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Q&A: BdF Central Banker and Basel Committee Member Sylvie Matherat on Capital Adequacy and the Eurozone

Sylvie Matherat, Banque de France - 16 May 2014

In this Q&A Interview with gtnews' Neil Ainger, the deputy director general, Banque de France (BdF), and chair of the liquidity group on the Basel Committee, Sylvie Matherat, discusses the incoming Basel III capital adequacy regime and what it might mean for treasurers in terms of trade finance, collateral pricing and bank lending practices. The general economic picture in the eurozone and future of interest rates is also addressed, as the BdF is a key member of the Eurosystem of national central banks that advise the European Central Bank (ECB).

According to Sylvie Matherat, deputy director general at Banque de France (BdF) in the directorate of general operations unit which covers all markets (front, middle and back) including payment and settlement systems, infrastructures and banking services, a slow recovery is occurring in the eurozone after the trials of recent years.

Interest rates in the euro area will remain at present or lower levels for an extended period of time, in-line with the European Central Bank's (ECB) forward guidance and assisted by BdF's role as one of the lead implementers of its polices, adds this central banker and European insider.

Matherat, speaking as chair of the liquidity group on the Basel Committee, also addressed the impact of regulation on corporate treasuries and what she terms the non-bank 'real economy'. The Committee is of course introducing the Basel III capital adequacy regime in order to try to strengthen banks' capital bases in the wake of the 2008 financial crisis, but this will have crucial impacts on trade finance for businesses, collateral pricing, bank and capital market lending practices, and so forth.

Q (gtnews): What are the main driving forces behind the new Basel III capital adequacy regime?
A (Sylvie Matherat): The Basel III regulatory framework is partly a response to the financial crisis, which started in 2007 and came to a head in 2008 onwards. The driving forces behind the new capital adequacy rules are threefold. First, we on the Basel Committee wanted to have more resilient banks, which means a strengthening in capital quantity and quality, enhanced market risk coverage, a reduction in leverage, and a sounder liquidity profile.

Second, we on the Basel Committee have taken on board the systemic risks associated with big financial entities: specific measures have therefore been designed for systemically important banks, insurance companies and funds, and a resolution framework has been decided for these institutions.

Thirdly, we have created incentives for macro-prudential policies in order to limit pro-cyclicality, in particular by implementing capital buffers [*in effect encouraging counter-cylindrical accounting so money is stored away during good economic times -Ed*]. For all these reasons, I believe the new Basel III regulatory framework is more comprehensive and more risk-sensitive than the previous ones.

What will be the key stipulations in the final wording of the Basel III regulation you're working on ahead of this autumn's G20 meeting, plus its compliance start date, key criteria, regional harmonisation safeguards, etc?
Most of the Basel III framework has already been endorsed by the Basel Committee and its governing body, the Committee of Governors and Heads of Supervision. Only a few elements remain to be finalised such as the Net Stable

Funding Ratio (NSFR) or the Securitization regulation. The implementation dates have been set and communicated, and will range from 2015 to 2019 [*see gtnews' regulation section for more information -Ed]*. A gradual implementation of the Basel III framework is key because market participants need time to adjust.

On the point of harmonisation, the predecessor Basel II regulation never gained the international following in the US or other countries it should have done, creating regional differences. Do you think this problem of cross-border regulatory differences will resurface?

All countries have suffered during the financial crisis and its aftermath. We have a common assessment on the causes of the crisis and a shared commitment to address the issues identified at the global G20 level. The US in particular has stated they're willing to implement the Basel III framework. Some cross-border regulatory differences might still be maintained, but they should be rather limited in scope this time around and compliant with the 'super-equivalence' principle of the Basel rules, which in effect mean a regional or national regulator can be tougher but not softer than the Basel rules.

What will be the major impacts of Basel III in respect of corporate treasurers? I'm thinking in terms of trade finance pricing, collateral pricing and bank lending practices - and do you think treasurers are aware of these impending changes? If not, how can they be educated?

