The Adoption and Implementation of the Recommendations from Basel in the Context of the African Financial system

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12 November 2020

Agenda

No.	Agenda Items
1	African Regulatory Context
2	Basel Regimes
3	Benefits and Challenges in the Adoption of Basel Standards in Africa
4	Conclusion

African Regulatory Context

Context

With a population of over 1.2 billion and a median age of 19 years, **Africa will play an increasingly important role in shaping the future world economy**

The average annual GDP growth in Africa has exceeded the global average over the past several years, **and six of the world's 10 fastest-growing economies hail from this continent**

Africa's banking systems, are among the **fastest-growing and most profitable** of any region.

During the period 2012–17, **African banks' revenue grew at a compound annual rate of 11%,** and these institutions are projected to continue to be among the fastest-growing banking systems over the coming years

Africa has been at the **forefront of using technology** for banking services, long before "fintech" become a household term.

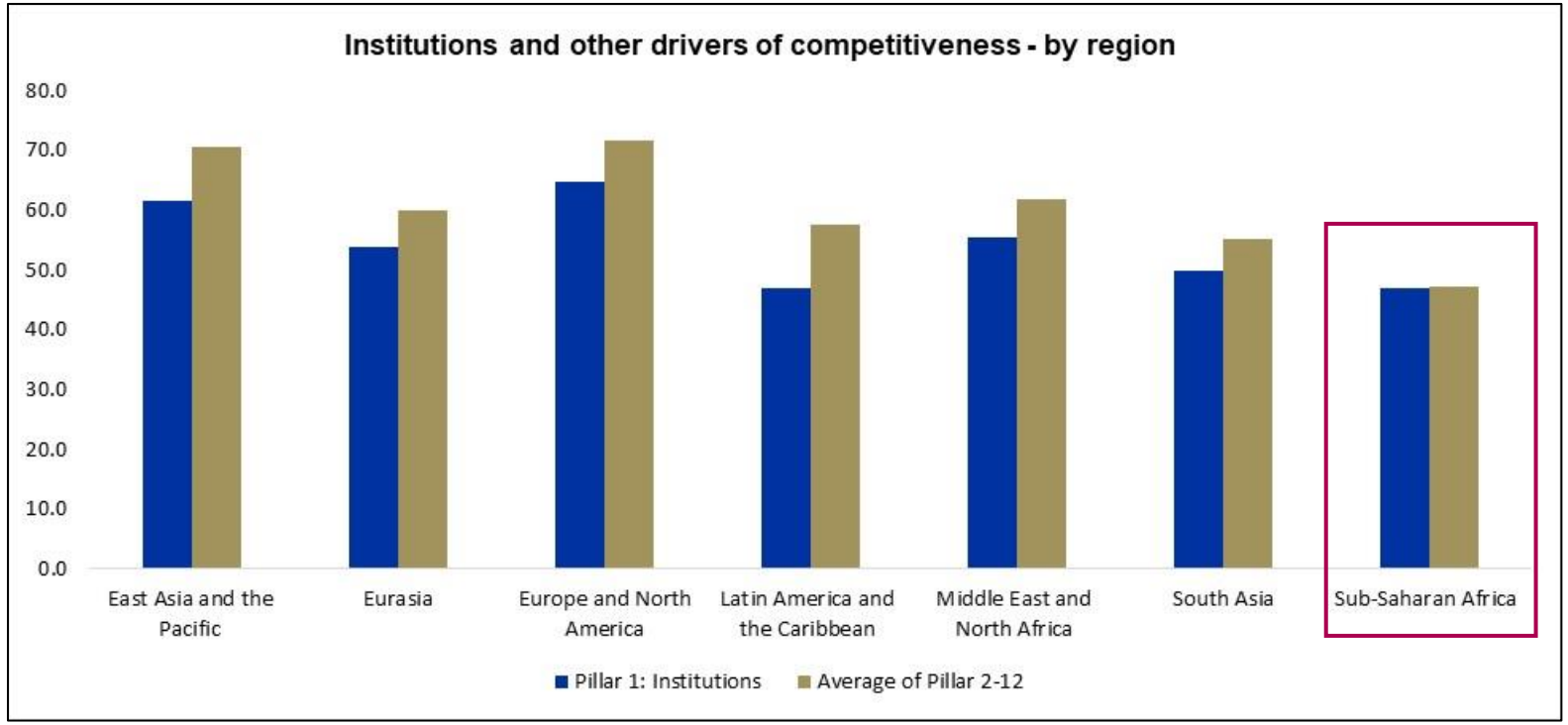
Kenya's M-Pesa mobile money service or Nigeria's Interswitch digital payments – which were set up over 15 years ago. With the more recent fintech startups, there are now over 250 active fintech companies in SSA

