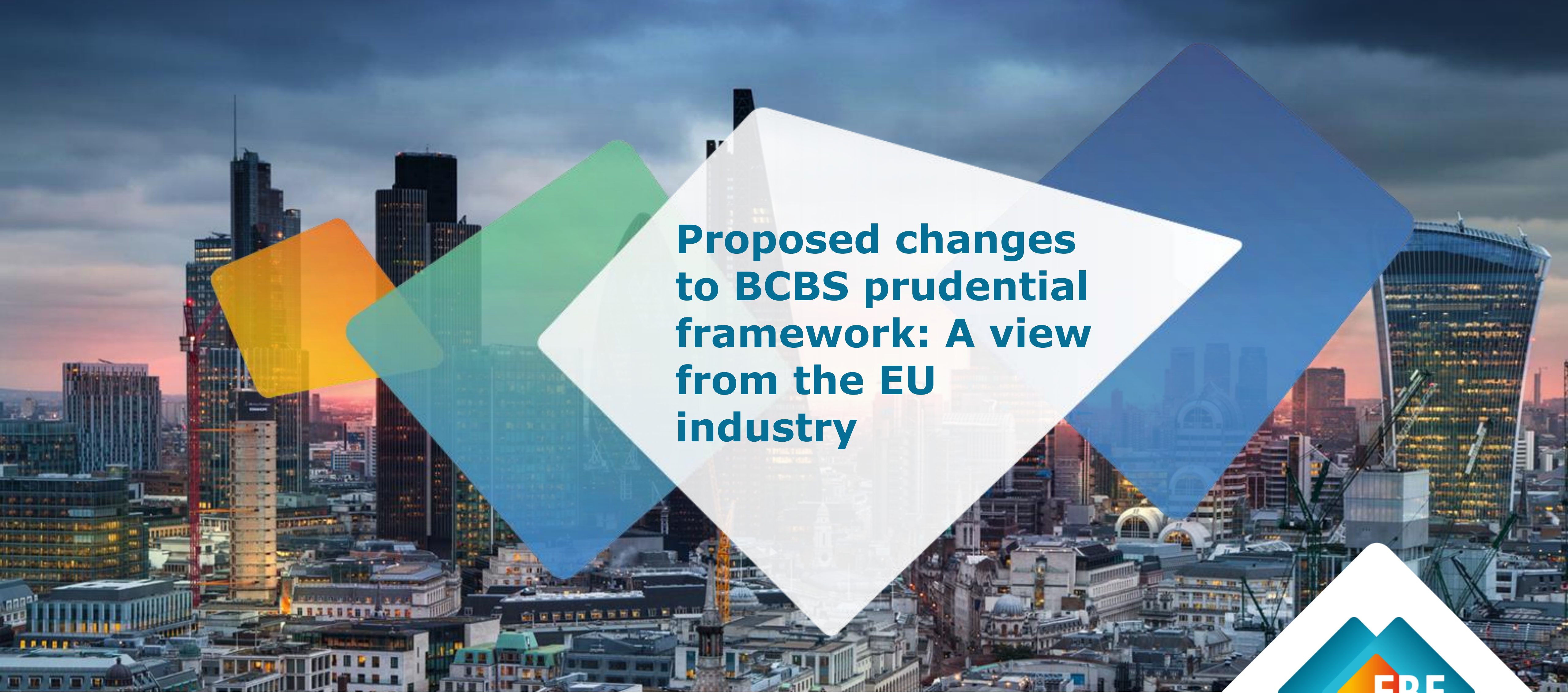

Proposed changes to BCBS prudential framework: A view from the EU industry

European Institute of Financial Regulation (EIFR)

Paris, 13 October 2016

Gonzalo Gasós – Head of Banking Supervision (EBF)

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1. Basel III has been accomplished
2. Where does the EU banking system stand?
3. The impact of Basel IV would be huge for the EU
   (unless the current proposals are carefully reviewed)
4. What you need to know about the risk weight density and the level playing field
5. What should be done?

1

Basel III has been accomplished

EBF credibly assessed Basel III

01

The Basel III impact was first assessed by EBF in 2010

- EBF estimated €559bn additional capital in 2010
- EBA confirmed initial shortfall of €544bn capital in 2011
- EU banks recapitalisation reduced shortfall to only €5bn in 2015
- The ambitious program set out by the GHOS is completed

02

The EBF put forward recommendations on Basel III

- Phase-in periods (taken)
- Protection of minority interests (taken after IMF&EBRD advice)
- Less tight liquidity ratio (taken)
- Review of required stable funding factors in NSFR (taken)
- No restrictions on distribution policies (not taken)

(*) EBF presentation on the impact of Basel III (June 2010)

Basel Committee
on Banking Supervision

Basel III
Monitoring Report

March 2016

"ALL LARGE INTERNATIONALLY ACTIVE BANKS MEET BASEL III MINIMUM AND CET1 TARGET CAPITAL REQUIREMENTS"

(http://www.bis.org/bcbs/publ/d354.pdf)

