BASEL III

RMB Morgan Stanley

Basel III, Capital and Liquidity Event

Cape Town

2 May 2012

MAKE THINGS HAPPEN

NEDBANK GROUP

A Member of the OLD MUTUAL Group

BASEL III (& BASEL II.5) IN A NUTSHELL

ASSETS AND OFF-BALANCE SHEET

Market risk and securitisation (Basel II.5)
- Introduction of a stressed value-at-risk (VaR) capital requirement for trading risk
- Introduction of an incremental risk charge (IRC)
- Increase of capital requirements for complex securitisations
- Improved process and modeling of securitisation risk

Counterparty credit risk (CCR)
- Introduction of additional capital charges for CCR credit exposures arising from banks' derivatives, repo and securities financing activities….based on stressed inputs, a credit valuation adjustment (CVA) charge, large exposures to FIs, wrong-way risk, etc
- Central clearing counterparties / exchanges introduced
- Extensive new CCR risk management requirements

Credit risk (banking book)
- Basel II 1.06 credit RWA (IRB) scaler (Basel II.5)
- Dampen procyclicality (TTC PDs)
- Forward looking provisions (IFRS 9), integrated credit risk measurement framework with Basel II

Leverage ratio
- Introduction of a non-risk based supplementary measure
- Includes off-B/S exposure
- Minimum Tier 1 ratio of 3% (SARB minimum 4%)

Regulatory and Accounting convergence
- Valuations
- Forward looking provisions (IFRS 9)
- Hedge accounting

Off balance sheet items
- Included in RWA, leverage and liquidity ratios

Other
- Enhancements to Pillar 2 and ICAAP (Basel II.5)
- Remuneration (risk based, deferrals, etc)
- Recovery and resolution plans

WIDER REGULATORY FRAMEWORK

LIABILITIES AND CAPITAL

Net stable funding ratio (NSFR) – 2018
- Long-term funding encouraged; long-term lending implications
- Single biggest issue in Basel III; expect significant revision to NSFR
- Onerous new data and process requirements

Liquidity coverage ratio (LCR) – 2015
- Short-term liquidity resilience
- In 'stressed' scenario
- Onerous new data and process requirements

Liquidity risk monitoring metrics

Minimum capital ratios
- Significant increase of the minimum CARs, esp Core Tier 1 (4.5%)
- Pillar 2A systemic risk add-on for South Africa (2%)
- Pillar 2B bank specific add-on
- SIBs add-ons (G-SIB vs D-SIB)

Capital conservation and countercyclical buffers
- Introduction of capital conservation (2.5%) and countercyclical (0-2.5%) buffers
- An extension to Core Tier 1 minimum above

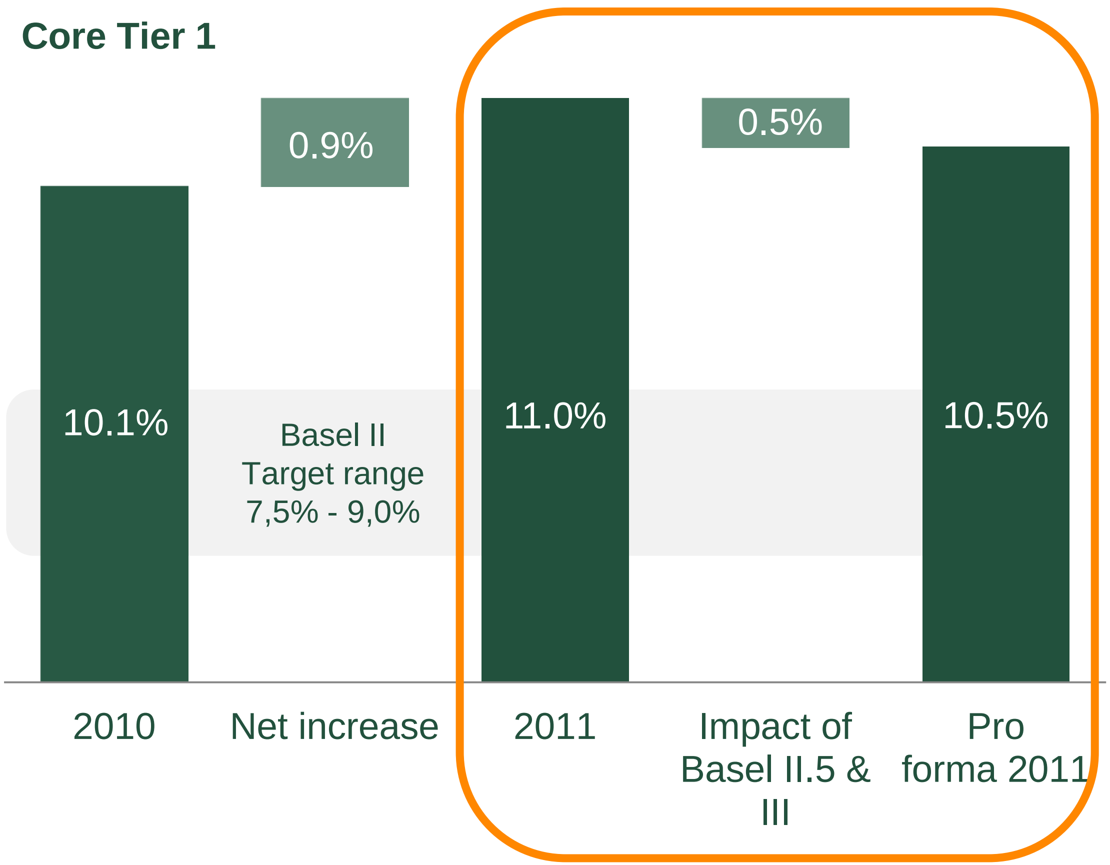
Capital quality
- Core Tier 1 capital is the predominant focus
- Fully loss absorbent capital instruments required (Non-core Tier 1 & Tier 2)
- Tier 2 instruments to contain no step ups or incentives to redeem
- Grandfathering of existing capital instruments @ 10% p.a from 2013
- Phase-out of hybrid debt capital in South Africa (≠ Basel III)
- CoCos and bail-in debt?

