

BIS 3 implementation in Asia - Implications for Asian Banks

Seminar on Imperatives of Basel III Capital Requirements

10.45 am to 11.15 am July 4th, 2014

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Topics

- Scope of this seminar segment

- Basel II vs. Basel III (including A-IRB vs. Standardised) Discussion
- Creation of CET1 & T1 & Capital Buffers. Slide 3
- Target CAR: Integrating Basel III Buffers with Basel II Pillar 2 ICAAP. Slide 4
- Local Regulatory Guidance for CET1, T1 & Total – examples. Slide 5
- And now it gets complicated – how do we create a level playing field? Slides 6/7
- Integrating Leverage Ratio buffer with Basel III Buffers. Slides 8/9
- Propositions/Questions Slide 10

Calibration of the Pillar 1 Basel III Minimum Capital Framework

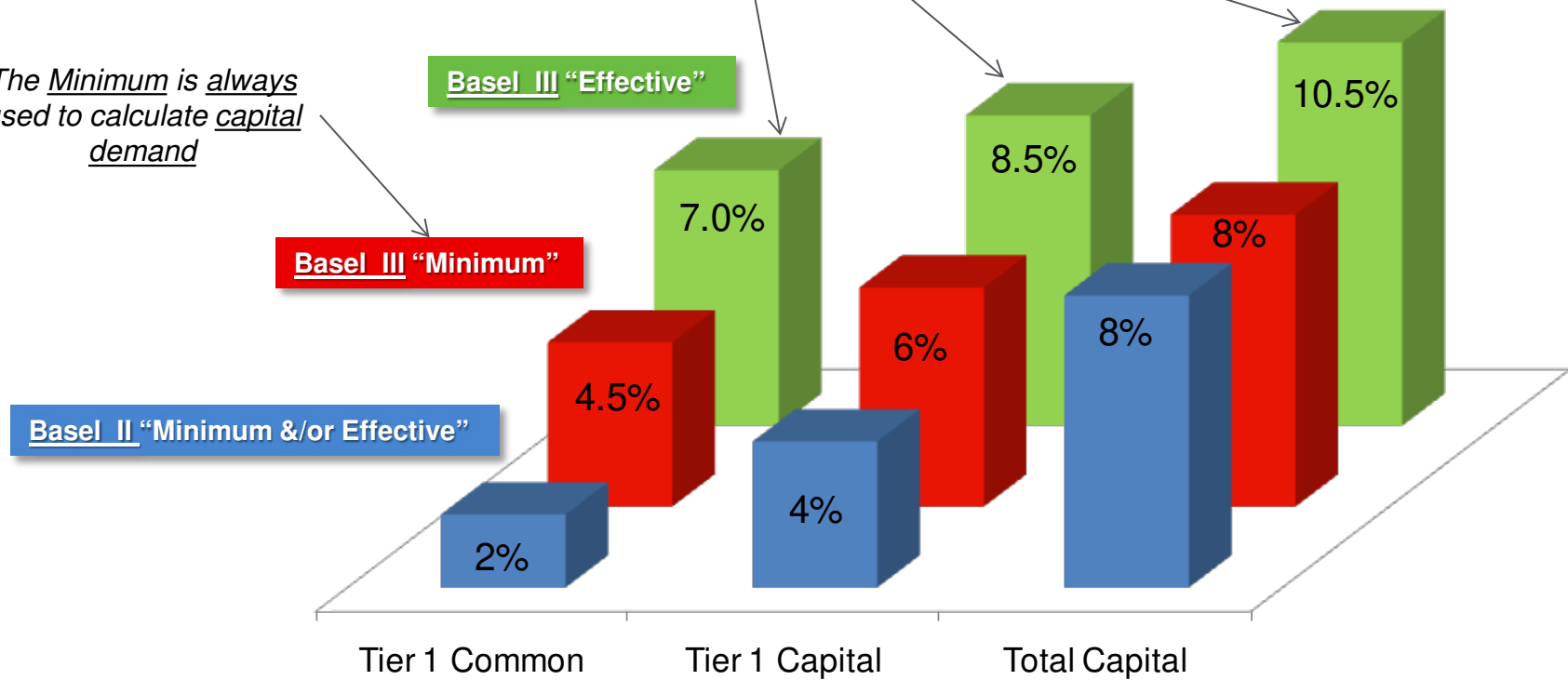
Basel III			
Classification	CET1	T1	Total
Minimum CAR	4.5%	6.0%	8.0%
Conservation Buffer	2.5%	2.5%	2.5%
Countercyclical Buffer	0-2.5%	0-2.5%	0-2.5%
SIB Buffer	0-2.5%	0-2.5%	0-2.5%
Min Effective Value	7.0%	8.5%	10.5%
Max Effective Value	12.0%	13.5%	15.5%

Conservation Buffer of 2.5% ensures banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred.