Basel III has been accomplished

Basel III has been accomplished

Basel III in the EU: substantial recapitalisation

TOTAL ***	Jun-2011	Dec-2015
Core Equity Tier 1 Capital	5,3%	12,7%
CET1 shortfall (€bn) at 4.5%	29	0
CET1 shortfall (€bn) at 7% *	277	1
Tier 1 Capital	6,8%	13,3%
Total Capital	8,1%	15,8%
Tier 1 Capital shortfall (€bn) *	411	4
Total Capital shortfall (€bn) *	544	5
Leverage Ratio (3%)	2,8%	4,9%
Leverage shortfall (€bn)	N/A	N/A
Liquidity Coverage Ratio	71%	134%
LCR shortfall (€bn) **	1.200	11
Net Stable Funding Ratio	89%	107%
NSFR shortfall (€bn) **	1.800	240

* Including G-SIB surcharge
** Overall shortfall group1 and group 2
*** Assumption of weights: 80% G1; 20% G2

Source: EBA

- Basel III Monitoring Exercises clearly indicate that the ambitious targets agreed by the GHOS in 2010 have been largely achieved in Europe

"WE SUPPORT THE WORK BY THE BASEL COMMITTEE TO REFINE ELEMENTS OF BASEL III FRAMEWORK…
WITHOUT FURTHER SIGNIFICANTLY **INCREASING** OVERALL CAPITAL REQUIREMENTS"

No further increase sought but…

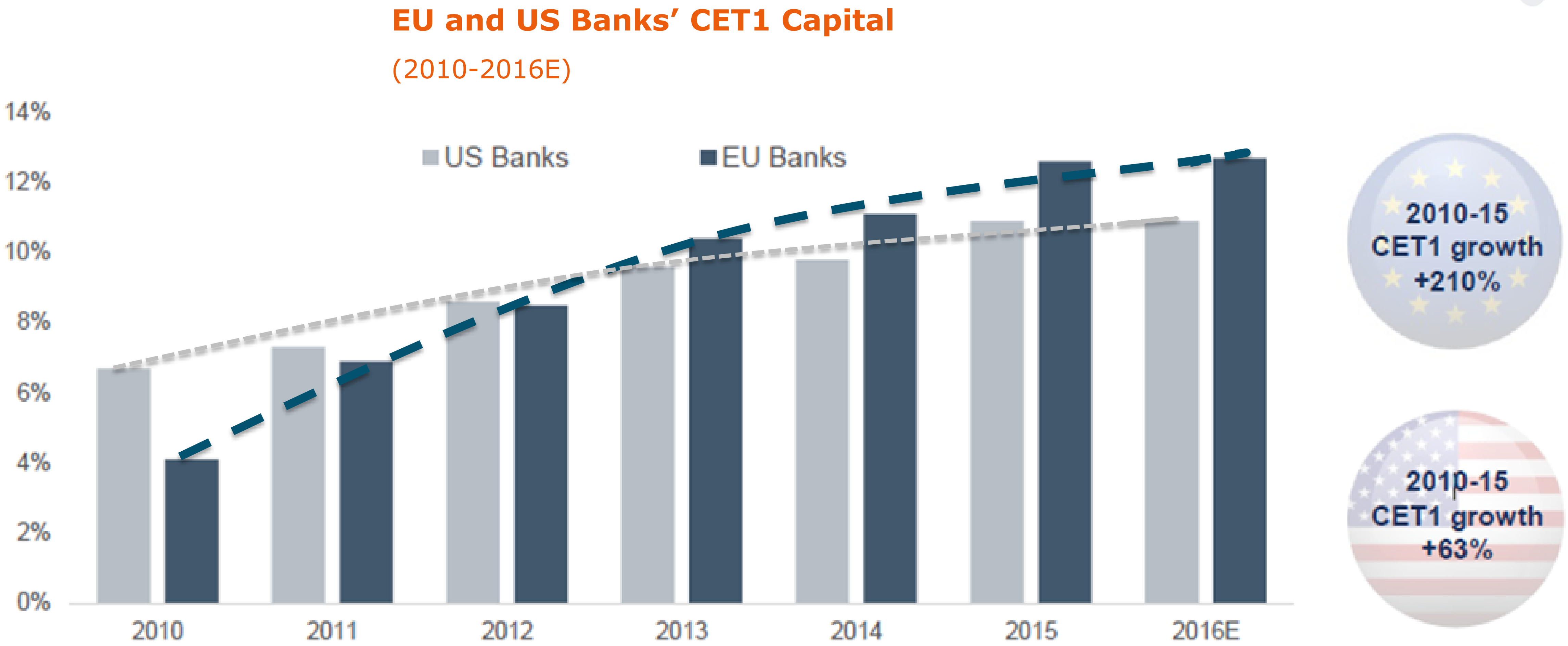
“THERE IS NEVERTHELESS A SENSE ACROSS THE SECTOR THAT THE FRESH CAPITAL REQUIRED WOULD AMOUNT INTO THE **HUNDREDS OF BILLION EUROS**”

But the market speaks differently

2

Where does the EU banking system stand?