Regulatory capital deductions
- Tighter definitions, more deductions, enhanced quality of capital
- Qualifying capital - includes 'accumulated comprehensive income & other disclosed reserves….SBPR/FCTR/AFS qualifies, as does Insurance capital up to 10% of CT1
- Minority interest up to 7% of bank's CT1 qualifies

Other
- Consolidated supervision enhancements
- Integrated balance sheet management
- New data and regulatory reporting requirements

NEDBANK'S STRONG CAPITAL POSITION

Well capitalised & positioned for Basel III, on back of successful Basel II implementation



CAR targets & dividend cover under review, pending finalisation of SA regulations

Basel II.5 capital (-0.5%)

- 6% scaler for credit RWA IRB portfolios
- Stressed VAR for market trading risk

Basel III capital (neutral)

- New capital deductions e.g. deferred tax assets, 100% EL - IFRS impairments

+ Offset by new qualifying capital: AFS, FCT & SBP reserves etc
+ Upside from further RWA optimisation

Liquidity coverage ratio (anticipate compliance)

- Surplus liquid assets increased
- National discretion likely e.g. committed liquidity facilities (Australia)

Net Stable Funding Ratio (structural constraints)

- Expecting fundamental revision of NSFR by Basel Committee
- G20 meeting in Mexico highlighted EM issues
- Anticipate pragmatic approach by SARB

PROPOSED SOUTH AFRICAN BASEL III CAPITAL RATIOS – DRAFT 1

- Draft 1 of the SA regulations were released by SARB on 30 March 2012, comments due back by 18 May 2012

	Proposal for SA Regulations	Common Equity Tier 1	Tier 1 Capital	Total Capital	Effective date
1	BCBS Basel 3 minimum	4.5%	6.0%	8.0%	
2	Pillar 2A for SA systemic risk	2.0%	2.0%	2.0%	Phased-in from 2013 to 2015
3	**SARB Basel 3 minimum**	**6.5%**	**8.0%**	**10.0%**	
4	D-SIB capital add-on B4 buffers	ds%	ds%	ds%	Phased-in from 2016 to 2018
5	Pillar 2B - bank specific add-on	x%	y%	z%	As from 1 January 2013
6	Capital conservation buffer	2.5%	2.5%	2.5%	Phased-in from 2016 to 2018
7	Countercyclical buffer range (0 - 2.5%)	cc%	cc%	cc%	Phased-in from 2016 to 2018
8	**SARB Basel 3 minimum including buffers**	**9.0% + ds% + cc% + x%**	**10.5% + ds% + cc% + y%**	**12.5% + ds% + cc% + z%**	
	Current SARB Basel 2 minimum	5.25%	7.0%	9.5% + z%	

Line 2

The SARB minimum ratios include an additional capital requirement pertaining to systemic risk, referred to under the current capital framework as Pillar 2A.

Line 4

D-SIB stands for domestic systematically important banks, where the Big 5 SA banks are likely to be classified as such, as opposed to global systematically important banks (G-SIB) – SARB await BIS paper on D-SIBs before finalising this aspect.

KEY OUTSTANDING BASEL III MATTERS

- **Liquidity ratios**
  - **LCR** standards will evolve over time but for now 'what has been agreed has been agreed', subject to making specific adjustments by end 2012, effective 2015
  - **NSFR** not on the agenda for now; revisions may take considerable time
    - BCBS will 'reflect on need to make some announcement about it'
    - The industry sees the need for a fundamental rethink
    - There is a danger of undermining the traditional maturity transformation function of banks, especially with a one-size fits all solution
    - A pillar 2 type of risk management solution to assess the risks of each bank's business model would be more appropriate

- **Fundamental Review of the Trading Book**
  - Initial consultative paper to be issued soon, with four-month consultation period
  - TB/BB boundary to be retained, but made more risk-focused
  - BCBS considering Standardized Approach as a floor for TB internal models
  - Floor concepts are troubling to the industry because of double-calculation burdens and the conceptual retreat from truly risk-sensitive models as a driver of capital regulation
  - The interaction of CCR capital issues and the TB can be significant and there are many technical issues to be resolved

KEY OUTSTANDING BASEL III

- **Systemic Banks**
  - The third G-SIB analysis will be published in November, but G-SIBs largely completed
  - Further work will be done, and then a consultation paper on D-SIBs will be issued (expect mid year)
    - SARB awaiting this for SA regulations
  - Effects of D-SIB rules on G-SIB subsidiaries have been "heavily" discussed, but no outcome as yet; agreed on the goal of avoiding double-counting

- **Implementation of the Basel framework**
  - Industry argued for a look-back to check whether standards are working as intended
  - Some Basel III implementation dates may be changed where necessary because of delays in finalizing specific requirements (may or may not affect national implementation dates)
  - RWA analysis aims at "comparability and consistency" of banks' internal models, while still allowing for divergence of risk profiles

- **Other issues**
  - Leverage Ratio
  - Large Exposures
  - Accounting discrepancies
  - Pillar 3 disclosure