But capital conservation restrictions apply if CET1 CAR is in 4.5% to 7.0% range:

Common Equity Tier 1 Ratio	Allowed Capital Distributions and Discretionary Bonus Payments
> 7.0%	100%
>5.125% - 5.75%	80%
>5.75% - 6.375%	60%
>5.125% - 5.75%	40%
4.5% - 5.125%	0%

The Minimum is always used to calculate capital demand



Integrating the Conservation Buffer & the Pillar 2 ICAAP Buffers

The Pillar 2 ICAAP report measures the CAR impact of:

1. Additional risks to the Credit, Market and Operational risks covered in Pillar 1.
2. A 1-in-25 year firm wide stress event on all Pillar 1 & 2 Risks.

In the chart to the below these impacts are represented by “Other Pillar 2 Risks” and “Pillar 2 Stress Impact” respectively. Since “the Conservation Buffer ensures banks build up capital buffers outside periods of stress which can then be drawn down as losses are incurred”, the Target CAR in the example below is calculated as follows:

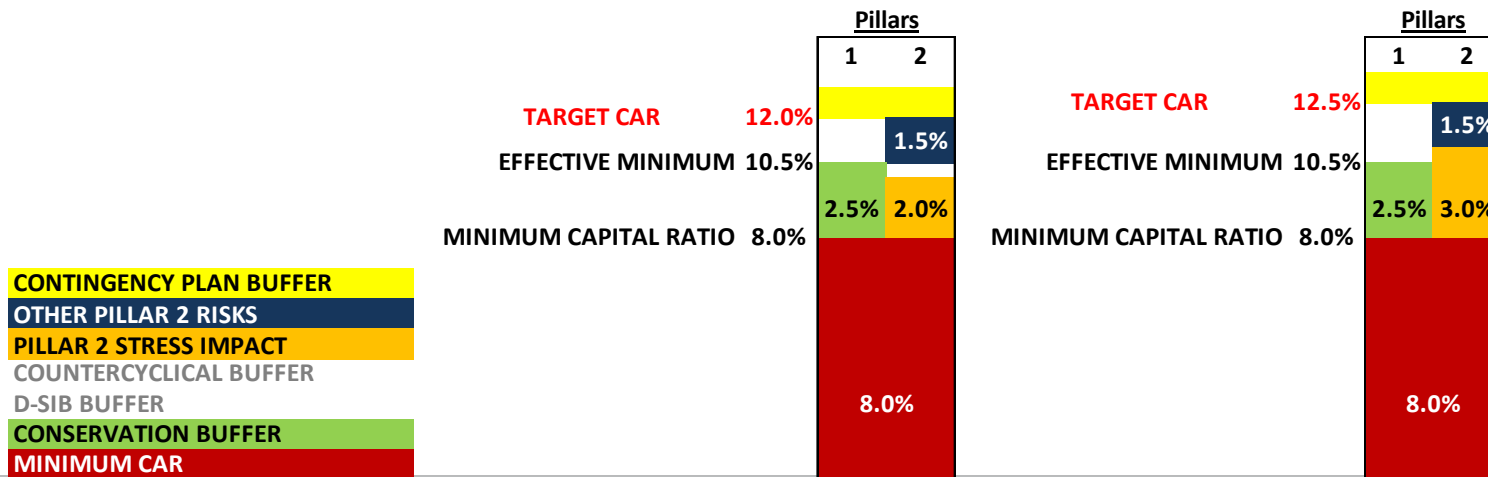
B3 TARGET CAR equals the **Minimum Capital Ratio (8.0%)**,
plus the **Other Pillar 2 Risks impact** (typically ~1.0% to 1.5%)
plus the **greater of** the **Conservation Buffer (2.5%)** and the **Pillar 2 Stress impact** (2.0% & 3.0% in the two examples below),

A Trigger CAR is set at a sufficient level above the Target CAR to accommodate capital contingency plan lead times. Countercyclical and D-SIB buffers should only be considered when there is specific guidance to do so issued by the regulator.