EU banks recapitalisation completed

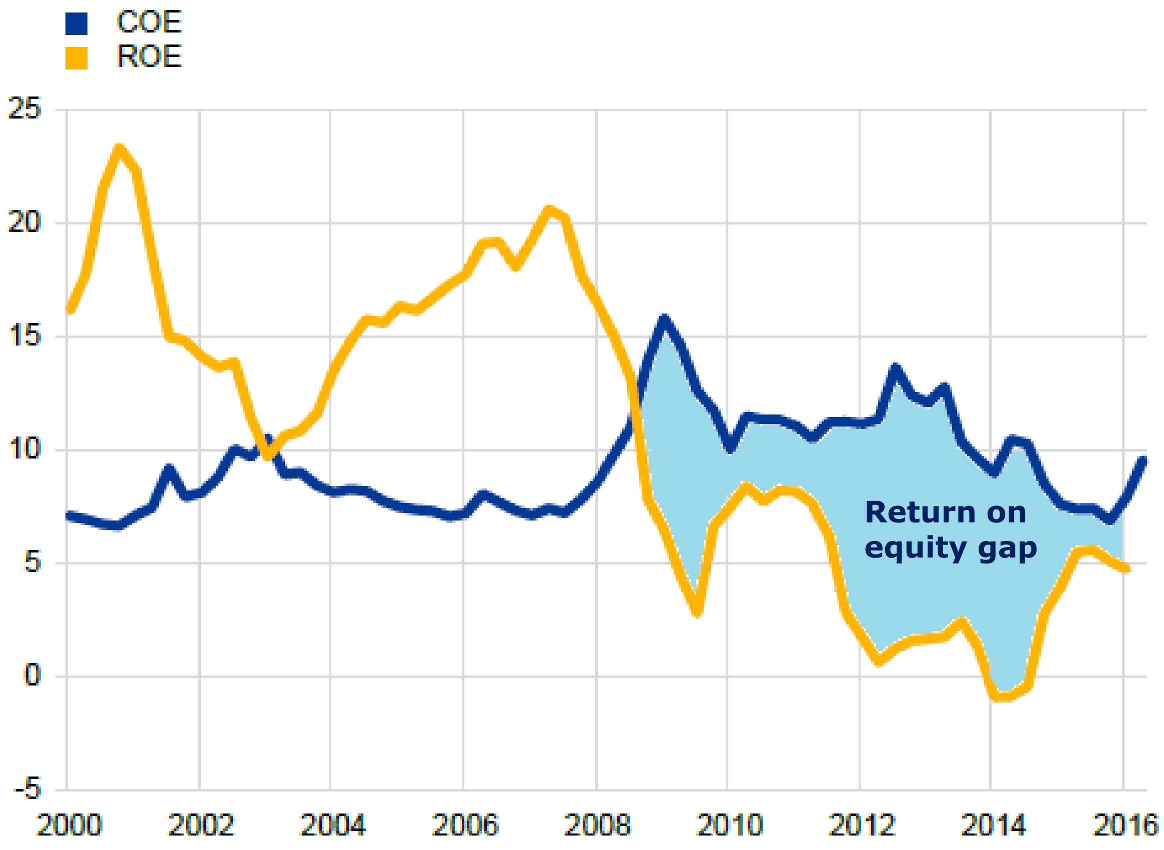


Source: Algebris Investments (UK) LLP, Morgan Stanley Research, Company Reports, July 2016

The new normal is unsustainable

Return on equity and cost of equity for listed euro area banks

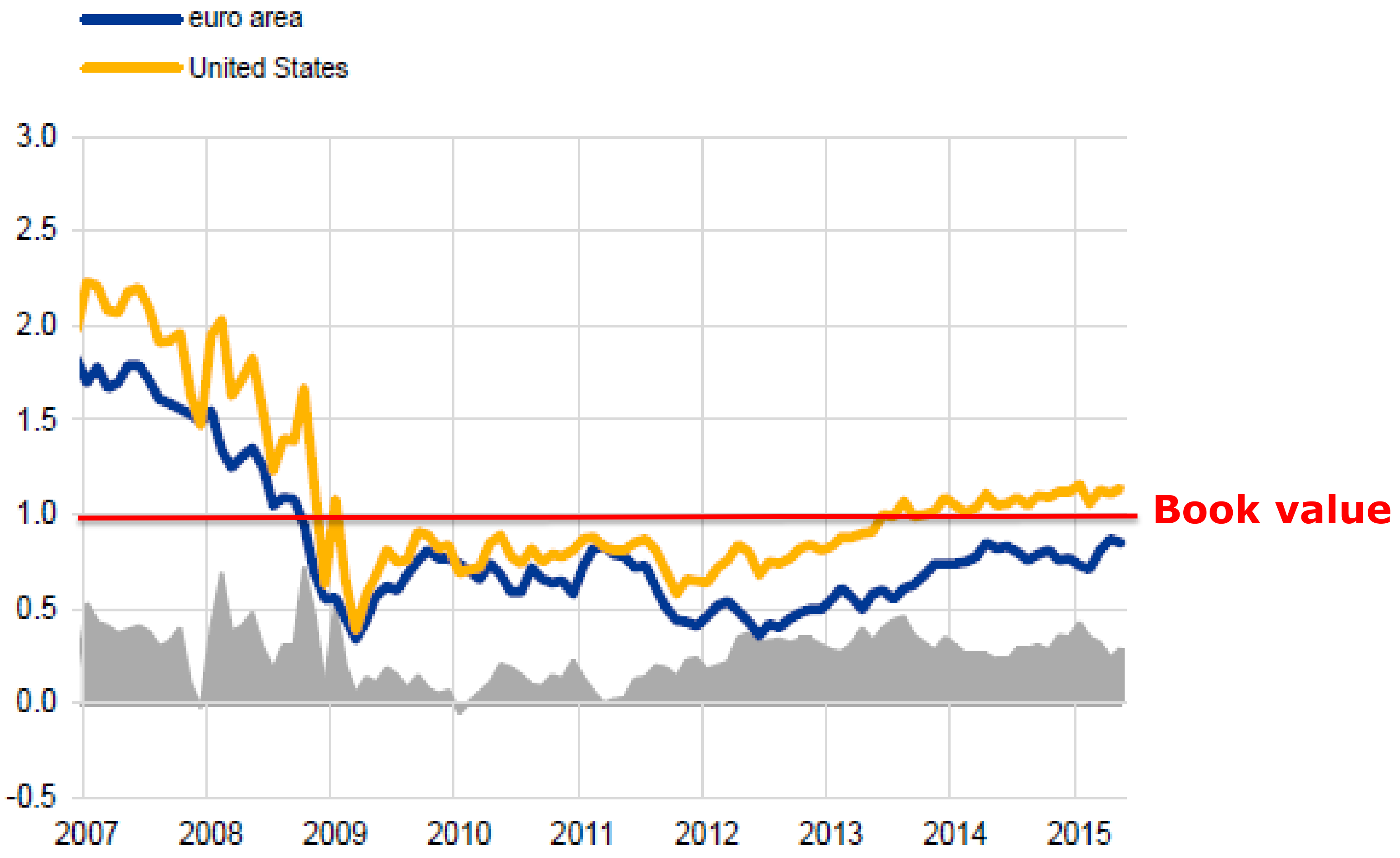
(Q1 2000 – Q2 2016; percentages)



