Summary of basel iii guidelines

The Basel III Agreement is a series of financial reforms developed by the Basel Committee on Banking Supervision (BCBS) with the aim of strengthening regulation, supervision and risk managementSystem systemic risk systemic risk can be defined as the risk associated with the collapse or failure of a company, industry, financial institution or entire economy. It is the risk of a major failure of a financial system, with a crisis occurring when investors lose confidence in capital users in the banking sector. Due to the impact of the 2008 global financial crisis on banks, Basel III was introduced to improve banks' ability to cope with shocks caused by financial stressCosts of debtThe cost of debt is the return that a company makes available to its debtors and creditors. The cost of debt is used in WACC calculations for valuation analysis. increase their transparency and disclosure. Basel III builds on the existing Basel I and II agreements and is part of a continuous process to improve regulation in the banking sector. The agreement is designed to prevent banks from harming the economy by taking more risks than they can manage. The Basel CommitteeThe BCBS was founded in 1974 by the Federal Reserve (The Fed). The Federal Reserve is the central bank of the United States and the tax authority behind the world's largest free market economy. Governors of the Group of Ten (G10) countries in response to disruptions in the financial markets. The Committee was set up as a forum for Member States to discuss banking supervision issues. BCBS is responsible for ensuring financial stability by strengthening regulatory, supervisory and banking practices worldwide. The Committee was enlarged in 2009 to 27 countries, including Brazil, Canada, Germany, Australia, Argentina, China, France, India, Saudi Arabia, the Netherlands, Russia, Hong Kong, Japan, Italy, Korea, Mexico, Singapore, Spain, Luxembourg, Turkey, Switzerland, Sweden, South Africa, the United Kingdom, the United States, Indonesia and Belgium. Its secretariat is located in Basel, Switzerland, at the Bank for International Settlements (BIS). Since its inception, the BCBS has formulated the Basel I, Basel II and Basel III agreements. Basic Principles of Basel III1. Minimum capital requirementsThe Basel III agreement has raised the minimum capital requirements for banks from 2% in Basel II to 4.5% of the share capital as a percentage of the bank's risk-weighted assets. In addition, there is an additional buffer capital requirement of 2.5%, which increases the minimum requirement to 7% overall. Banks can use the buffer when faced with financial burdens, but this can add to even more financial constraints the payment of dividends. From 2015, core capital requirements increased from 4% in Basel II to 6% in Basel III. The 6% includes 4.5% of Common Equity Tier 1 capital and an additional 1.5% of Additional Tier 1 capital. that the should be implemented from 2013, but the implementation date has been postponed several times and banks now have until 1 January 2022 to implement the changes.2. Leverage RatioBasel III introduced a non-risk leverage ratio to serve as a backstop for risk-based capital requirements. Banks must maintain a leverage ratio of more than 3%. The non-risk-based leverage ratio is calculated by dividing Tier 1 capital by a bank's average consolidated total assets. To meet this requirement, the Federal Reserve Bank of the United States set the leverage ratio at 5% for insured bank holding companies and 6% for systematically important financial institutions (SIFI).3. Liquidity requirementsBasel III introduced the use of two liquidity ratios – the liquidity coverage ratio and the stable net financing ratio. The liquidity coverage ratio requires banks to have sufficient high-liquid assets that can withstand a 30-day stress financing scenario set by the supervisory authorities. The liquidity coverage mandate was introduced in 2015 at only 60% of the stated needs and is expected to increase by 10% per year by 2019 if it suspends its full impact. On the other hand, the Net Stable Funding Ratio (NSFR) requires banks to maintain stable financing above the required amount of stable funds for a period of one year of prolonged stress. The NSFR is designed to address liquidity sinks and will begin operations in 2018. The demand of Basel IIIThe requirement that banks must keep a minimum capital amount of 7% in reserve will make the banks less profitable. Most banks will try to maintain a higher capital reserve to cushion themselves from financial difficulties, even if they reduce the number of loans to borrowers. They will be obliged to hold more capital against assets, which will reduce the size of their balance sheets. A 2011 study by the Organisation for Economic Co-operation and Development (OECD) found that the medium-term impact of Basel III on GDP would be -0.05% to -0.15% per year. To stay afloat, banks will be forced to increase their credit spreads by passing on the extra costs to their customers. The introduction of new liquidity requirements, in particular the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), will have an impact on the business activities of the bond market. In order to meet the LCR criteria for liquid assets, banks will be reluctant to hold high outflow assets such as Special Purpose Vehicles (SPV). SPV is a structured investment vehicle (SI) Investment Vehicle (SIV)A Structured Investment Vehicle (SIV) is a non-bank financial company set up to acquire investments designed to benefit from the difference in interest rates - the so-called credit spread - between short- and long-term debt. The demand for Assets and low-value corporate bonds will decline due to LCR bias against banks holding government bonds and covered bonds. As a result, banks will hold more liquid assets and increase the share of long-term debt to reduce maturity inruence and maintain the minimum number of NSFR. Banks will also minimise business operations that are more subject to liquidity risks. The implementation of Basel III will have an impact on derivatives markets as more and more clearing brokers leave the market due to higher costs. The Basel III capital requirements focus on reducing counterparty risk, which depends on whether the bank trades through a trader or a central clearing counterparty (CCP). When a bank enters into a derivative trade with a trader, Basel III creates a liability and requires a high capital burden for that trade. On the contrary, trading derivatives via a CCP only leads to a 2% fee, which makes it more attractive to banks. The exit of traders would consolidate the risks of fewer members, making it more difficult to transfer transactions from one bank to another and increasing systemic risk. CriticismThe Institute of International Finance, a 450-strong banking association based in the United States, protested against the implementation of Basel III because of its potential to harm banks and slow economic growth. The OECD study found that Basel III was likely to reduce annual GDP growth by 0.05 to 0.15%. The American Bankers Association and a host of Democrats in the US Congress also opposed the implementation of Basel III, fearing that it would paralyze small US banks by increasing their holdings of mortgage and SME loans. Other ResourcesCFI is a global provider of financial modeling courses and financial analyst certificationFMVA® CertificationJoin 350,600+ students working for companies such as Amazon, J.P. Morgan and Ferrari. To further develop your career as a financial professional and gain a more thorough understanding of the banking industry, review the following additional CFI resources:Credit RiskCredit Risk Is the risk of a loss that may arise from a party's failure to comply with the terms of a financial contract, mainly capital controlsCapital controlsCapital controls capital controls are measures taken by either the government or the central bank of an economy to regulate the outflow and inflow of foreign capital in the country. The measures taken may take the form of taxes, duties, quantitative restrictions or complete legislation. Currency RiskCurrency RiskCurrency Risk currency risk, or exchange rate risk, refers to the investors or companies operating in different countries in relation to unforeseeable gains or losses due to changes in the value of one currency in relation to another currency. Quantitative easingQuantitative easingQuantitative easing (QE) is a monetary policy of money printing implemented by the central bank to stimulate the economy. The central bank creates