B3 TARGET CAR DEVELOPMENT

With Pillar 2 Stress impact **LESS** than Conservation Buffer

With Pillar 2 Stress impact **MORE** than Conservation Buffer



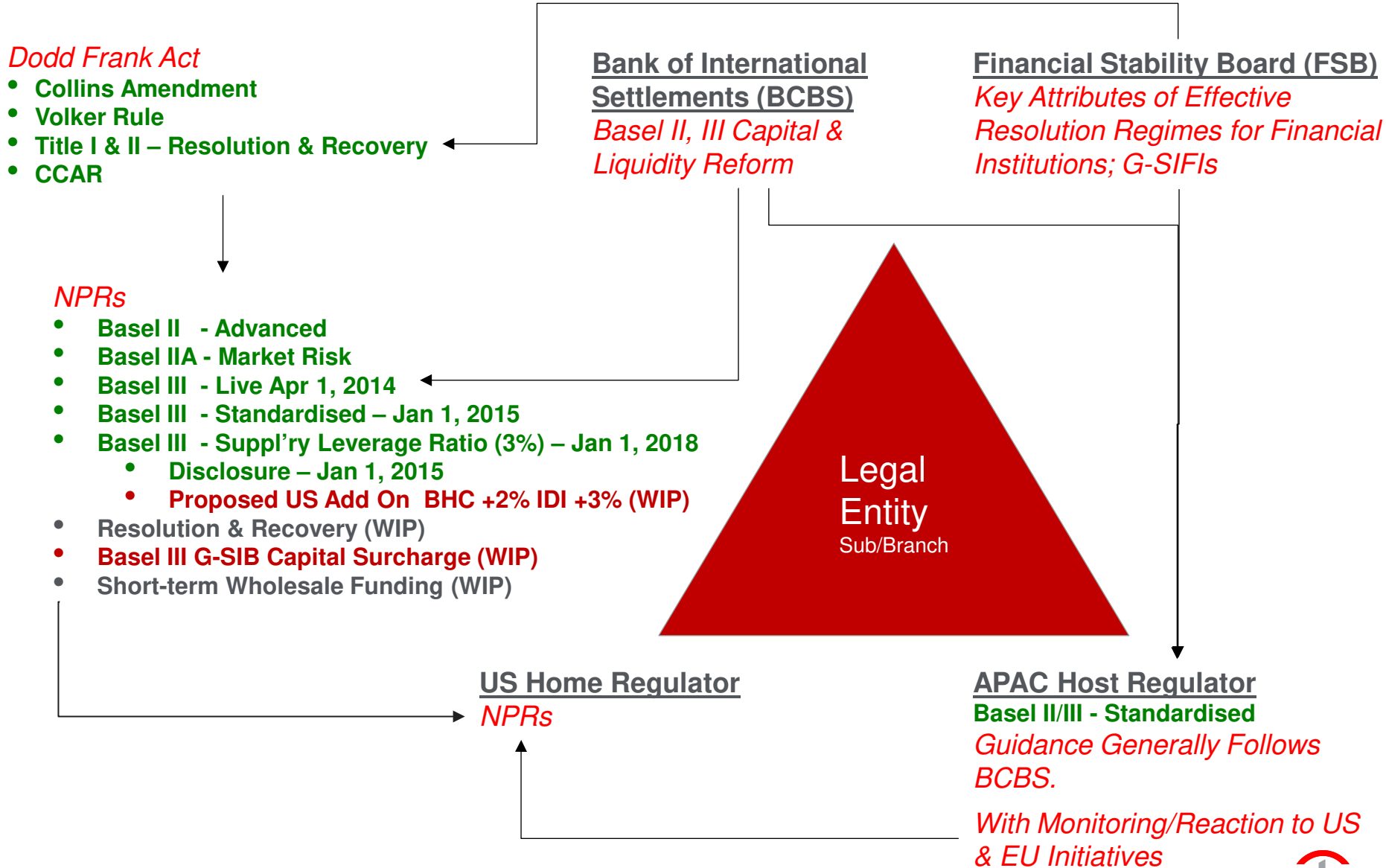
Basel III: Asia Pacific Reporting vs. Citigroup US Cons Reporting