Source: ECB – "Challenges for the European banking industry (2016)"
Note: Latest observations are for Q1 2016 (ROE) and Q2 2016 (COE)

Price remains below book value

Price to book value ratio for euro area and US banks
(Jan. 2007– May 2015, grey shaded area represents the difference between United States and the euro area)



Source: ECB Financial Stability Review May 2015

EU banks sliding in world rankings

MARKET VALUE OF LARGEST BANKS (2003)

Rank	Bank	Country	Market cap ($billion, 20/01/2012)
1	Citigroup	US	249,53
2	HSBC Holdings	UK	171,08
3	Bank of America	US	119,31
4	Wells Fargo	US	99,46
5	Royal Bank of Scotland	UK	86,01
6	UBS	Switzerland	79,73
7	JP Morgan Chase	US	74,39
8	Wachovia	US	61,35
9	Barclays	UK	57,12
10	US Bancorp	US	57,09
11	BNP Paribas	France	55,62
12	Banco Santander	Spain	55,42
13	Bank One	US	51,09
14	HBOS	UK	49,25
15	Mitsubishi Tokyo Financial	Japan	49,24
16	Deutsche Bank	Germany	46,99
17	Fleetboston Financial	US	46,02
18	Lloyds TSB	UK	43,65
19	BBVA	Spain	43,53
20	Credit Suisse	Switzerland	42,85
21	Societe Generale	France	37,94
22	ABN Amro	Netherlands	37,12
23	Washington Mutual	US	36,05
24	Credit Agricole	France	34,43
25	Mizuho Financial Group	Japan	34,18
26	UniCredit	Italy	33,69
27	Fifth Third Bancorp	US	33,37
28	National Australia Bank	Australia	33,28
29	Royal Bank Canada	Canada	30,86
30	Sumitomo Mitsui Financial	Japan	29,71

15 European institutions among the 30 largest banks (2003)

6 European institutions among the 30 largest Banks (2016)

MARKET VALUE OF LARGEST BANKS (2016)

Rank	Bank	Country	Market cap ($Billion, 11/03/2016)
1	Wells Fargo & Co	US	254,19
2	Industrial & Commercial Bank of China (ICBC)	China	226,55
3	JP Morgan Chase	US	217,79
4	China Construction Bank	China	155,97
5	Agricultural Bank of China	China	155,04
6	Bank of China	China	144,16
7	Bank of America	US	142,39
8	HSBC Holdings	UK	128,91
9	Citigroup Inc	US	126,74
10	Commonwealth Bank of Australia	Australia	99,69
11	Westpac Banking Corporation	Australia	83,53
12	Royal Bank of Canada	Canada	83,36
13	Toronto-Dominion Bank	Canada	71,11
14	Lloyds Banking Group	UK	73,77
15	Banco Santander	Spain	71,16
16	US Bancorp	US	70,24
17	Mitsubishi UFJ Financial Group	Japan	69,43
18	Goldman Sachs Group	US	67,91
19	UBS Group AG	Switzerland	65,33
20	BNP Paribas	France	62,6
21	China Merchants Bank	China	59,17
22	Bank of Nova Scotia (Scotiabank)	Canada	56,62
23	Australia and New Zealand Banking (ANZ)	Australia	56,48
24	National Australia Bank	Australia	56,27
25	Bank of Communications	China	55,08
26	Intesa Sanpaolo	Italy	51,4
27	Itau Unibanco Holding	Brazil	51
28	Morgan Stanley	US	50,92
29	Shanghai Pudong Development Bank	China	48,71
30	HDFC Bank Limited	India	48,45

Source: World's largest banks - www.relbanks.com

3

The impact of Basel IV would be huge for the EU

(unless the current proposals are carefully reviewed)

What are the components?

