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DNR [Diarienummer]

Governor Stefan Ingves at the Foreign Bankers Association

Date and time:
25 April 2014, 12.00 – 13.30

Venue:
Deutsche Bank office, Stureplan 4A , Stockholm

- *I have been asked to talk about the work agenda of the Basel Committee. As you may be aware, I will have chaired the Committee for three years this summer. During this time, the focus of the Committee has of course been Basel III and other associated reforms. As I see it, this will gradually change going forward; with focus shifting more and more towards implementation of the standards.*

- *The Committee's work can be grouped into <u>4 broad themes</u>: finishing the policy reforms, monitoring implementation, looking at RWA consistency within the broader theme of simplicity, comparability and risk sensitivity, and enhancing effective supervision.*

- *We now have three of the four components of Basel III pretty much done: The* ***risk-based capital framework*** *is largely done and the* ***Liquidity Coverage Ratio****, or so-called LCR, is complete. For these parts of the Basel framework focus is instead on implementation.*

- *Also the* ***leverage ratio*** *is now done except for the decision on the final calibration. The monitoring period will continue until 2017, but the attention has now shifted towards the final calibration and the interaction of the leverage ratio with the risk-based ratio. One thing that is important to point out when it comes to disclosure of the leverage ratio is that the institutions will be required to disclose the* <u>*net as well as the gross leverage ratio*</u>*.*

- *Therefore, the main issue we have to finish this year is the* ***Net Stable Funding Ratio*** *- NSFR. This is as many of you know one of two liquidity measures introduced with Basel III. The objective of the NSFR will encourage banks to maintain more stable and longer-term funding. It does this essentially by placing a ceiling on the maximum maturity mismatch allowed. This will help ensure that banks internalise some of the costs associated with relying on short-term and flighty funding.*

- *A consultation document for the NSFR was put out in early January this year. The period for comments on the proposal closed two weeks ago. It's too early to say too* *much about the feedback just yet, but in our discussions with banks and other interested parties over the past couple of months it is probably fair to say that the 'temperature' of the discussions has been lower than was the case, for example, for the LCR or the leverage ratio. That probably reflects the fact that the changes we proposed generally made the NSFR easier for most traditional retail and commercial banks to meet. Of course, there will still be plenty of issues raised, but we've been looking at this for a while so most are pretty well known at this stage.*

- *The Committee will work through the comments over the next couple of months, along with the results from the Committee's impact study (QIS). The Committee's intention is to be able to finalise the framework by the turn of this year.*

- *Besides the NSFR, the next highest policy priority of the Committee when it comes to policies is probably* ***securitisation****. A proposal for a revised capital framework was put out for public consultation last December. I think this proposal was much better than the previous version, in that the framework is simpler and the calibration lower and more realistic than the earlier proposals. Similar to the NSFR, we are currently working through the feedback from industry and the QIS results, and will be aiming to finalise the framework by the end of 2014.*

- *Beyond those two issues, our* ***review of the trading book*** *continues, but is unlikely to be finalised until 2015. Here the reforms may not have a greater impact on your institutions than on Swedish banks in general. The aim is to address the weaknesses of the old framework. In particular, we have aimed to strengthen the approach to risk measurement by ensuring that regulatory capital will be sufficient in periods of significant stress. But there are many more changes as well.*

- *Side-by-side with this, we are also looking at* ***interest rate risk in the banking book****. Specifically, we are examining the need for a capital framework for interest rate risk in the banking book, particularly given the desire to limit arbitrage opportunities between the trading and banking books.*

- *The Committee has also taken on a new and, in my view, important task by doing* ***country-by-country assessments*** *of how Basel III is being implemented. So far, six assessments have been completed and published. All six assessments were considered compliant, mainly as a result of the willingness of jurisdictions to rectify findings. Hence, the assessments work as a mechanism to guarantee that the regulations are implemented as intended.*

- *Currently the Committee is assessing Canada, the US and EU. The result of those assessments will be published later this year. The assessments made so far focused on the capital adequacy framework, but going forward they will be extended to liquidity and the framework for systemically important banks.*

- *The third major theme on the Committee's agenda is the issue of* ***RWA consistency****. As matters stand, we've so far published three studies on risk-weighted asset variability - two for the trading book and another for the banking book. Taken together, these show that actual risks drive the lion's share of differences in risk weights and capital requirements. This, of course, is just as it ought to be.*

- *However, variations in RWA also arise from supervisory and bank practice-based idiosyncrasies, and these can result in material discrepancies. While it is difficult to be precise on how much scatter is "too much", the range of bank practice-based show unacceptably large variations in the outcomes of RWA calculations both across a global sample and within the same country. This erodes both the credibility of capital standards and their comparability across banks, hence undermining market discipline.*

- *The Basel Committee takes this issue very seriously. Various policy proposals are being worked on. There are* *some things we might be able to do now, but given there are some parts of the framework where we are still assessing the extent of the problem, the plan will not be complete - this will inevitably be a multi-year programme.*

- *To give you a flavour of the policy work that is being discussed with respect to RWA variability I will mention a few examples:*
  - *First, there is an ongoing review of the Pillar 3 framework – This responds to concerns about the opacity of internal model-based approaches to risk weights, but also reflects a broader dissatisfaction with Pillar 3 in its current form. The Basel Committee also intends to tighten the requirements on the disclosure of RWA information.*

  - *A second strand of work is reviews of modelling practices in the trading book and in the banking book – as I mentioned a review of the framework for the trading book is already going on. Alongside that, the Committee is looking into what can be made with respect to the banking book.*

  - *For a more direct impact, we are also looking at the role of floors and benchmarks within the Basel III framework. Floors are not a new phenomenon in the capital framework: we have them already at the aggregate level - in the form of the transitional floor* *relative to Basel I that remains in place - and for some risk parameters - for example, the minimum loss-given-default for residential mortgage loans.*

- *Lastly, we also need to examine whether there is a case for the greater use of floors at a more granular level, particularly for products and markets where data are limited or where there are other characteristics that make them hard to model reliably. In these instances, the case for relying completely on bank models to determine regulatory requirements is far from compelling.*

- *More generally, the Committee has also started to think more fundamentally about the* ***simplicity vs risk sensitivity balance in the framework****, and what we can do to improve it. A paper was issued last summer. But again, that is a long term exercise and I don't expect anything to emerge in the near term.*

- *Before concluding I will also say something about the Committee's* ***work on supervision.*** *This may be a less well-known area of the Committee's work outside the regulatory community. However, there is a steady stream of work done in this area by the Committee, which will impact banks practices. Some recent examples include, updated guidance on capital planning and on external audits, and will soon have updates on corporate* *governance and supervisory practices for dealing with weak banks. This sort of work goes on even when the policy reforms reach their conclusion.*

- *I hope I have been able to give you a sense of the priorities of the Committee going forward. As you hear, although the work with Basel III is coming to an end, there are still there are still many things for the Committee to do, both in the near and longer term.*

- *Implementing the standards, we must recognise that this will often pose challenges in the short term. However, I think it is important that we push ahead and do the repair work that needs to be done, as soon as possible. Reforms are often seen as imposing costs; I prefer to think of them not as costs, but as investments in a more stable banking system.*