Funding the economy

What impacts are the new prudential rules having ?

HIGH LEVEL SEMINAR
FINANCING THE REAL ECONOMY POST-CRISIS :
EXPERIENCES IN THE EURO-MEDITERRANEAN AREA

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Banks subjected to heightened regulatory measures

1.1. Regulators toughen the regulatory constraints on banks

CET1 = capital + reserves / weighted risks
with a number of buffers

Leverage = Tier 1 (CET1 + add Tier 1) /total adjusted Balance Sheet

LCR = liquid assets (Govies and CB deposits) / net cash outflows 30 days

NSFR = stable resources / sustainable uses

Solvency	➢ Contain quality impairment concerning capital instruments ongoing since 1998; ➢ Learn from the emergency bailouts in 2008 to avoid systematic States' intervention; capital buffers need to be increased; ➢ Continue working on a definition of capital requirements by honing the way market risks are measured as they are notoriously «underrated» and yet represent a significant portion of the profit and real risks.
Liquidity	➢ 2008 was a reminder that mainstream banking crises (individual or collective) are, first and foremost, liquidity crises spurred by doubts concerning solvency; ➢ Put an end to jumboisation funded by short term market funding which is by definition unstable.

Heightened requirements with gradual phase-in where « time » for a regulator does not mean the same as « time » for a market operator

ACPR BANQUE DE FRANCE

1. Banks subjected to heightened regulatory measures

1.2. Potential impacts on business models (1/2)

EBA report – Feb. 2015
Overview of the potential implications of regulatory measures for bank business models

			Potential implications of individual regulatory measures						Cumulative potential implications	
			1	2	3	4	5	6	7	8
Business model components			CRR/CRD IV Capital requirement	Basel III LR	Basel III Liquidity rules (LCR/NSFR)	Reforms of banking structures (ring-fencing measures)	Resolution regimes (BRRD)	EMIR, (clearing OTC derivatives)	Average 'quantitative' effect(1)	Final Including expert judgment(2)
1	Activities	Retail banking	+	-	-	=	=	=	-	-
		Corporate banking	+/-	+	-	+/-	=	=	+/-	-
		Investment banking – Proprietary trading	-	-	+/-	-	=	-	-	-
		Investment banking – Market making	-	-	+/-	-	=	=	-	-
		Investment banking – Hedging activities	+	-	-	-	=	-	-	-
		Private banking	+/-	+/-	+	+/-	=	-	+/-	-
		Non-banking activities (insurance exposures...)	+	+	=	=	=	=	+	+
		Off-balance-sheet exposures	-	-	-	+/-	=	+/-	-	-
2	Banking model	Universal banking structure (diversified)	=	+/-	+	-	=	=	+/-	+
		Specialised banking structure	=	+/-	+/-	+	=	=	+/-	-
3	Resources/ liquidity profile	Capital	+	+	+	+	+	-	+	+
		Deposits – Retail deposits	=	=	+	=	+	=	+	+
		Deposits – Corporate deposits	=	=	+	+/-	+	=	+	+
		Asset encumbrance	=	=	-	+	-	+	+/-	+
		Reliance on wholesale funding	=	=	-	+/-	-	=	-	-
		Maturity of wholesale funding	=	=	+	+/-	+	=	+	+
4	Structure of income	Interest rate income	+/-	+/-	-	+/-	-	=	+/-	-
		Trading income	-	-	=	-	=	-	-	-
		Commissions and fees	+	+/-	+	+/-	=	-	+/-	+

1. Banks subjected to heightened regulatory measures

1.2. Potential impacts on business models (2/2)

				Potential implications of individual regulatory measures						Cumulative potential implications	
				1	2	3	4	5	6	7	8
Business model components				CRR/CRD IV Capital requirement	Basel III LR	Basel III Liquidity rules (LCR/NSFR)	Reforms of banking structures (ring-fencing measures)	Resolution regimes (BRRD)	EMIR, (clearing OTC derivatives)	Average 'quantitative' effect(1)	Final Including expert judgment(2)
5	Geographic scope	Non-domestic exposures	EU exposures	+	+/-	+	=	=	=	+/-	+
			Foreign (excl. EU) exposures	+	+/-	-	-	=	=	+/-	-
		Non-domestic funding	EU funding	+	+/-	-	=	=	=	+/-	-
			Foreign (excl. EU) funding	+	+/-	-	-	=	=	+/-	-
6	Size	Size		-	-	=	-	=	=	-	-
		Leverage		-	-	-	-	=	=	-	-
7	Originate to hold/to distribute	Use of securitisation		-	+	+	+/-	=	=	+/-	+
8	Risk appetite and performance	Risk appetite (RWA/total exposures)		-	+	-	+	-	-	-	-
		RoE		-	+/-	-	-	-	+/-	-	-
		Loan to deposit ratio		=	-	-	+/-	-	=	-	-
		Cost	of funding	-	+/-	+	+	+	+/-	+	+
			of operations (excluding the cost of implementing the regulatory measures)	+	=	+/-	+	=	+	+	+
9	Operational structure and governance	Number of branches and subsidiaries		+/-	=	-	-	=	=	-	-
		Intragroup flows		+/-	=	-	-	+/-	=	-	-
		Importance of internal governance		+/-	+/-	+	+	=	=	+	+