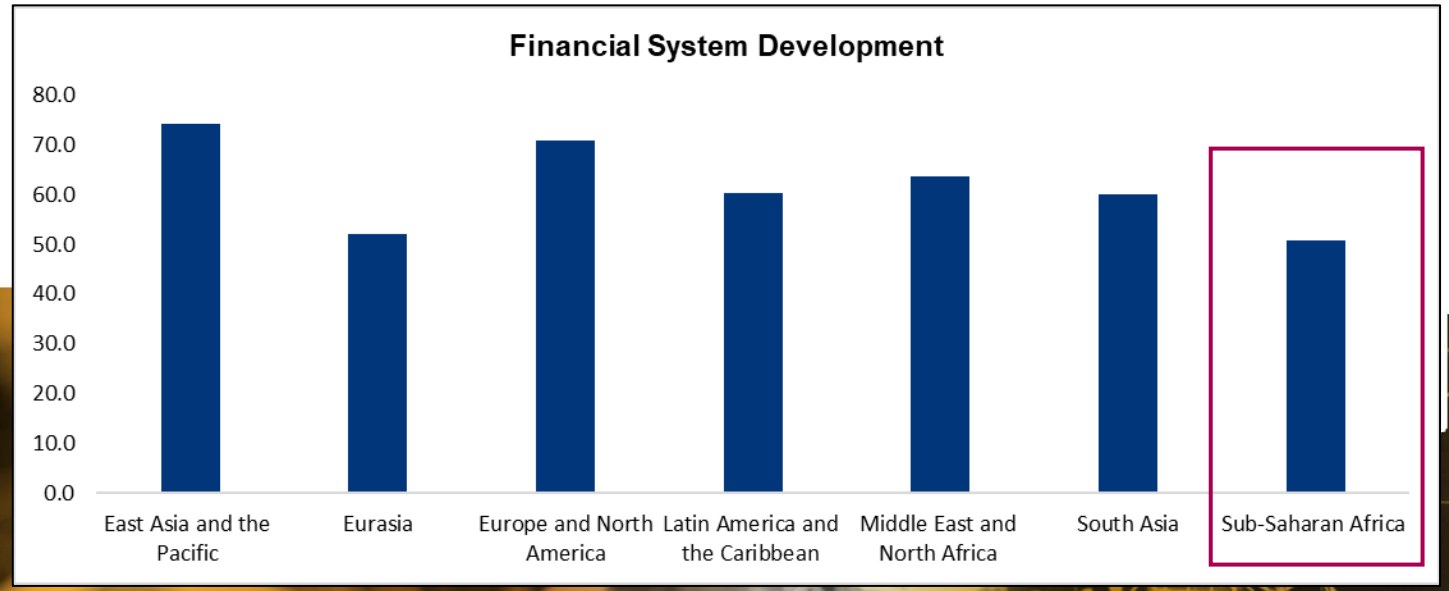
The prospects for Africa's banking systems require a robust and resilient regulatory foundation

Such a foundation helps deliver sustainable and healthy banking systems that can serve the real economies at all points of the financial cycle

Source: BCBS, 2020, 'Basel III: the implementation imperative'

Competitiveness of Financial Institutions





Source: World Economic Forum, 2020, 'The Global Competitiveness Report'.

Common Risks Faced by Banks

Shadow Banking

- Unregulated activities
- New competitors

Cybercrime

- Exponential technological changes
- Change in workplace environment
- Legacy infrastructure
- Security sufficiency
- Adequate operational continuity

Global Economy

- Covid-19 pandemic
- Economic slow-downs
- Political uncertainty
- Commodity price volatility
- Environmental risk

Volume of Regulations

- Regulatory Reform/ Evolution
- Covid-19 policy responses and the reversal thereof
- Higher cost of compliance
- Long-term financial stability

