Basel III – What does it mean for you?

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Deutsche Bank
What is Basel III?
"Basel III’ is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector.

These measures aim to:

— improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source
— improve risk management and governance
— strengthen banks' transparency and disclosures”

Source: Bank for International Settlements
It’s complicated

Continually Increasing Complexity of Financial Regulations

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<tbody>
<tr>
<td></td>
<td>33</td>
<td>30</td>
<td>347</td>
<td>616</td>
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</table>

A crisis triggered reform package

- FI capital levels proved insufficient
- Rapid evaporation of liquidity & long-standing illiquidity add severe stress
- Central Bank and government take action to support institutions
- Highlights FIs need for sufficient deposits and capital

Basel III
Motivation for Basel III – a regulator’s perspective

… we have introduced a global liquidity standard to supplement the capital regulation. …. Liquidity risk was not priced into many banking activities or even considered to be a key risk at the system level. …. We therefore will require banks to be able to withstand a 30 day system-wide liquidity shock as well as maintain a more robust structural liquidity profile. No doubt, this will raise the cost of funding in normal times and have an impact on business models...

Excerpt from a speech by Stefan Walter, Secretary General, Basel Committee on Banking Supervision, at the 5th Biennial Conference on Risk Management and Supervision, Financial Stability Institute, Bank for International Settlements, Basel, November 3-4, 2010
How might it affect you?

- Value of deposits is changing
- Access and pricing of bank credit
- Need to tighten cash forecasting and enhance risk management

Basel III impacts banks, but its effects are expected to ripple through to corporates.
Basel III Impact on Banks
## Basel Accords

<table>
<thead>
<tr>
<th>Basel I</th>
<th>Basel II</th>
<th>Basel III</th>
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<tbody>
<tr>
<td><strong>Credit risk</strong></td>
<td><strong>Credit risk</strong></td>
<td><strong>Credit risk</strong></td>
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<tr>
<td>Minimum capital requirements</td>
<td>Minimum capital requirements</td>
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<tr>
<td><strong>Operational risk</strong></td>
<td><strong>Supervisory review</strong></td>
<td><strong>Leverage ratio</strong></td>
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<td><strong>Liquidity risk</strong></td>
<td><strong>Market discipline</strong></td>
<td><strong>Liquidity coverage ratio</strong></td>
</tr>
<tr>
<td><strong>Net stable funding ratio</strong></td>
<td><strong>Supervisory review</strong></td>
<td><strong>Net stable funding ratio</strong></td>
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</table>
Leverage Ratio

Non-risk-based backstop indicator

Tier 1 Capital

- Tier 1 capital corresponds to Basel III definition (e.g. common shares issued by the bank, retained earnings)

Exposure Measure

- Exposure measure is based on accounting assets with special treatment for derivatives and Securities Financing Transactions (SFT)
- In addition to on-balance sheet assets, the exposure measure also includes off-balance sheet items
Liquidity Coverage Ratio (LCR)

Reliable source of liquidity, even under stressed conditions
- Assets weighted to reflect their liquidity
- Outflows from deposits, secured funding, credit/liquidity facilities, etc., during a 30-day stress period
- Inflows/outflows determined as given percentages of liabilities without maturity or maturities up to 30 days
## Net Stable Funding Ratio

Net Stable Funding Ratio balances the longer-term funding profile. It includes:

- Liabilities considered as stable funding sources, weighted according to their stability during a stress scenario.
- Funding requirements of a bank’s on- and off-balance sheet assets.
- The RSF factors represent the portion of an asset that cannot easily be converted to cash (e.g., through sale or in a secured funding transaction).

<table>
<thead>
<tr>
<th>Available Stable Funding</th>
<th>≥100%</th>
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</thead>
<tbody>
<tr>
<td>Required Stable Funding</td>
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</tbody>
</table>
## New Basel III measures at a glance

### Liquidity Coverage Ratio

<table>
<thead>
<tr>
<th>Liability Type</th>
<th>Outflow</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Medium Enterprises (SME)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transactional</td>
<td>Insured</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td>Uninsured</td>
<td>10%</td>
</tr>
<tr>
<td>Corporates, Sovereigns, Central Banks, Public Sector Entities (PSEs)</td>
<td>Operational</td>
<td>Insured</td>
</tr>
<tr>
<td></td>
<td>Uninsured</td>
<td>25%</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>Operational</td>
<td>Insured</td>
</tr>
<tr>
<td></td>
<td>Non-Operational</td>
<td>Uninsured</td>
</tr>
</tbody>
</table>

**High Quality Liquid Assets**

**Stressed 30 Days Net Cash Outflows**

≥100%

### Net Stable Funding Ratio

<table>
<thead>
<tr>
<th>Liability Type</th>
<th>Available Stable Funding (ASF)</th>
<th>Required Stable Funding (RSF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Medium Enterprises (SME)</td>
<td>Stable</td>
<td>90%</td>
</tr>
<tr>
<td></td>
<td>Less Stable</td>
<td>80%</td>
</tr>
<tr>
<td>Corporates</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Financial Institutions &amp; Others</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

**Available Stable Funding**

**Required Stable Funding**

≥100%

### Leverage Ratio

<table>
<thead>
<tr>
<th>Tier 1 Capital Exposure Measure</th>
<th>≥3%</th>
</tr>
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<tbody>
<tr>
<td>On-balance sheet</td>
<td>✗</td>
</tr>
<tr>
<td>Off-balance sheet</td>
<td>✗</td>
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</tbody>
</table>

**Tier 1 Capital**

≥3%
Not all banks are treated the same

Group of 28 Global Systemically Important Financial Institutions (G-SIFIs)

Requirements for banks determined to be globally systemically important to have additional loss absorption capacity tailored to the impact of their default, rising from 1% to 2.5% of risk-weighted assets (with an empty bucket of 3.5% to discourage further systemic-ness), to be met with common equity.