MINIMUM & EFFECTIVE CAPITAL ADEQUACY RATIOS IN 2019

		BIS & Citi (US Cons)		China		B/(W)		Hong Kong		B/(W)		Singapore		B/(W)		India		B/(W)		Australia		B/(W)	
Minimum	CET1	4.5%	5.0%	(0.5%)	5.1%	(0.6%)	6.5%	(2.0%)	5.5%	(1.0%)	4.5%	-											
	T1	6.0%	6.0%	-	6.8%	(0.8%)	8.0%	(2.0%)	7.0%	(1.0%)	6.0%	-											
	Total	8.0%	8.0%	-	9.0%	(1.0%)	10.0%	(2.0%)	10.0%	(2.0%)	8.0%	-											
	Timing	2013-2015	2013		2013-2015		2013-2015		2013-2015		2013-2015		2013-2015		2013-2015		2013-2015		2013-2015		2013-2015		
Buffers	Cons Buffer	2.5%	2.5%	-	2.5%	-	2.5%	-	2.5%	-	2.5%	-											
	G/D-SIB	2.0%	-	2.0%	-	2.0%	-	2.0%	-	2.0%	-	2.0%	-										
	Countercyclical																						
Effective	CET1	9.0%	7.5%	1.5%	7.6%	1.4%	9.0%	-	8.0%	1.0%	7.0%	2.0%											
	T1	10.5%	8.5%	2.0%	9.3%	1.3%	10.5%	-	9.5%	1.0%	8.5%	2.0%											
	Total	12.5%	10.5%	2.0%	11.5%	1.0%	12.5%	-	11.5%	1.0%	10.5%	2.0%											
	Timing	2016-2019	2013-2018		2016-2019		2016-2019		2016-2019		2016-2019		2016										
Mgt & ICAAP Pillar 2		1.5%	1.5%		1.5%		1.5%		1.5%		1.5%												
Target CAR		14.0%	12.0%		13.0%		14.0%		13.0%		12.0%												