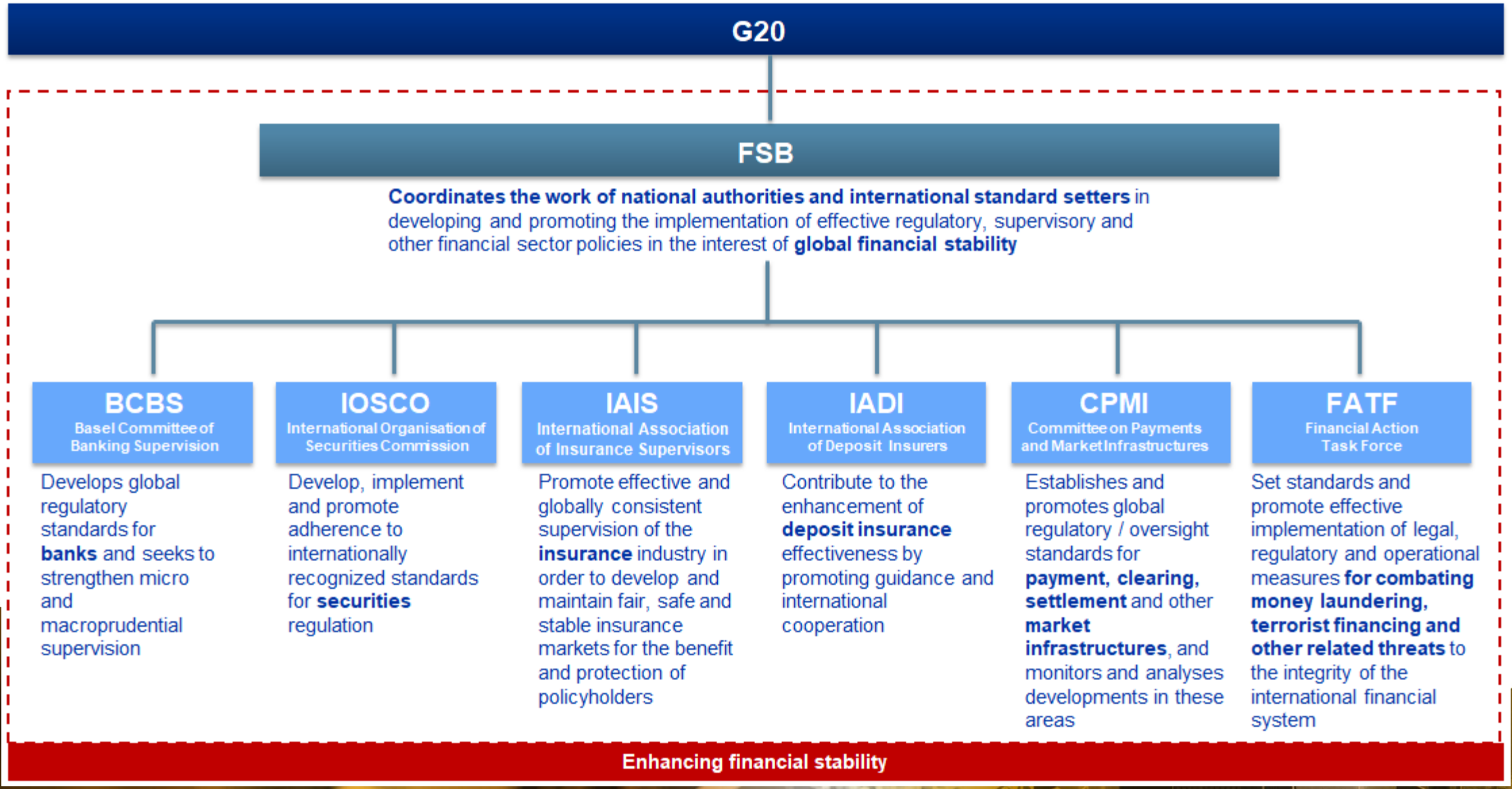
Social Changes

- Demographic changes
- Social and behavioural changes
- Urbanisation
- Acts of terrorism

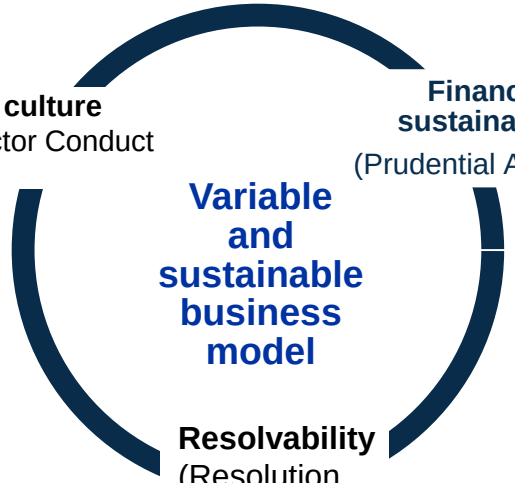
Global Interconnectivity

- Cross border interaction
- Workable and efficient resolutions

International Standard Setting Bodies



Categories of Banking Regulation



Conduct and culture
(Financial Sector Conduct Authority)

Financial sustainability
(Prudential Authority)

Resolvability
(Resolution Authority)

Conduct and culture

- customer fairness
- market integrity
- consumer empowerment
- executive and board accountability
- bias and conflicts of interest
- fees
- transparency
- transformation

Enabling regulations

- additional supervisory and regulatory frameworks for conduct
- standardising and developing comprehensive frameworks for customer protection, especially vulnerable consumers
- payments legislation, enabling inter-operability and increasing competition