Buckets for Risk-Weighted Assets (RWA)

- 2.5% RWA
- 1.5% RWA
- 2.0% RWA
- 1.0% RWA
...and will adjust their business model

“The design of products that consume less capital will become one of the strategic priorities for banks over the next few years... You may need to keep some products in your portfolio for strategic reasons, even if they are no longer profitable. To do this, you will need to create other opportunities with the same customer.”

Paolo Bordogna, Compliance and Competitiveness, Report from Economist Intelligence Unit, June 2011

“The supply of funding risks being further curtailed by the new Basel III capital rules... [Trade Finance] is likely to be hit by higher risk weights and new bank leverage ratios.”

The Wall Street Journal, October 29, 2011
New regulations lead to innovative solutions…

In a changing regulatory environment, some new and some existing products will help banks and clients meet their goals

<table>
<thead>
<tr>
<th>Investment Solutions</th>
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<tbody>
<tr>
<td>Time Deposits</td>
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<tr>
<td>— Enhance rates through a defined maturity</td>
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<tr>
<td>Call Deposits</td>
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<tr>
<td>— Enhance rates through an open-ended maturity</td>
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<tr>
<th>Liquidity Management Tools</th>
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<tbody>
<tr>
<td>— Integrated solution for treasury and liquidity management that reduces data complexity, improves forecasting efficiencies and maximizes value of liquidity</td>
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Liquidity products for Basel III

Time Deposits

- Time deposits with a fixed maturity date are a familiar banking product
- Time deposits, whether new or rolled over, hold LCR value only for the periods exceeding 30 days

Call Deposits

- Call deposits have an agreed-upon notice period but no predefined maturity date
- Call deposit will hold LCR value until called
  - Once called, they continue to hold value until the maturity is less than 30 days

Liquidity Profile of 45-day Time Deposit

Rollover into new time deposit

Liquidity Profile of 45-day Call Deposit

Call notice received

LCR Measurement

Beneficial for Basel III LCR
Basel III Impact on Corporates
Newton’s Third Law of Motion

“When one body exerts a force on a second body, the second body simultaneously exerts a force equal in magnitude and opposite in direction to that of the first body.”

Isaac Newton, Mathematical Principles of Natural Philosophy, 1687

While not exact, legislation does affect corporates
A history of regulation influencing treasury priorities

Market regulation...

**1980s**
- Money Laundering Control Act (1986)

**1990s**
- The Euro (1999)
- Patriot Act (2001)

**2000s**
- SOX (2002)

**2010s**
- Dodd Frank (2010)
- Basel III (2011)

...typically does impact corporates and their focus

- Know Your Customer
- Control/Risk Management
- Bank/Counterparty Mgmt
- Liquidity/Borrowing Mgmt
Impact of Leverage Ratio

**Basel III change**

- Increased capital for higher-rated / shorter-dated loans
- Internalize cost and accept lower RoE or increase pricing / seek higher returns
- Reduction in repo lines
- No benefit for OTC derivative collateral – shift in business practices

**Tier 1 Capital**

**Exposure Measure**

**Possible bank impact**

- Increased bank asks for other revenue and/or loan repricing
- Resize loans to limit unused liquidity and bifurcate facilities into committed and uncommitted
- Decrease in repo investment opportunity
- Shift in OTC derivative business practices

**Potential corporate impact**
Leverage Ratio impact on corporates

Strategic Considerations

- Review your banking relationships
  - Where are your banks in meeting their Basel III metrics?
  - Do you have the right bank group to meet your needs?
- Consider your industry
  - How do your credit needs fit into the bank’s balance sheet?
- Start negotiations early
  - Where do you stand? Where do you need to be?
- Be prepared to be flexible in adapting to regulatory impacts
  - Requirements may take significant time to be finalized, making ultimate costs difficult to ascertain in the near-term
Basel III change

- High Quality Liquid Assets ≥100%
- Stressed Net Cash Outflows
- Available Stable Funding ≥100%
- Required Stable Funding

Bank impact

- Costs increase for short term “hot” deposits
- Large deposits magnify the problem (retail preferred over wholesale deposits)
- Need for more liquidity assets

Potential corporate impact

- Banks expected to push for longer-term deposits and pricing reflects this change
Liquidity Coverage Ratio and Net Stable Funding

Strategic Considerations

- The model is changing – not all balances have the same value to banks
  - Main trade off is tenor and rate
  - Banks want longer-term deposits – do you?
  - Expect more fees in lieu of balances
- Consider bank counterparty risk
  - Do you want to be locked-in with that bank?
- Asset allocation
  - Invest within your asset allocation guidelines
Basel math

Leverage Ratio + Liquidity Coverage Ratio + Net Stable Ratio

The Need to Optimize Working Capital Management
Working Capital – back to basics

Leverage your internal liquidity

1. Visibility to cash balances
   - You cannot manage a blind spot

2. Gain access to trapped liquidity

3. Improve accuracy and reliable cash flow forecasting
   - The cornerstone for working capital management

4. Get your money when you need it, where you need it
   - Avoid overdrafts
   - Invest idle balances
Linkages between the customer and the bank

Banks and their clients can work together to achieve their goals

The Customer’s Perspective

- Maximize earnings potential
- Minimize credit risk
- Undergo a more active approach in managing balances

Corporate Treasury

Linkages

The Bank’s Perspective

- Greater transparency
- Visibility of account positioning
- Inter-company balance management

Internal Treasury

- Target deposits with liquidity value
- Increased demand for longer dated deposits
- Minimize cost of funding
Questions and Answers
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