Basel III

- Capital: quality and quantity
- Risk coverage
- Leverage ratio
- Liquidity: liquidity coverage ratio and net stable funding ratio

Basel IV

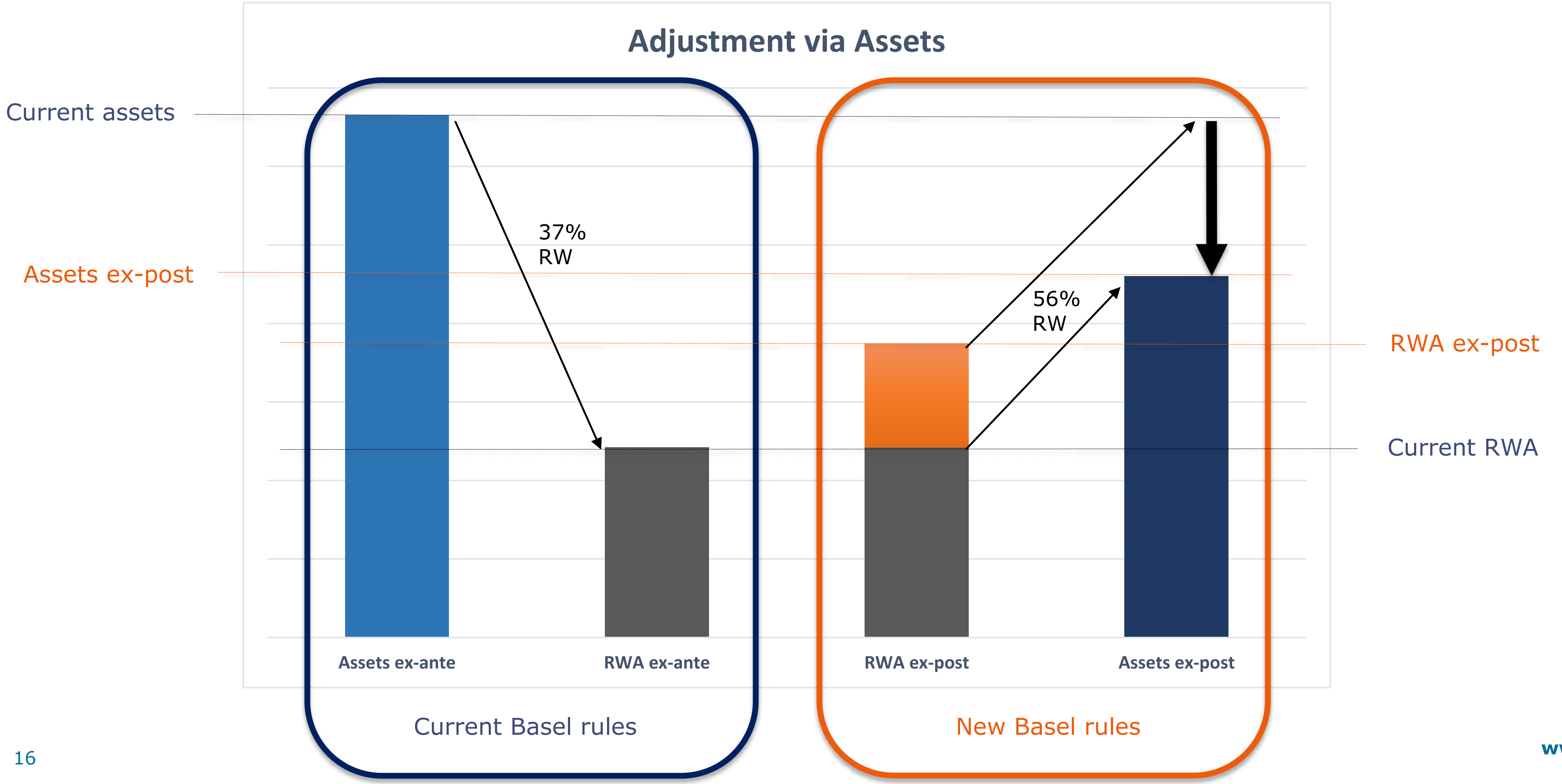
- Revision to the standardised approach for credit risk
- Constraints and removal of internal models
- Floors based on the standardised approach
- Revision of the operational risk framework

Basel IV+

- The potential impact of the IFRS9 Expected Loss model
- The TLAC requirements as of 2019
- The TLAC requirements as of 2022

Potential impact on Assets

The effect on assets if the capital ratio is kept unchanged



4

What you need to know about the risk weight density and the level playing field

What you need to know about the risk weight density and the level playing field

Big differences in the risk weight density:

