Impact of Basel III on low income housing

Nicholas Nkosi, Director : Affordable Housing,
Standard Bank of South Africa

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Regulatory Changes

Background

Regulatory Changes:

- Over the past 24 months **several banking regulatory proposals** have been announced for implementation over the next few years
- The proposals carry **substantial implications for** banking and specifically mortgages
- **Not all** regulations **impact Low income housing** but key proposals have been identified

Regulations

Summary of new South African banking-related regulations

Category	Regulation	Elements
1. Solvency & liquidity	Basel 2.5 / III	• Quality and quantity of capital, liquidity coverage, funding stability, reduce leverage
	SAM / Solvency II	• Insurance capital adequacy and risk management regulation
2. Reducing systemic risk / structural industry reform	SIFI requirements	• Heightened capital requirements for G-SIFIs and N-SIFIs
	RRPs	• 'Living wills' resolution and recovery plans in UK, US, others considering
	Transaction tax	• Financial transaction tax in Europe
	ICB retail ringfence	• Ringfencing of retail operations for UK banks (potential SA implementation)
	Dodd-Frank, Volcker, Push-out	• Separate entity for swaps on commodities ex gold/silver, equity, un-clearable CDS • US ban on prop trading, hedge funds and PE for deposit taking institutions
3. OTC derivative & market reform	OTC execution, clearing, real time Reporting, registration	• Shift standard OTC to e-trade on SEF/OTF, increase in pre-trade transparency • Mandatory central clearing for standardised OTC; capital punishment otherwise • Increase in post-trade reporting requirements, registration with data repositories
	Short selling	• Disclosures and bans (naked short selling –Fr., or under economic duress -EU)
	Commodities	• Transparency requirements, position limits
4. Investor protection	Skin in game	• Securitisation risk retention requirements in Europe and US
	Prof. investors	• Duty of care regulations for some client segments. FAIS in South Africa
	FATCA	• Tax liability reporting and compliance for US person accounts
	Regulation 28	• Amendments to Pension Funds Act to limit investment by retirement funds and members
	Intermediary exams	• Insurance intermediaries Regulatory Exams (RE1), to be completed by June 2012
	IFRS 4 Phase II	• International insurance accounting standards
5. Consumer protection	Micro-insurance	• Separate micro-insurance licence and regulation (including products and distribution)
	Debt collection	• Limits ability to collect debt - Business Rescue, Debt Review for individuals
	Treat Cust. Fairly	• Duty of care, transparency, standards for suitability of products
	Cons. Prot. Act	• Consumer protection (Mar 2011), potential extension to life ins. 2013
	Deposit insurance	• Revision of deposit insurance limits and coverage post-crises
	Interchange	• Price regulation of bank card payments
	PoPI	• Consent required for sharing and processing personal data
	Conflicts of interest	• Effective April 2011, aims to ensure providers and intermediaries act in the interest of clients
	RDR / commission	• Impacts remuneration of intermediaries (both tied agents and IFAs)
6. Adjacent regulation	Retirement reform	• National Social Security Fund, changes to occupational pensions etc.
	Health reform	• Introduction of National Health Insurance, and potentially other health reform
	SA tax reform	• Wide-ranging changes impacting insurance products and businesses
	Land reform	• Land and property reforms affecting property rights
	Transformation	• South African equality and other legislation

Regulation impacting IB

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Regulatory Changes

Background

- **Basel III** proposes the introduction of several material requirements:
  - From a **liquidity** perspective:
    - The introduction of two new liquidity ratios namely **Liquidity Coverage Ratio** (LCR) and **Net Stable Funding Ratio** (NSFR), effective from 2015 and 2018 respectively
  - From a **capital** perspective
    - The introduction of the **conservation**, **countercyclical** and **Systemically Important Bank** buffers
    - An **increase** in **the minimum capital requirement of 1%**
    - These impacts are staggered, however **full implementation** is scheduled for **2019**

Basel III

Global Adoption/Implementation – Basel III Capital Framework

- The Basel Committee on Banking Supervision met on the 13-14 Dec'12 to discuss the progress of its members in implementing the capital adequacy reforms within Basel III
- While some Jurisdictions may not have met start date, a large number will be ready to introduce capital regulations on 1 Jan'13
- The globally **agreed timelines** provide for a **gradual phasing in** of the new capital requirements
- It is expected that as remaining jurisdictions finalise their domestic guidelines they will incorporate the transitional deadlines to ensure compliance with the original global agreement.
- Furthermore where delays are evident national **supervisors are ensuring** that **internationally active banks** are, where necessary, making progress in **strengthening their capital** base
- The Basel Committee reiterated their commitment to implement the globally-agreed reforms
  - 11 member jurisdictions have **published the final set of Basel III regulations effective 1 Jan'13 (**Australia, Canada, China, Hong Kong, India, Japan, Mexico, Saudi Arabia, Singapore, **South Africa** and Switzerland)
  - 7 Other jurisdictions have issued draft regulations and are working towards finalisation
  - Argentina, Brazil, European Union, Indonesia, Korea, Russia and USA
  - Turkey will be issuing draft legislation in 2013