1. Banks subjected to heightened regulatory measures

1.3. Banks have to contend with 3 challenges

1. A **regulatory shock** (Basel III) which increases intermediation costs by requiring more capital and more « bailinable » resources…

Capital requirements « Core Tier 1 »	Leverage ratio	Liquidity ratio, 1 month (LCR)	Transformation ratio (NSFR)	TLAC

Impacts on BS	More own funds Less short term market refinance More deposits Less lending (on the BS ?)
Impacts on business	More disintermediation

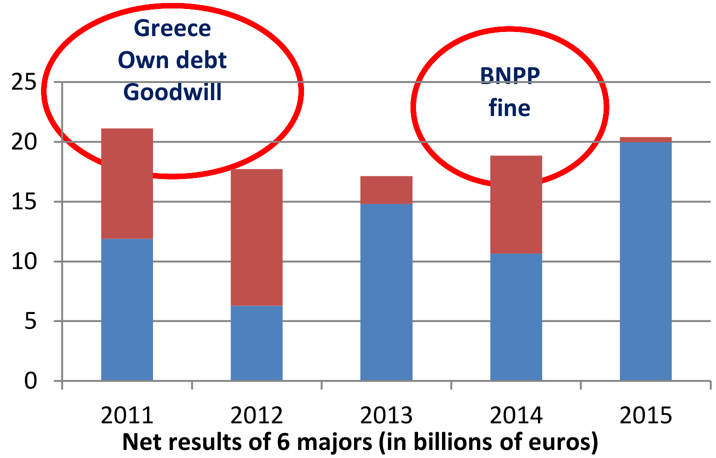
2. A **technology shock** to facilitate competition from non banks : platforms that facilitate contact and access to means of payment

3. A **very low interest rate shock** which erodes bank intermediation margins and encourages the search for alpha

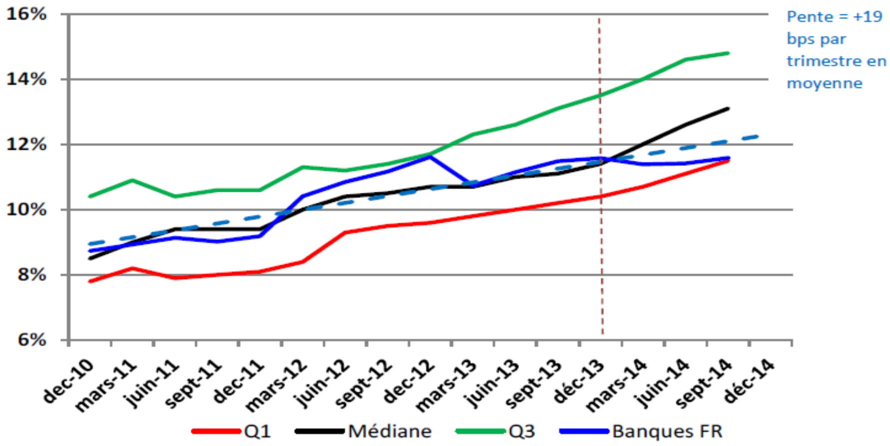
2. Have we managed to secure funding for the economy ?