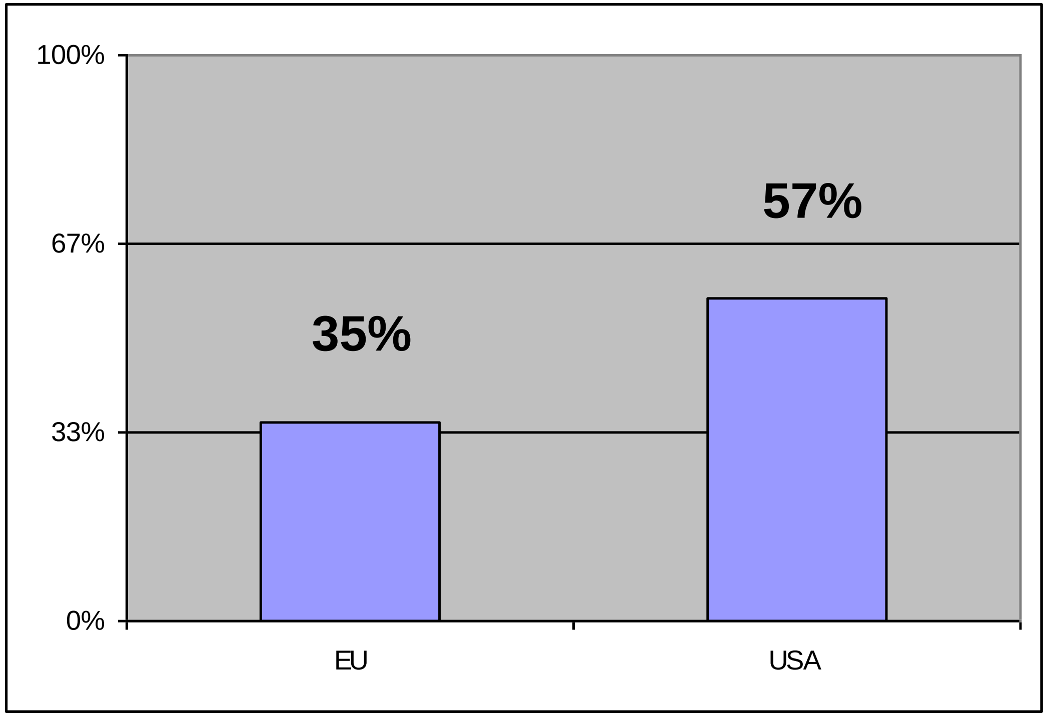
1. Accounting standards
2. Mortgage loans
3. Pillar 2
4. Operational risk
5. Software

What you need to know about the level playing field

Comparing the risk weight density is misleading and has given rise to a widespread misconception that EU banks bear less prudential pressure

EU banks exhibited lower risk weight density* (35%) than their US peers (57%) in the IMF landmark study.

A closer look follows…



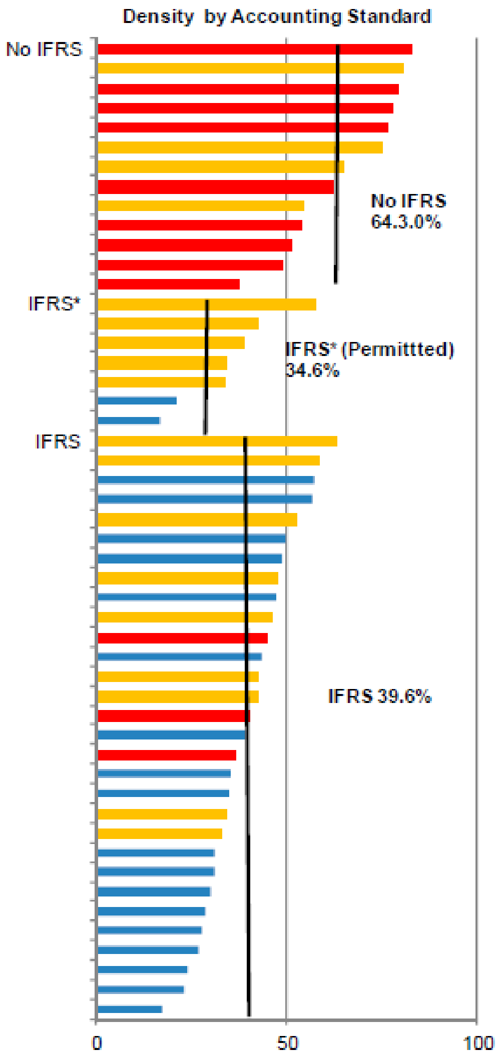
Source: IMF, Pillar 3 reports

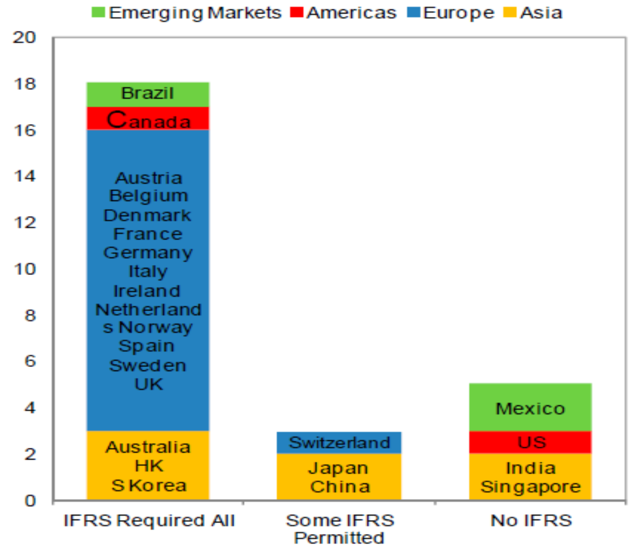
* Risk weight density is the quotient between risk-weighted assets (RWA) and total assets