Basel III, FSB, Dodd Frank, NPRs & Local Regulatory Guidance

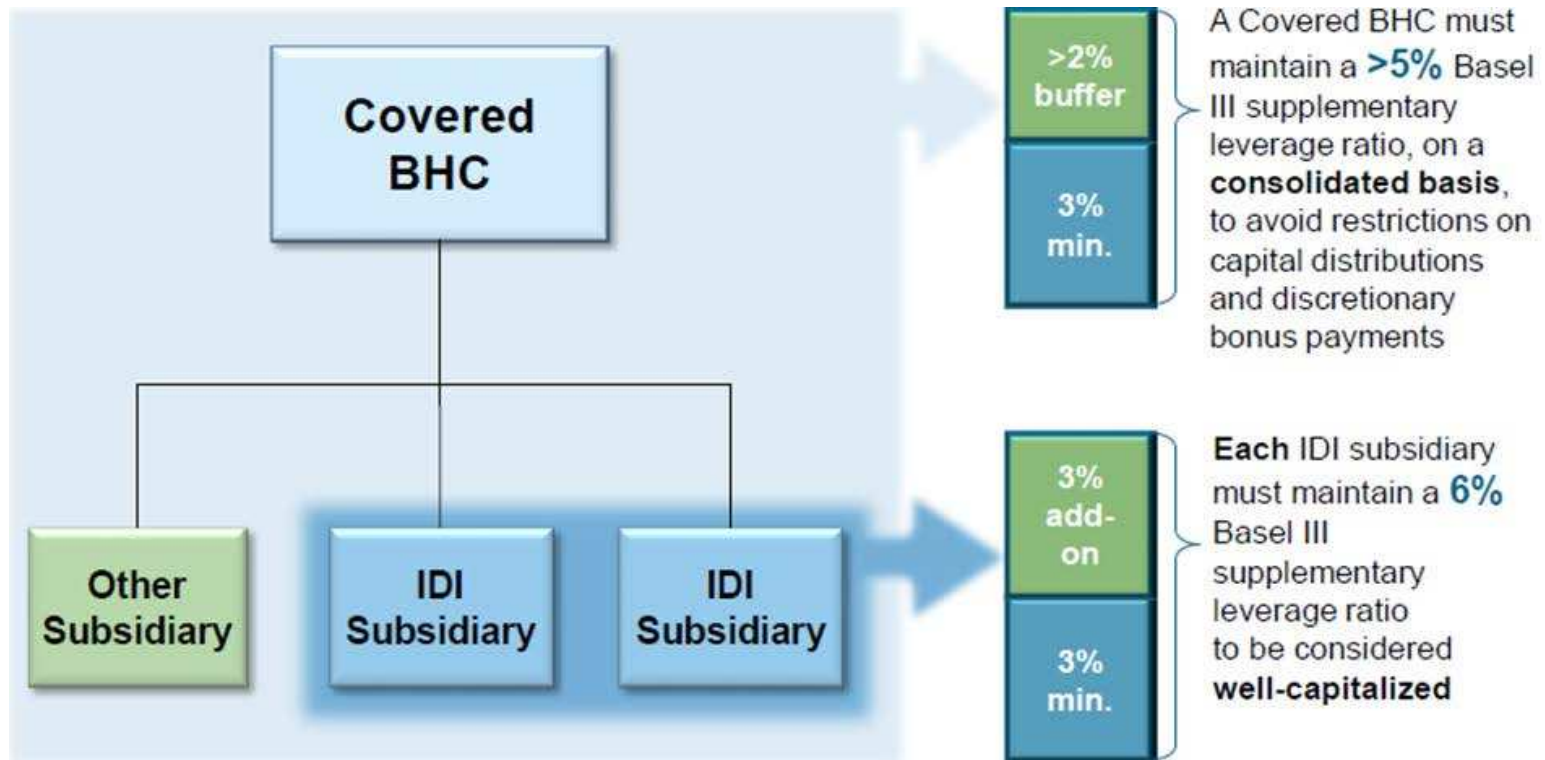


And now it gets complicated.....

- Collins Amendment: States that no US bank can take advantage of using the Advanced Approach (supposedly creating lower RWA)
 - Each A-IRB bank must concurrently run a Standardised approach and compare results – taking the larger of the two for CAR purposes.
- Volker Rule: Prohibits proprietary trading for own account globally.
- Title I & II – Resolution & Recovery: Prescribes authority structure and resolution processes.
- Proposed US Leverage Ratio Add On: BHC +2% IDI +3%.

The US Add-on to Basel III Supplementary Leverage Ratio NPR

- The proposed US Add-on would require the eight US Banking holding companies (BHCs) identified as SIFIs, and their insured depository institution (IDI) subsidiaries, to maintain a Basel III supplementary leverage ratio greater than 5% and 6% respectively. The BHCs are required to maintain buffer in a similar way to the capital conservation buffer in the U.S. Basel III final rule.



The US Add-on to Basel III Supplementary Leverage Ratio NPR

The Covered BHC is subject to the **lower** of:

1. the maximum payout amount as determined under the capital conservation buffer framework **and**
2. the maximum leverage payout amount as determined under the leverage buffer framework

CONSERVATION BUFFER

Individual bank minimum capital conservation standards	
Common Equity Tier 1 Ratio	Allowed Capital Distributions and Discretionary Bonus Payments
> 7.0%	100%
>5.125% - 5.75%	80%
>5.75% - 6.375%	60%
>5.125% - 5.75%	40%
4.5% - 5.125%	0%

LEVERAGE BUFFER

Individual bank minimum capital conservation standards	
Leverage Ratio	Allowed Capital Distributions and Discretionary Bonus Payments
> 5.0%	100%
>4.5% - 5.0%	60%
>4.0% - 4.5%	40%
>3.5% - 4.0%	20%
3.0 - 3.5%	0%

Let's say B3 ratios:

- CET1 Car is 10.0% (max payout is 100%)
- Leverage Ratio is 4.9% (max payout is 60%)

Max payout will be limited to 60%

Propositions on the Topics

For Foreign and Asian Banks:

- Creation of CET1 & T1 & Capital Buffers. Slide 3
- Target CAR: Integrating Basel III Buffers with Basel II Pillar 2 ICAAP. Slide 4
- Local Regulatory Guidance for CET1, T1 & Total – examples. Slide 5
 - Departure from BIS MCRs by some local regulators lead to increased Target CARs, but not really a mountain on the competitive playing field.
 - Severity of stress testing is very variable across the countries in Asia Pacific (including CCAR results) – with management actions reducing the severity.

For Foreign Banks:

- And now it gets complicated Slides 6/7
- Integrating Leverage Ratio buffer with Basel III Buffers. Slides 8/9
 - There are still unknowns around the Collins Amendment – certainly changing the RWA calculation from Advanced to Standardised would create significant impacts on some products Return on B3RWA and TCE. BCBS Standardised Approach wisely does not include a “Use Test”. Maybe the same principle will apply and allow the use of IRB models to manage the business.



Thank You