credit exposure arising from the creditworthiness of the reference entity
  – Enhanced treatment of Securities Financing Transactions: No accounting netting; add-on for counterparty credit risk (current exposure)
Leverage Ratio: Reactions and open issues

• **Consultative ended on 20 September 2013:** 63 feedback letters received

• **Main issues:** Calibration, incentives, scope of consolidation and modalities of the calculation; the Basel Committee is currently looking into the following:
  
  – **Securities and Financing Transactions:** The required gross treatment (the ECB is currently analysing potential monetary policy implications)
  
  – **Derivatives:** Treatment of collateral and centrally cleared derivatives
  
  – **Written credit derivatives:** Maximum possible loss; eligible hedges
  
  – **Off-balance sheet items:** Introduce a more gradual treatment?
  
  – **Frequency of calculation:** Average of the 3 month-end LR over a given quarter OR simple quarter-end calculation?
  
  – **Scope of consolidation:** Prudential OR extended scope (June 2013)?
Liquidity Coverage Ratio

- **Objective:** To establish a minimum level of high-quality liquid assets to withstand an acute stress scenario lasting one month

- **Design/formula:**
  \[
  \frac{\text{Stock of high quality liquid assets}}{\text{Net cash outflows over a 30–day time period}} \geq 100\%
  \]

- **January 2013 revisions:**
  (i) inclusion of an additional level of liquid assets;
  (ii) material revisions in in- and outflow factors and (iii) a long phase-in

- **Remaining work by the Basel Committee:**
  - Disclosure framework: Starting date, Granularity, Frequency.
  - Interaction with monetary policy: Restricted-Committed Liquidity Facility
  - Market-based indicators of liquid assets: Assess options to define high-quality liquid assets based on quantitative asset characteristics

- **Work under the EBA on MBI:**
  large scale quantitative assessment; EBA public hearing suggested some important departures from Basel definition
Net Stable Funding Ratio

- **Objective:** To ensure a closer alignment of the funding of longer-term assets or activities by more stable medium or longer-term liability and equity financing

- **Design/formula:**
  \[
  \frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} > 100\%
  \]

- **Issues under discussion: general calibration of the NSFR**
  - Below 1-year bucketing
  - Encumbrance
  - Short-term matched funding
  - Derivatives

- **QIS Indications**
  - Based on 2010 NSFR Basel banks report an NSFR of 100% (42% meet 100% minimum)
Set of Monitoring Tools

- **Objective:** to complement the LCR and to further strengthen and promote global consistency in liquidity risk supervision.

- **Set of tools:**
  - Contractual maturity mismatch
  - Concentration of funding by counterparty and product
  - Available unencumbered and encumbered assets
  - By significant currency

- **Issues of on-going work under EBA**
  - Implementation time (1 January 2015)
  - Remittance period (15 days)
  - Proportionality criteria (balance sheet size and cross-border activities)