Resolvability

- legislative requirements for resolution
- credible and effective resolution funding plans
- resolution planning by the authorities
- continuity of critical economic functions and of the services that support them
- sufficient loss absorbing capacity

Enabling regulations

- higher loss absorbing capacity requirements
- for systemic institutions
- recovery and resolution plans
- country resolution framework and standards
- resolvability assessments
- structural reform

Profitability

- RoE more than covers the COE
- profitable business lines
- cost control

Capital and Liquidity

- meet all regulatory capital, leverage and liquidity requirements
- meet internally assessed capital and liquidity requirements
- capital and liquidity planning
- ability to access equity and additional funding as and when required

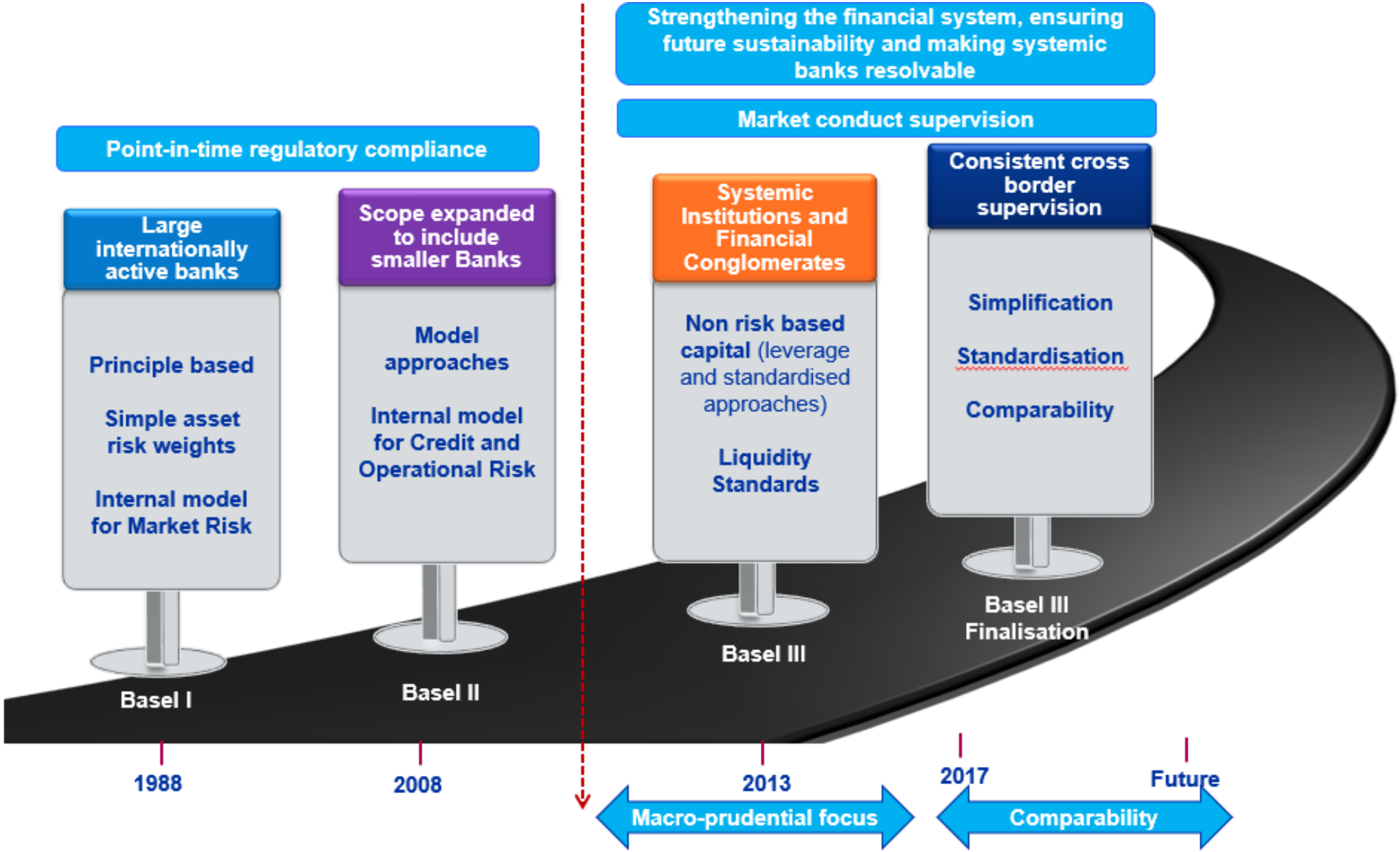
Enabling regulations

- Relevant Basel regime finalisation
- solvency and asset management
- Common framework
- OTC derivative reforms