The new Basel framework will indeed modify banks' behaviour and business models for them and their clients. This is clearly intended as we wanted a stronger focus on liquidity risk at banks, because risk was not priced correctly before the crisis. The aim of post-crisis regulation is to strongly incentivise market participants to internalise the costs of these risks [freeing up the taxpayer from any burden in respect of bailouts -Ed]. Therefore, the risk premium under Basel III may increase by a few basis points.

Do you think treasurers know about Basel III's liquidity coverage ratio (LCR) and particularly the net stable funding ratio (NSFR), which might drive banks to prioritise multinational corporations (MNCs) as customers in order to meet their large collateral requirements, consequently neglecting small-to-medium sized enterprises (SMEs)? Additionally, is there a possibility this could starve the real economy of finance for growth and job creation, which traditionally comes from SMEs?

It is true that capital market financing, with technical assistance provided by banks, will probably become a more important source of financing for corporates in the future - at the expense of bank financing. It should not, however, be a problem for big corporates. We have already seen a significant shift in the MNC funding profile during the financial crisis and its aftermath, with firms' increasingly moving towards equity and bond issuance.

Some concerns have arisen about the funding of SMEs in the future. Public authorities have committed themselves to promoting alternative sources of funding, however, in particular through safe and sound securitization, so there are measures in place in regard to this specific concern.

More generally speaking, we at the BdF and the Basel Committee liquidity group which I lead - not to mention other central banks - have conducted impact studies in regard to Basel III and we have adapted the ratio's calibration in order to avoid unintended consequences for the real economy. The most constrained [bank] business lines in the past are the ones that had little to do with the financing of the real economy. The new regulatory framework has been designed to channel financing back to the real economy, which is what is paramount. By promoting financial stability and by freeing resources, the new post-crisis regulatory framework should on the contrary help growth and job creation at the macro level.

What about intra-day liquidity requirements under Basel III? Could you briefly explain these and discuss whether you think it'll mean some corporate treasuries' payments at particular times of the day attracting additional fees, while other large payment runs outside of the usual end-of-month payroll may be treated differently, changing banks' charging structure for liquidity risk and real-time collateral and causing new reporting tools to be developed?

Actually, the Basel III liquidity standards - such as the LCR - do not include intraday liquidity within its calibration. However, it is true that the management of intraday liquidity risk remains a key element of a bank's overall liquidity risk framework, which is why the Basel Committee on Banking Supervision (BCBS), based in Basel, Switzerland, wrote in that respect in its 2008 whitepaper entitled 'Principles for Sound Liquidity Risk Management and Supervision', which I would urge everyone to read.

To complement this guidance, the BCBS, in consultation with the Bank for International Settlements (BIS) Committee on Payment and Settlement Systems [*CPSS - on which Matherat also sits*], has developed a set of quantitative tools. These tools are designed to enable banking supervisors to monitor a bank's intraday liquidity risk and their ability to meet their payment obligations under both normal and stressed conditions. It is important to point out that there is no intention to set new liquidity standards behind these tools. The objective is just to better understand banks' payments behaviour. It is the bank-focus that is key for us.

Do you think that treasurers should be part of the Basel III post-crash regulatory debate and have they been? After all, MNC payments are as big as some banks?

Regular high-level meetings have occurred during the conceptual design of the Basel III framework. In particular the B20 group has been involved in the debate. [*Note: the B20 taskforce has been arguing that the new rules may penalise banks in countries where banking and financial markets are less developed, with possibly harmful economic and company impacts. The B20 includes global institutions like Standard Chartered, HSBC, Citi, Santander, DBS, Mexico's Grupo Financiero Banorte and the insurer MetLife, and has sought to represent itself as a defender of emerging markets -Ed*].

We have listened to all market participants at various levels, in various formats. The Basel Committee has launched public consultative papers to gather reactions from market participants for every piece of regulation. As far as I'm concerned, all opinions, including the ones of corporate treasurers have been taken on board.