2.1. Banks are more resilient and can fund the economy better

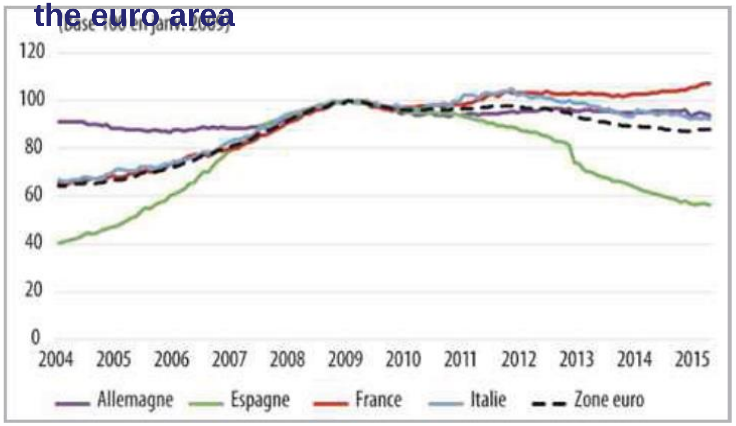
1. Robust results for French banks



2. European banks better capitalised

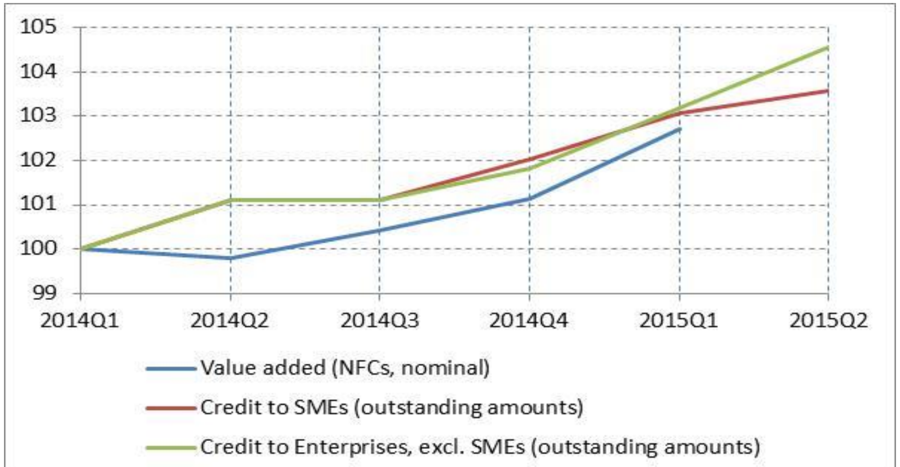


3. Lending to Non Financial Companies (NFCs) on the rise in France, but falling in the euro area



Source : BCE.

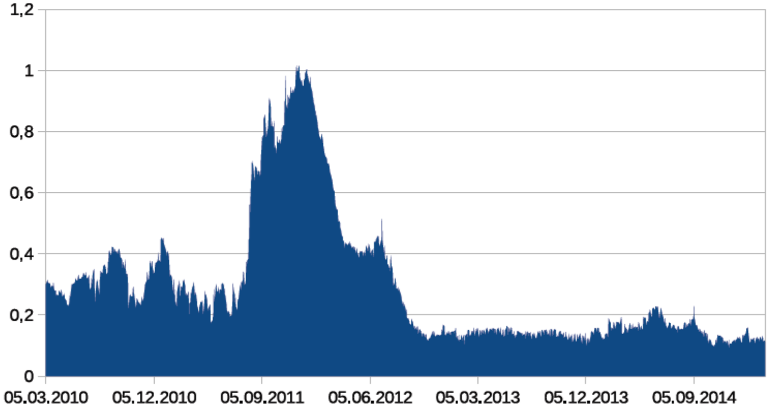
4. Quicker lending growth as compared with value added, a sign that there is no credit crunch



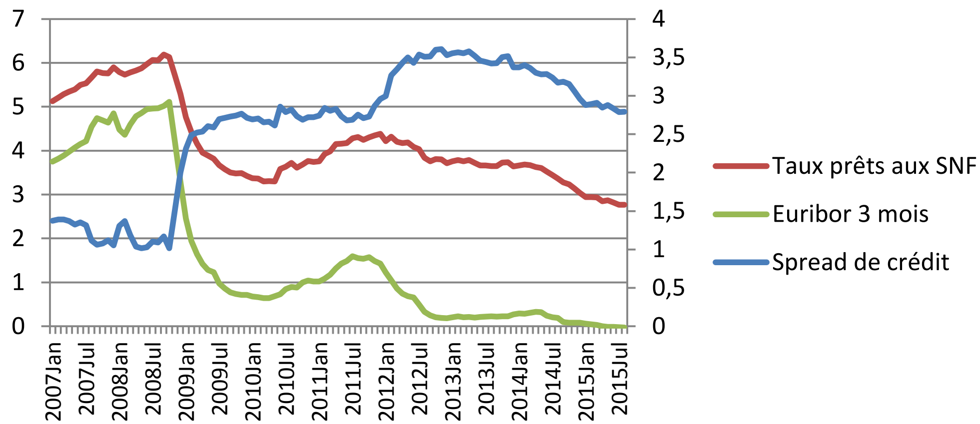
2. Have we managed to secure funding for the economy ?