Source: Standard Bank Group, 2020, ‘Risk and Capital Management Report 2019’

Basel Regimes

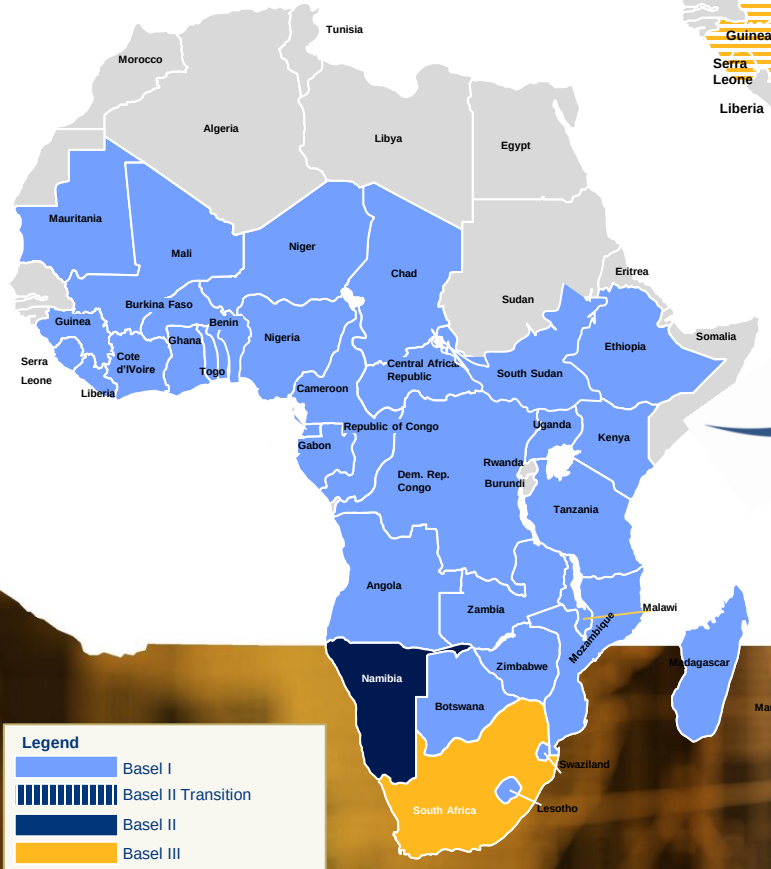
Evolution of the Basel Regulatory agenda



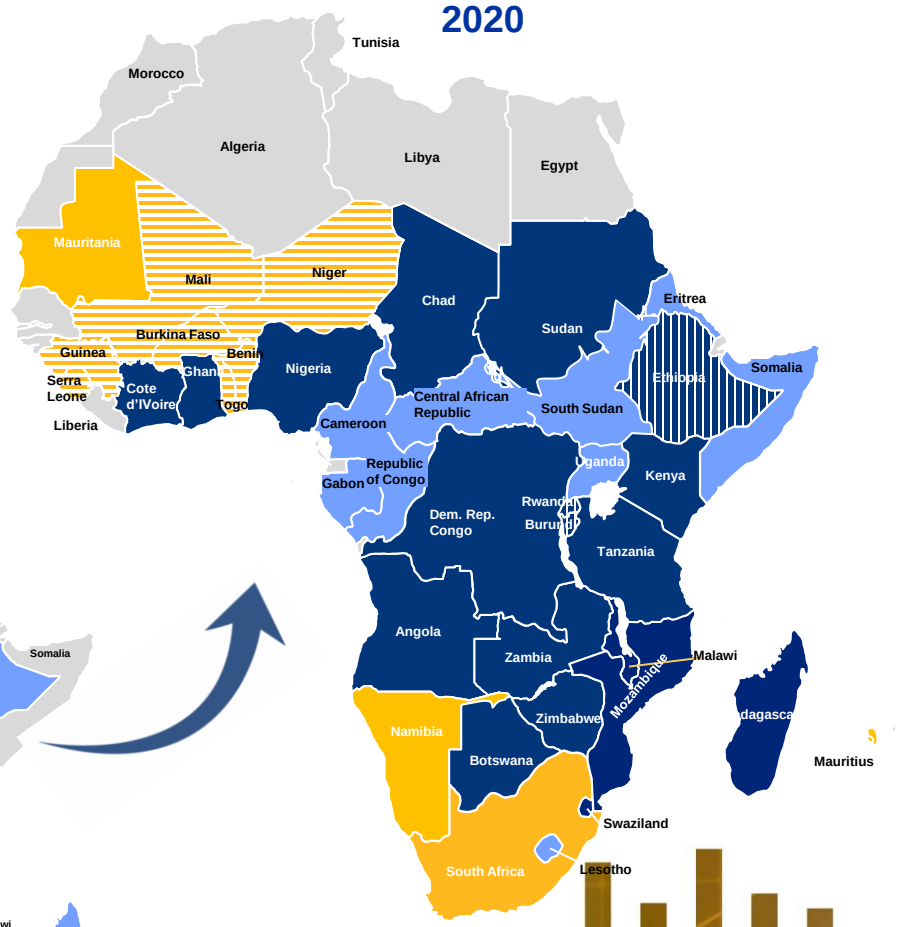
Status of Adoption of Basel Standards - SSA