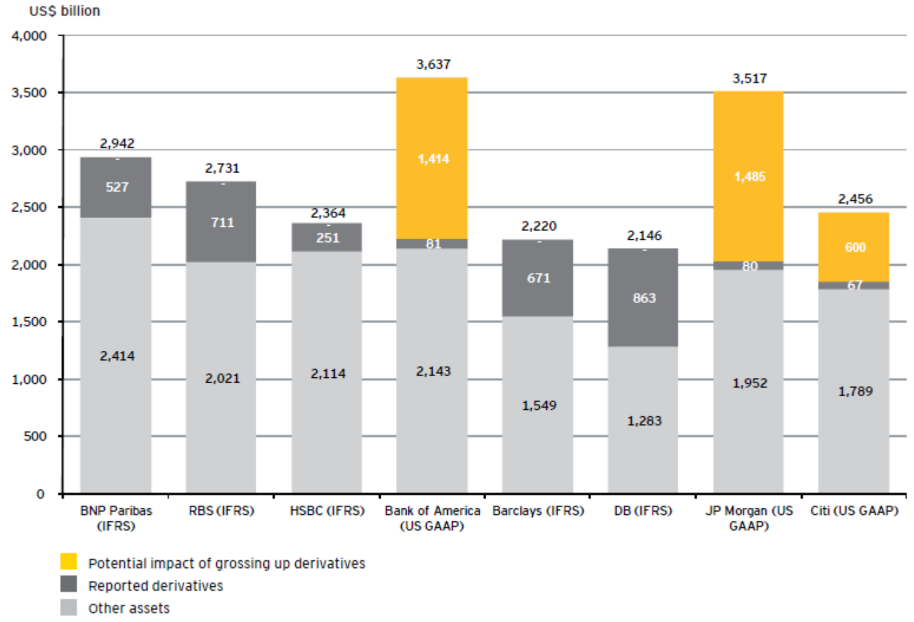
What you need to know about the level playing field

1. Accounting standards

- Total Assets under IFRS look quite bigger than under US GAAP because of derivative netting rules
- As a result, the RW density looks smaller under IFRS than it is under US GAAP
- Non-IFRS countries show risk weight density of 64%
- Countries under IFRS show risk weight density of 35% to 40%







Sources: IMF, The Banker, EBF, Pillar 3 reports, Financial statements of individual banks

What you need to know about the level playing field

2. Mortgage loans

EUROPE

- Residential mortgage class represents 24% of bank loans
- Around EUR 6.5 trillion booked on the balance sheet of banks
- The lower risk profile of the mortgage portfolio pulls down the risk weight density of EU banks (thus making the floors more binding)

UNITED STATES

- The bulk of the mortgage loans (USD 8 trillion) is transferred to Government Sponsored Entities (GSE), Fanny Mae & Freddy Mac
- Those mortgage loans disappear from US banks' balance sheets pushing up the average risk weight (and making floors less binding)

What you need to know about the level playing field

3. Pillar 2

- Much of the regulatory pressure of European banks comes from Pillar 2 capital requirements which range from 2% to 8% for the majority of EU banks with 4% as a median level. This is not reflected in the RW density.

4. Operational risk

- EU banks have computed RWA for operational risk (about 10% of total RWA) from the onset of Basel II but it is not counted in the risk weight density metric.

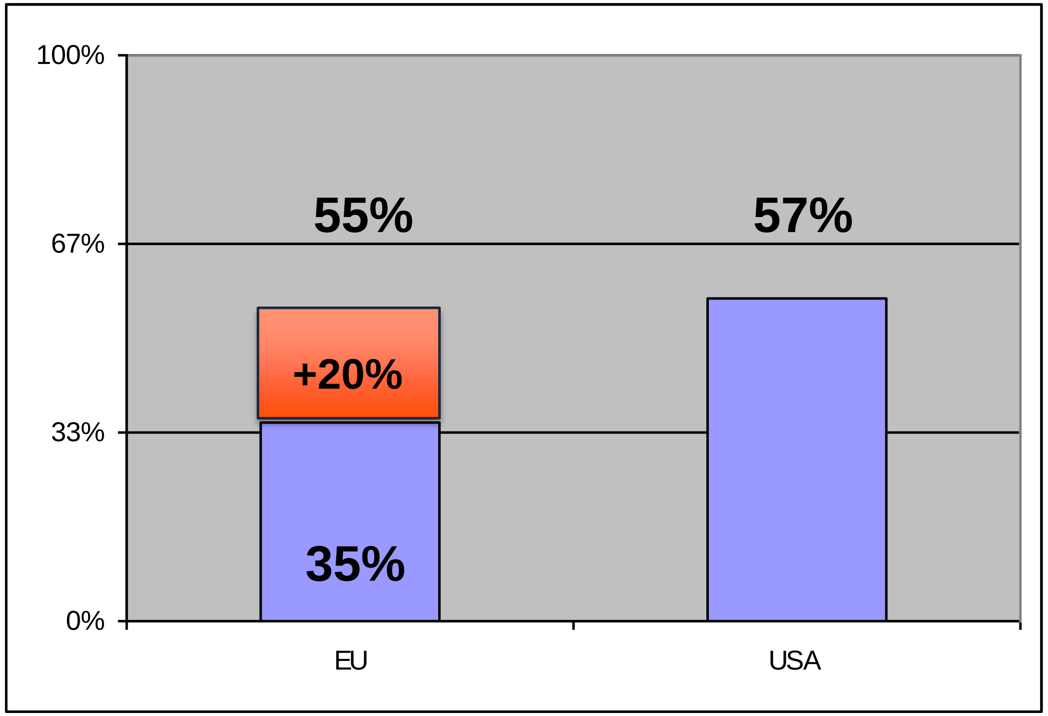
5. Software

- Europe requires full deduction instead of 100% risk weight as plants and equipment (i.e. 12.5 times more capital).