2.2 Hard to dissociate regulatory impact from a macroeconomic background

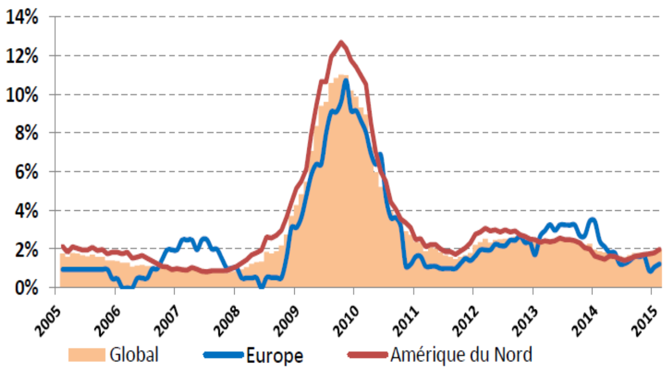
An accommodative monetary policy pushed interbank spreads down tremendously in 2012



But despite that the spread on lending to NFCs did not return to normal pre-crisis levels in the euro area



A high credit spread doesn't seem to be explained by increased corporate failures

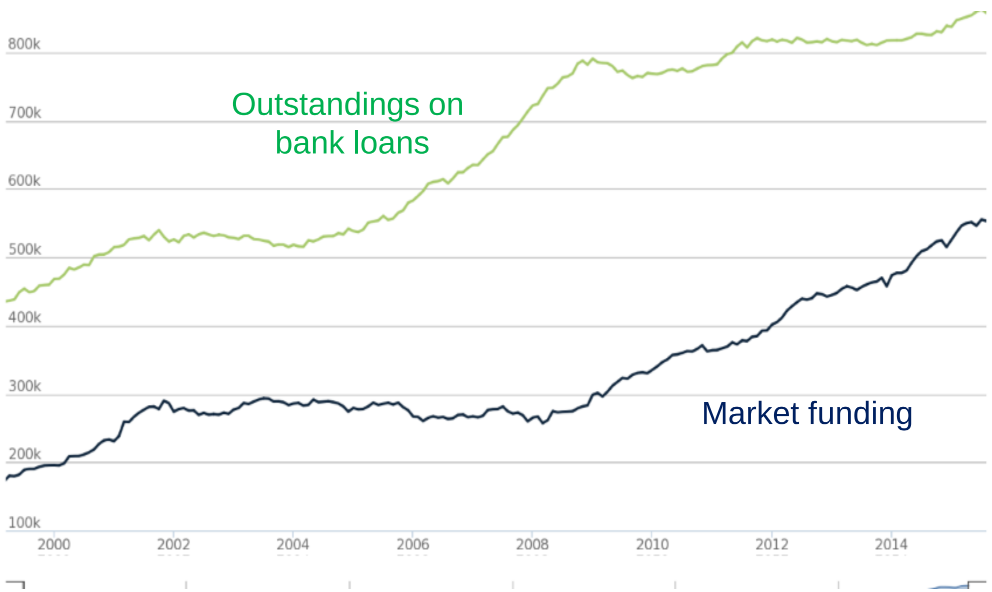


Interest rates are relatively low in France for multi maturity lending under one million euros

2. Have we managed to secure funding for the economy ?

2.3. Funding modes change

Steep increase in post crisis market funding



Loans can now be granted by new stakeholders :

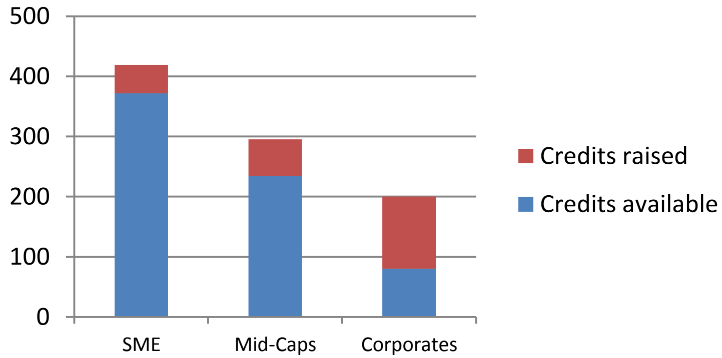
- insurers : funds for lending to the economy
- individuals: peer-to-peer lending (*crowdfunding*)
- companies : facilitate inter company loans

Funding for NFCs

Distribution of outstanding amounts (in %)

	Dec. 2005	Dec. 2008	Dec. 2011	Sept. 2015
Bank lending	68 %	73 %	68 %	61 %
Market funding	32 %	27 %	32 %	39 %