Basel Adoption

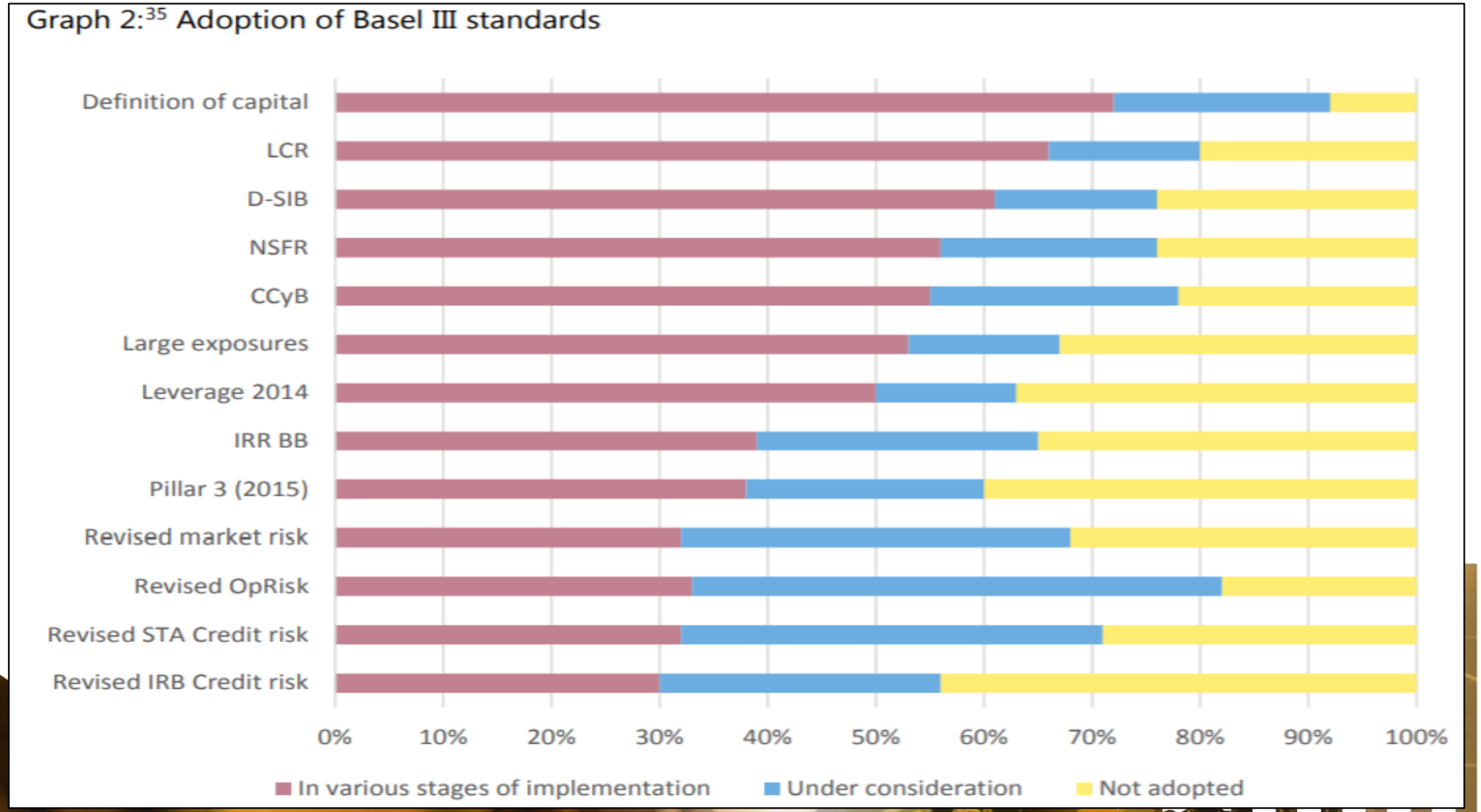
2013



2020



Basel III Adoption Journey



Source: BIS, November 2018, 'The Basel framework in 100 jurisdictions: implementation status and proportionality practices'

