YEPP Resolution:
The provision for stricter regulation of the securitisation activities of investment banking houses through the Basel III accords.

Recognising:

- That financial liberalisation, innovative financial products, international imbalances and poor monetary policy were the prime contributing factors to the recent credit crunch, global financial crisis and following economic recession.

- That the Basel Accords, which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision (BCBS), are due to be updated (2012) and reinforced in response to the recent global financial crisis. The new accords will be known as Basel III.

- The Basel Committee's proposals are to strengthen global capital and liquidity regulations with the goal of promoting a more resilient banking sector. The Basel III proposal, which has become the focus of the financial reform efforts of the G20 group, attempts to fix the shortcomings of an earlier revision, known as Basel II, which was initiated by lenders in the late 1990s and lowered capital requirements by as much as 29 percent for some banks.

- That as the ECB stipulates monetary policy for members of the Euro zone members have no control over monetary policy in their respective countries. Thus, member states cannot implement the necessary policy to manipulate economies to prevent or minimise financial crises. This required alternative methods of monetary control need to be explored - regulation.

Acknowledging:

- The Basel III proposals, which are to be phased in from January 2013 with full implementation achieved only by January 2019, have only dealt with bank capital. They require banks to hold 4.5 percent of 'core' capital to 'risk-weighted assets' (RWA) along with a 'capital conservation buffer' of 2.5 percent to RWA to be built in good times and be used in times of hardship.

- Basel III has been proposed to deter the international contagion of future crises. The further implication being that toxic leverage is highly probable, so that when the RWA are a small proportion of total assets, then the exposure of the banking sector to risk would be very high indeed. Clearly, then, Basel III has failed to correct the mechanism through which the main cause of the 'great recession'. Both measures have been diluted and, more importantly, they have been postponed by very successful bank lobbying.

- Basel III does not address the 'too big to fail' syndrome. The new rules do not provide a firm solution to the authorities' conundrum, in the case of financial and economic turmoil, in terms of their decision to accept it and let institutions to fail or inject tax-payer money to help them.

- One of the primary purposes of Basel III is to ensure banks hold sufficient equity that would be available to absorb losses in a crisis. This agreement was a primary goal of the G20 meeting in November 2010, but several key elements were omitted. Most significantly in relation to liquidity standards, these relevant decisions have been postponed until 2018, which seriously endangers the financial system.

- The above postponement can be considered a victory for the banks, as it gives them longer to earn profits to offset against losses accumulated during the recent crisis and in the process significant tax advantages emerge.

YEPP calls on:

- The European Union, through the ECB and Central Banks of member states, to consider the inclusion of a provision for stricter more transparent regulation of the relationship between investment banking houses and retail banking within the new Basel III framework, while encouraging a re-examination of the relationship between financial conglomerates, investment banking houses and holding companies with retail banking and insurance companies.

- The European Union to encourage a supervisory review process, including assessment of internal group activities, internal control structures and global risk assessment of investment banking activities and their respective participation in national and global markets.

- The European Union, through the ECB and Central Banks of member states, to insist on prioritisation of talks on the development of new liquidity standards within the Basel III accords, as a delay until 2018 may seriously undermine confidence in the rebuilding of the financial system.

Appendices:

1) The **Basel Committee on Banking Supervision** is an institution created by the central bank Governors of the G20 nations. It was created in 1974 and meets regularly four times a year.

The Basel Committee formulates broad supervisory standards and guidelines and recommends statements of best practice in banking supervision in the expectation that member authorities and other nations' authorities will take steps to implement them through their own national systems, whether in statutory form or otherwise.

The purpose of the committee is to encourage convergence toward common approaches and standards. At present the IMF and the ECB is collaborating with the Committee to improve bank regulation.

2) **Summary of Changes Proposed in Basel III**

- First, the quality, consistency, and transparency of the capital base will be raised.
    - Tier 1 capital: the predominant form of Tier 1 capital must be common shares and retained earnings
    - Tier 2 capital instruments will be harmonised
    - Tier 3 capital will be eliminated.
- Second, the risk coverage of the capital framework will be strengthened.
    - Strengthen the capital requirements for counterparty credit exposure arising from banks' derivatives, repo and securities financing transactions
    - Raise the capital buffers backing these exposures
    - Reduce procyclicality and
    - Provide additional incentives to move OTC derivative contracts to central counterparties (probably clearing houses)
    - Provide incentives to strengthen the risk management of counterparty credit exposures
- Third, the Committee will introduce a leverage ratio as a supplementary measure to the Basel II risk-based framework.
    - The Committee therefore is introducing a leverage ratio requirement that is intended to achieve the following objectives:
        - Put a floor under the build-up of leverage in the banking sector
        - Introduce additional safeguards against model risk and measurement error by supplementing the risk based measure with a simpler measure that is based on gross exposures.
- Fourth, the Committee is introducing a series of measures to promote the build up of capital buffers in good times that can be drawn upon in periods of stress ("Reducing procyclicality and promoting countercyclical buffers").
    - The Committee is introducing a series of measures to address procyclicality:
        - Dampen any excess cyclicality of the minimum capital requirement;
        - Promote more forward looking provisions;
        - Conserve capital to build buffers at individual banks and the banking sector that can be used in stress; and

    - Achieve the broader macroprudential goal of protecting the banking sector from periods of excess credit growth.
        - Requirement to use long term data horizons to estimate probabilities of default,
        - downturn loss-given-default estimates, recommended in Basel II, to become mandatory
        - Improved calibration of the risk functions, which convert loss estimates into regulatory capital requirements.
        - Banks must conduct stress tests that include widening credit spreads in recessionary scenarios.
    - Promoting stronger provisioning practices (forward looking provisioning):
- Advocating a change in the accounting standards towards an expected loss approach.
- Global minimum liquidity standard for internationally active banks that includes a 30-day liquidity coverage ratio requirement underpinned by a longer-term structural liquidity ratio.

The Committee also is reviewing the need for additional capital, liquidity or other supervisory measures to reduce the externalities created by systemically important institutions.

Adopted by the YEPP Council in Caserta on February 5, 2011.