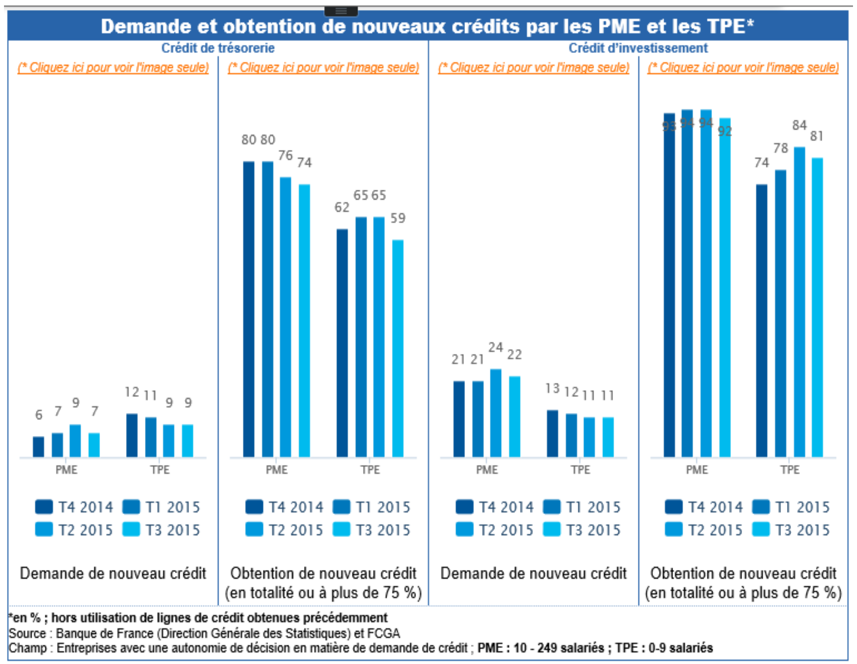
Outstanding amounts on bank loans per company size (in billions of euros)



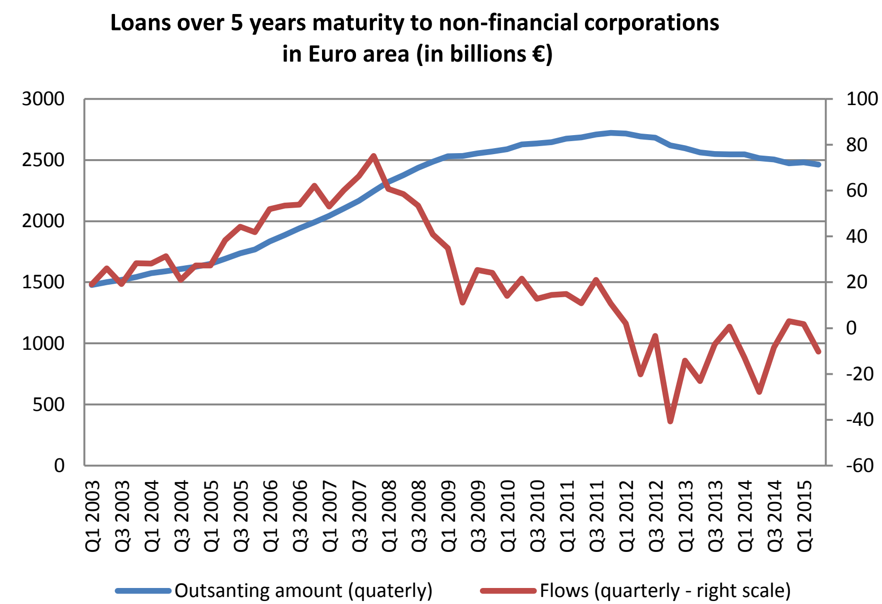
Sources : Banque de France

2.4. Bank lending still possible

Very high rate of new facilities granted in Q3 15



Infrastructure lending programmes (estimated by 5 yr + loans) have dropped since the crisis but regulatory requirements have not changed.



2. Have we managed to secure funding for the economy ?

2.5. The regulator’s « perception » of SME risk remains favourable

- SME funding is highly dependent on banks that encounter difficulties raising cash on the market on account of access costs and information asymmetries
- The default rate on loans to SMEs is higher than for big groups : (18.6% vs 9.3%)
  - Source : ABE, july 2015
- Loss Given Default on loans to SMEs is in practice lower than most of the current IRB modelling
- SMEs make for a more buoyant labour market

- **Reasons for lowering regulatory capital requirements for bank lending to SMEs**