Value of Adoption of International Standards

Safeguarding financial stability is a matter of global collective responsibility. In a world with cross-border capital flows, no jurisdiction can preserve financial stability domestically through only its own policies

Preserving global financial stability requires jurisdictions to cooperate in identifying and mitigating risks to the global financial system

In developing the Basel III reforms, the Committee carefully weighted the costs and benefits of regulation

The benefits of Basel III accrue both to society as a whole, in the form of reduced frequency and impact of banking crises, and to banks directly, in the form of lower funding costs and better-quality lending

Adoption of Basel Regimes by Member Countries

Full implementation

The full scope of globally agreed reforms are expected to be implemented. A selective implementation of Basel III will result in a frail regulatory foundation, exposing banks and the real economy to vulnerable pockets of unmitigated risks

Timely implementation

The reforms are expected to be implemented no later than the agreed implementation dates

Consistent implementation

The reforms are expected to be implemented in a faithful and compliant manner. This means meeting both the letter and spirit of the standards (while allowing for any non-substantive drafting variations for the purpose of domestic legislation)

Source: BCBS, 2020, 'Basel III: the implementation imperative'

Proportionality and the Basel framework

Due to BCBS comprehensive approach to designing standards, **countries do not need to "adapt" Basel III to suit its domestic circumstance**

The BCBS supports the use of proportionality in implementing the Basel framework in a manner consistent with the Core Principles.
These principles are relevant for all banks and jurisdictions around the world, and provide the basis for a resilient banking system

Proportionality can take different forms

- Implementing the **most appropriate approaches** among those available in the Basel framework for **internationally active banks in member jurisdictions**.
- Implementing standards for banks in **non-BCBS member jurisdictions** that are **broadly consistent with the principles of the applicable Basel standards**
- A proportionate framework should **not reduce the resilience of banks or dilute the prudential regulatory framework**, but rather reflect the relative differences in risk and complexity across banks and the markets in which they operate
- A proportionate framework should also **consider supervisory capacity and resources**, particularly when implementing more complex standards.

The BCBS encourages jurisdictions in Africa to pursue a proportionate approach to their implementation of the Basel framework along these lines, where relevant

Source: BCBS, 2020, 'Basel III: the implementation imperative'

Making Basel III work for Africa

The financial systems in Africa show the following critical differences, relative to financial systems in advanced countries, that need to be considered when designing a regulatory framework

- Highly **variable access** to international capital markets
- High macroeconomic and financial **volatility**
- **Less developed** financial systems
- **Limited availability of market data** and limited transparency
- Capacity, governance, and **general institutional constraints**

These characteristics help explain why the impact of international regulatory reforms, such as those under Basel III, is expected to be different in Africa than in advanced countries. **They also imply the need for a differentiated approach to bank regulation to make Basel III work in Africa**

Three principles for consideration

Minimize the negative spill-over effects of Basel III adoption in advanced countries, which might arise from effects in cross-border lending to EMDEs and the emergence in EMDEs of an unlevel playing field between affiliates of global banks and domestic banks.

Aim for proportionality in applying standards, by adapting them to country circumstances so as to maximize the benefits of stability for their financial systems. This implies both proper specification of risks and adequate calibration and adaptation of standards to those risks without weakening the prudential and supervisory framework.

Minimize the trade-offs between financial stability and financial development. Although the primary objective of financial regulation is financial stability, the economic and social returns to further financial deepening is substantially higher in Africa than in advanced economies, calling for a balance between stability and development concerns.

Source: Center for Global Development, 2019, 'Making Basel III Work for Emerging Markets and Developing Economies'

Benefits and Challenges in the Adoption of Basel Standards in Africa

Impact of Operating in Basel I & II & III Jurisdictions

Basel I Group in Basel I Jurisdiction

- ✗ **Misalignment with global standards** leading to **constraint in terms of raising international funding** required for economic growth
- ✓ Greater lending capacity due to lower capital ratios

Basel II Group in Basel I Jurisdiction

- ✗ Basel II group capital requirement may be higher than in-country requirements (can be at group level)
- ✗ Higher cost of capital which affects pricing of products and services
- ✗ Lower ROE compared to local peers
- ✓ Funding costs may be lower than that of local competitors
- ✓ Higher risk and capital management practices than local competitors

Basel II Group in Basel II Jurisdiction

- ✗ Higher capital requirements result in higher risk based pricing and constrained lending capacity
- ✗ Higher compliance cost and additional resource capacity required
- ✓ More sophisticated risk and capital management practices / disclosure result in higher resilience of entities and financial system

