Basel reform may lead to higher bank lending rates

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Named after the beautiful Swiss Town where it has its secretariat at the Bank for International Settlements, the Basel Committee on Banking Supervision was formed as an effort to raise the standards of banking supervision worldwide (Settlements B. f., 2011). It achieves so, via a mutual reciprocity of information on supervisory issues and techniques. After Basel I and II, the latest update to the Basel Accords (1988), Basel III is to be implemented starting from 1st January, 2013 (Settlements, 2010) and would take effect gradually over the next eight years. Its aim is to improve upon the banking sector's shock absorbing & risk managing ability and bolster its transparency (Settlements, 2011)

Basel III concentrates on achieving financial system cohesion, through its both micro and macro, institution-specific reforms. This is an improvement on Basel II, a proven failure in insuring banks with enough capital to withstand a juggernaut of a credit crunch, during global economic crisis. The Basel III micro reforms would include raising quality of capital, improved coverage of risk, requirement of higher level of capital and introduction of a global liquidity standard. Introduction of a leverage ratio, measures to raise capital levels and an enhanced loss-bearing capacity in the banks are its macro counterparts. (Settlements, 2010)

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These reforms, centrally, have two pivotal demands 1) the banks need to have more liquid assets (banks need to hold core Tier 1 capital of 4.5% + 2.5% buffer & there would be restrictions on dividends and bonus payout on any bank which operates below 7% ratio) (Griffiths, 2010) (the Bank of International Settlements have recently announced that there would have been a $762.85 Billion shortage, had Basel III rules come through in 2009 (Rogow, 2010)), like Government debt. The liquid assets that can be used in repo transactions, have been very assertively and specifically been defined by the APRA (Australian Prudential Regulation Authority). The length of the time period required to adjudicate whether a bank can withstand a particular crisis (liquid coverage ratio), has also been stretched. 2) Based on assessment of liquidity of assets and contingent liabilities, there is a requirement of a minimum proportion of long-term stable funding over one single year horizon. (Davis, 2010). Under the new rules, the Group 1 institutions (more than 3 Billion Euros in capital), require in additional common equity, 177 Billion Euros, which goes up to 577 Billion Euros, in order to maintain the 7% ratio (Griffiths, 2010).

The Australian Government, Reserve Bank of Australia (RBA), Australian Prudential Regulation Authority (APRA) and the Basel Committee on Banking Supervision announced the regulatory reforms on 12th December, 2010, which would bear immense importance to the Australian banks (Kuessner, 2010). One of the highlights has been the requirement to hold back an extensive amount of liquid assets by the banks. The shortage of Government bonds (APRA laid a

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serious stress on Government bonds and non-bank commercial papers as major liquid assets) has posed a serious concern in the country. The Government of Australia has a debt of only A$ 176 Billion while the four big banks have assets and deposits of A$ 530 and A$300 or more, each (Reuters, 2010). Some other forms of debts have also been pointed out as “level two” category liquid assets by the committee, which would possibly bring the contemplation of bank bonds or other debt instruments, but investors are pretty much sceptic about it being enough to meet the mandate (Rogow,2010).

In the wake of the official announcement of the new Basel III ‘high-liquidity’ rules, the Reserve Bank of Australia and the Australian Prudential Regulations Authority have announced that a bank or an authorized deposit taking institute, which would be adequate in size to bridge the gap between any banks high-quality liquid assets holding and its liquidity cover ratio requirement, can constitute a secured liquidity facility with the Reserve Bank of Australia (Rogow, 2010). All the assets acceptable as collateral for the secured-liquidity facility should be eligible for repurchase transaction with the Reserve Bank of Australia under normal market operations (Reuters, 2010).

However, usage of this secured liquidity facility would come at a certain price to the banking institutions, adding up to their rising cost of funds. The top four banks, i.e., National Australia Bank, Commonwealth Bank of Australia, Westpac Banking Corp. and ANZ would have to pay an accumulated fee of

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$593.4 Billion to $1.19Billion, according to Credit Suisse estimates. Some experts even say that for many of the banks the mandatory liquidity would pose an obstacle far greater than their capital challenge (Griffiths, 2010).

The noteworthy point here is that the Australian banks are few of the more profitable and stable banking institutions around. Their capital accumulation is above the minimum requirement and in the meantime they are building up on their stock of liquid assets (Reuters, 2010). Yet, experts say that the competition would be fiercely steep for the limited medium-term funding and retail deposits and borrowers might have to face a raised lending rate which the banks would probably impose to compensate for the secured liquidity facility fee.

Anticipating such a move from the nation's banks, Wayne Swan, Australian Treasurer has already made the first pre-emptive strike against them. Especially directing his statement towards the four major banks, he made it clear that no bank should try to make the Basel III regulations an excuse to hike their lending rates. His statement made it abundantly clear that there shouldn't be any attempt by the banks to defraud their customers by raising lending rates above the Australian Reserve Bank rates, as the banks are in a position even better than that of the pre-economic-crisis period (Rogow, 2010).

Basel III has been designed taking into account the recent severe economic downturn that the world had faced. Prudence is evident in each and

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every of the reform, either major or minor, that it's trying to bring in. So, Australian banks with the help of their Government should welcome Basel III into their land.

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