What you need to know about the risk weight density and the level playing field

Those factors are equivalent to about 20% of risk weight.

Conclusion: the regulatory pressure is similar in the 2 largest jurisdictions, the EU and the US.



Source: EBF estimates

* Risk weight density is the quotient between risk-weighted assets (RWA) and total assets

4

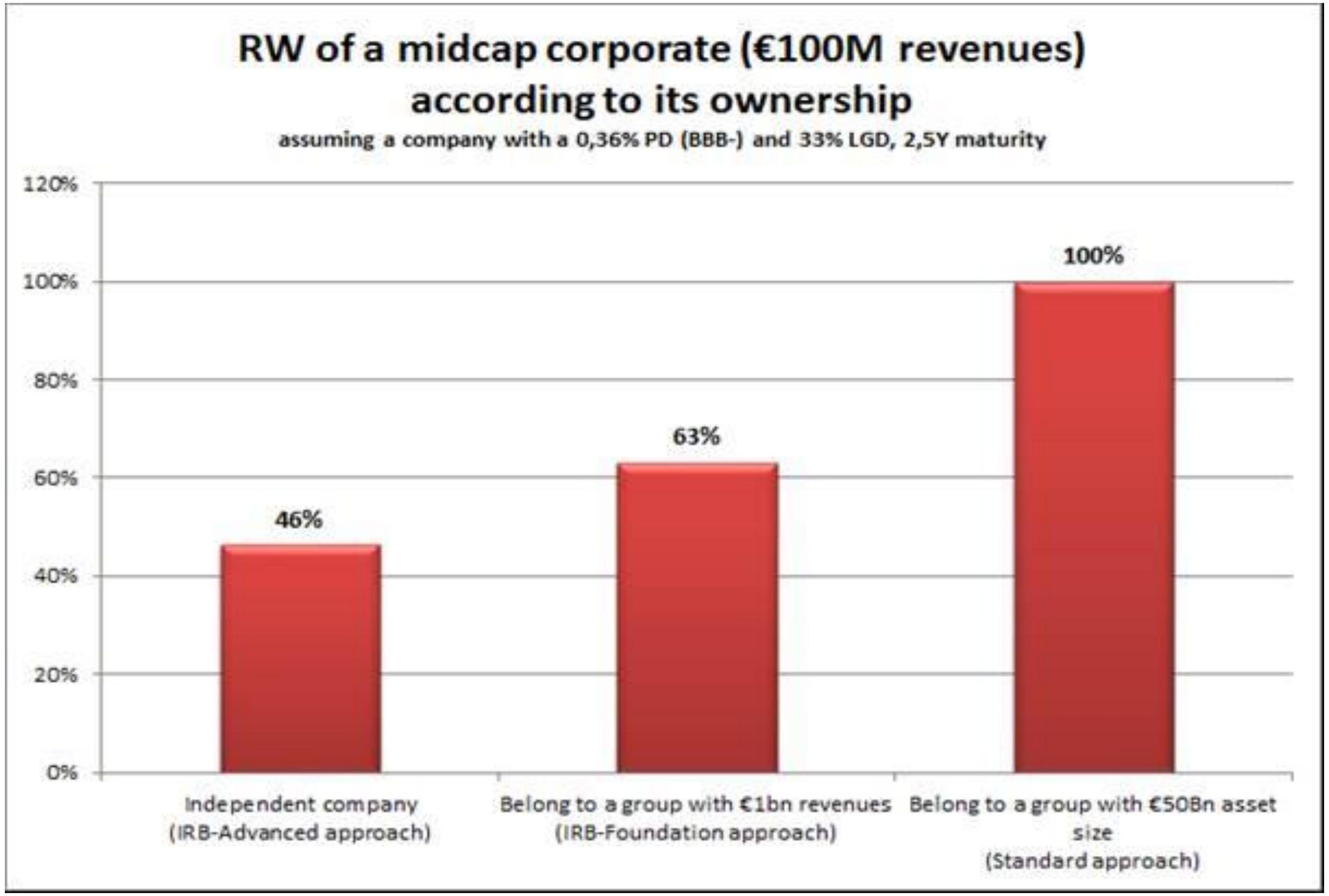
What should be done?

What should be done?

1. Maintain AIRB for corporate exposures
2. Define and calibrate UCC
3. Recalibrate mortgage RWs in the standardised approach
4. Leverage ratio should prevail over output floors
5. Make operational risk requirement stable
6. Let regulators and supervisors review IRB models according to global standards (as EBA is engaged in)

What should be done?

1. Maintain IRB for corporate exposures



Requests:

- IRB models should remain eligible for corporate exposures;
- Otherwise, size thresholds should be applied on a stand-alone basis

Open discussion on key decisions

1. Bank exposures
2. Corporate exposures
3. Retail exposures
4. Equity exposures
5. Specialised lending
6. Residential mortgage portfolio
7. Off-balance sheet items
8. Output floors
9. Other issues

Conclusion

- Basel III has been accomplished
- EBF recommendations to be regarded
- Refinements without significant increase of capital in the EU
- Turn the page of Basel III and…
- Help tackle the real threats: low interest rates and low returns

Please send comments and views to:

Proposed changes to BCBS prudential framework:
A view from the EU industry

Paris, 13 October 2016

Comments are welcomed at g.gasos@ebf.eu

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