Basel II Group in Basel III Jurisdiction

- ✗ Would have to adopt Basel III rules for the subsidiary operating in this jurisdiction

Basel III Group in Basel I / Basel II Jurisdiction

- ✗ Shallow debt markets / lack of term funding available in market – sourced in foreign markets at potentially high cost
- ✗ Limited scope for issuing Basel III compliant capital
- ✗ Use of standardized approaches and lack of credit ratings result in significant credit capital increase
- ✗ Sovereign treatment impact significant at group level due to large sovereign holdings
- ✓ Funding costs may be lower than that of local competitors
- ✓ Higher risk and capital management practices compared to local competitors

Basel III Group in Basel III Jurisdiction

- ✗ Higher funding costs due to demand for stable and longer-term funding
- ✗ Competition for valuable retail deposits
- ✗ Retention of profits and reduced dividends in order to meet capital requirements

Future Basel III+

- ✗ Basel IV - increased capital requirements will have an impact on capacity and cost to banks in providing financing in SSA
- ✗ Sovereign risk implications could be significant if not considering constraints of SSA markets
- ✗ FRTB – together with new CVA make hedges unfeasible, leading to risk built up in other sectors of economy

Implications of adopting Basel III for Africa

	Context	Basel Impact
SME Lending	**Formal MSME Finance Gap** • Global: $5.2 trillion • Sub-Saharan Africa: $331 billion • Middle East and North Africa: $195 Billion	• Capital requirements higher as fewer assets available for collateral • Potential diversification benefit
Infrastructure Financing	Cross-border nature of IF in EMDEs resulting in greater dependence on foreign sources of capital Limited ability to hedge currency risks creates some disincentives for IF investments in EMDEs	• Constraints of the large exposure rule • Capital requirements higher for long tenor infrastructure projects • Liquidity requirements will require banks to match longer-term assets with longer-term funding, which requires that banks have access to this type of funding

Source: FSB, 2019,'Evaluation of the effects of financial regulatory reforms on infrastructure finance'.
Source: Centre for Global Development, 2018, 'Basel III & Unintended Consequences for Emerging Markets and Developing Economies - Part 4: Challenges on Infrastructure and SME Lending'

Basel III Finalisation - Simplified Transition


Basel Committee
on Banking Supervision

Basel III: Finalising
post-crisis reforms

December 2017

BANK FOR INTERNATIONAL SETTLEMENTS

The Basel IIII Finalisation standardised approaches **have much more granular calculation rules than the existing BII/BIII standardised approaches** and will be more complex to implement

- However, **compared to the advanced approaches**, it will be **a relatively simpler implementation** that does not rely extensively on loss data availability, risk modelling expertise, re-training of bank staff to use model outputs in decisions, process changes

Migration **from the current BII/BIII to the Basel IIII Finalisation standardised approach should be achievable within a relatively shorter period by large African banks** compared to the multi-year transformation efforts typically associated with migrating from standardised to advanced approaches

Capital implications for African banks will be a function of many factors, such as

- **Extent of capital adequacy reform**, **business models** of banks and **risk profiles** of banks
- Some African countries **have set the minimum capital adequacy ratio at a large margin above the BCBS minimum requirement to compensate for the reduced risk sensitivity of the current standardized approaches**
    - This could be **reduced** when adopting the more risk sensitive standardised approaches under Basel III Finalisation rules

Benefits and challenges of Basel III adoption in Africa

Benefits

- **Comparability** with capital ratio components of banks in developed markets
- **Accreditation resulting in increased confidence** in the banking systems of African countries adopting Basel III
- The **increased risk sensitivity** of the standardized approaches and **enhanced disclosure will increase credibility in the capital adequacy measures** produced by these approaches

Challenges

- **Domestic banks** with limited cross-border exposure may show little enthusiasm to embrace Basel III standards
- **Regulators are often selective adopters** They choose some aspects of Basel standards to adopt and choose the aspects to ignore
- African banks will be **required to hold capital buffers** in line with Basel III standards

Source: Capital Markets in Africa, October 2016, ‘Emerging BASEL IV: An Opportunity For African Banks?’.

Conclusion

Conclusion – Adoption of Basel Regimes in Africa

Impact Assessments

- Impact on financial institutions
- Impact on EMDE countries' economic and development objectives, eg
  - Financial Inclusion
  - SME Lending
  - Infrastructure Financing
- Suitable timeline for transition

Harmonisation of Regulations

- Inter-agency co-ordination within jurisdiction
- Cross-border collaboration and information sharing between regulators
- Structured approach to harmonization – regional and global

Regulatory Accreditation

- Awareness of level of sophistication of financial regulations in each jurisdiction
- Participation in global surveys and potential future calibration of new standards