Basel III

Global Adoption/Implementation – Basel III Liquidity Framework

- The Basel Committee has acknowledged that the rules related to the **liquidity ratios might change** subject to the feedback obtained in the during the observation periods.
- During Jan’13, Basel announced several **amendments to the proposed LCR:**
  - **Phase-in** the LCR rule from 2015 **over four years** up to Jan 2019
  - **Widen the range of assets** banks can put in the buffer to include shares and mortgage-backed securities
  - Also agreed to **ease the "stress scenario"** for calculating the amount of liquid assets banks must hold, meaning the outflows to be covered will be lower

Basel III

Global Adoption/Implementation

USA:

Proposals contain a std and supplementary leverage ratio

Announced **intention** for US banks **to comply with liquidity ratios** but have **not yet issued** or consulted on the **details**

China/Asia:

China **capital implementation framework is stricter** than the international standard

Asia-Pacific announced **intention to comply with** the **liquidity ratios** but have **not published details**

India:

Reserve Bank of India announced the **delay of the Basel III capital implementation** by 3 months to 1 Apr'13

Europe:

EU member states will have **autonomy to increase capital requirements** by way of tackling any "bubbles"

Announced **intention to introduce** requirements for **LCR and NSFR**, however there **will be a review period** for LCR.
As of 2013, institutions will be required to have appropriate liquidity coverage
Based on the outcome of the observation period, the **European commission** will have the **power to specify the liquidity coverage requirement**

South Africa:

Intention to **fully comply with Basel regulations** with globally agreed time lines

Australia:

Accelerated implementation of Basel III capital reforms

Basel III

New Ratios Proposed

		Ratio	Objective	Mortgages	Card	Unsecured	Trans-actional
Liquidity Requirements	**Liquidity Coverage Ratio (LCR)** *1 January 2015*	$\frac{\text{Stock of high quality liquid assets}}{\text{Net cash outflows over a 30-day time period under acute stress scenario}} \geq 100\%$	Addresses the sufficiency of a buffer of high quality liquid assets to meet short-term liquidity needs under a specified acute stress scenario	• Increased marketable asset holdings	• Increased marketable asset holdings	• Increased marketable asset holdings	• Increased marketable asset holdings
Liquidity Requirements	**Net Stable Funding Ratio (NSFR)** *1 January 2018*	$\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} \geq 100\%$	Addresses extent of longer-term structural liquidity mismatch to cater for a possible extended firm specific stress scenario	• Maturity < 1 year*: 85% >1 year • Maturity > 1 year: 100% >1 year	• 85% > 1 year	• Maturity < 1 year: 85% >1 year • Maturity > 1 year: 100% >1 year	• 80% > 1 year
Capital	**Tier 1 Capital Requirements** *1 January 2013*	• **Min Tier 1 capital increases** • **Conservation buffer (2.5%)** • **SIB buffer (1-3%)** • **Countercyclical buffer (2.5%)**	• Elevated capital support • Decrease pro-cyclicality • Additional protection if systemically important institution • Takes account of macro-prudential conditions	• Material increase in capital requirements	• Material increase in capital requirements	• Material increase in capital requirements	• Material increase in capital requirements

* LTV/RW dependant

Basel III: Capital Forecasts

Key points

Implementation of capital buffers anticipated to occur incrementally over the 8 year period

On average the implementation of all the new buffers will lead to an estimated 3.75% increase in Tier 1 capital requirements"

Capital: Impact on Tier 1 Capital Requirements

Basel III: Capital Buffers

- Primary impact on the mortgage business pertains to the following components:
  - Increased min capital holding: +1%
  - New conservation buffer: +2.5%
  - New SIB buffer: +1-3% in line with capital management outlook we have forecast these levels at 1%
  - New countercyclical buffer: + 2.5% has not been incorporated given that this buffer would only arise under specific circumstances
- South African Reserve Bank (Central Bank) guidelines reflect an incremental approach to the implementation of the conservation buffer beginning in 2016
- Oct'12 SARB guidelines have seen some relaxation with regards the mix, but increases remain material

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Conclusion

- Basel III and liquidity will carry far reaching implications on the lending portfolios most notably in
    - Home Loans
    - Card
- These portfolios are influenced by the long term nature of the product offering
- Pro-active pricing management alongside innovative product offerings will be required to ensure long term lending business sustainability.
- The future of banking will see increased competition for retail transactional deposits and lending portfolio optimisation where liquidity and capital resources are carefully allocated to ensure optimal shareholder returns.