It'd be remiss of me not to ask a eurozone central banker about the future outlook for interest rates in the eurozone and the euro area's economic prospects. When do you think we'll see eurozone interest rates rise and an easing back of ECB special support for banks and the economy? Do you think the euro is now secure after all the Greek, Italian, Spanish, etc. travails?

The ECB has provided forward guidance in regard to the expected path of future eurozone interest rates and I'd refer you to that. On 4 July 2013, for instance, the Governing Council announced that it expects the key Eurosystem interest rates to remain at present or lower levels for an extended period of time. This forward guidance is here to avoid having expectations on short term interest rates at a level which is unwarranted, given our outlook on medium term inflation. This measure is meant to ensure that the effective stance of our monetary policy remains appropriate. The extended period of time during which the key interest rate will remain at present or lower levels is conditional on our assessment of key drivers - covering real economy and monetary developments - of underlying inflation. Interest rates are mainly driven by economic prospects in the longer term. I believe rates will surely increase, over the long term, but the timing is really related to the pace of economic recovery.

In answer to your second point, a lot of work has been achieved at the European level to create the necessary backstops [*to eurozone economic growth and the safety of the euro*]. The ECB has committed itself to protect the euro. The Outright Monetary Transactions (OMT) programme [*which is designed to support struggling EU member states and the euro single currency -Ed*] was announced with a view to restoring adequate functioning of monetary transmission in the euro area. It was introduced after money transmission mechanisms were severely impaired because of expectations of a break-up in the euro area a couple of years ago, which led to an increase in government spreads in EU member states and a disconnect with fundamentals. The OMT was very effective in rectifying this, very quickly.

The EU countries which were in difficulties, such as Greece, have also been reforming themselves in order to converge [*on the eurozone median*]. As a result, peripheral spreads have tightened significantly over the last year.

The EU Single Banking Union, previously declared by ECB president Mario Draghi, is also soon to be implemented, with the clear objective of severing the link between banks and sovereigns. As a consequence, in my honest opinion, all the preconditions for securing the future of the euro single currency have now been satisfied.

What about the economic prospects for recovery in France and the eurozone? When do you think we'll start to see growth again and strong job creation? Can treasurers help by investing more of their large cash reserves now that risk, in regard to the euro, has lessened?

A slow recovery is already occurring in the euro area. The cleansing of bank balance sheets and the efforts made in reducing the level of public deficits across the EU are costly but necessary steps to ensure a sounder and more sustainable recovery in the eurozone. We also need to monitor what happens in the United States and in emerging markets in order to be able to respond to the changing economic picture.

Investment figures are still staggered and erratic, in particular in Europe. If corporates resume investing on a large scale, however, it would be a good sign that the economic recovery process is strengthening.

What about the dip in emerging markets? As a central banker, is that a concern for the global economy?

Emerging markets have benefited from rather sustained capital inflows during and after the financial crisis from 2007-08 onwards. Some imbalances have been accumulating in some emerging economies for a long time, leading to real estate bubbles or excessive credit extension by some banks. The current dip in some emerging market economies is therefore more of a logical correction to what has been an unsustainable situation. However, we at the Banque de France and at the various Basel Committee, European and EU level institutions upon which I sit, have to monitor these fluctuations closely in order to remain on top of what may happen, and we are doing so.

In terms of the overall economic picture, what makes you hopeful for 2014?

2014 should be a turning point for Europe in the recovery process. The Banking Union is soon to become fully operational before the end of this year and that will help the recovery process. In addition, the Asset Quality Review [of banks in the eurozone, effectively a stress test designed to address concerns about liquidity at European banks -Ed) should also restore confidence in the banks' situation and, more generally, in the eurozone economy. The macroeconomic environment is set to improve and we are seeing signs of this. But in the end, my conclusion would be that 2014 still won't be easy - but things are getting better. 2015 should be better still.

Sylvie Matherat, Banque de France

Sylvie Matherat is deputy director general at Banque de France (BdF) in the directorate of general operations, which covers all markets (front, middle and back), including payment and settlement systems, infrastructures and banking services in an effort to deliver financial stability and regulation. Matherat also chairs the liquidity group on the Basel Committee, which is overseeing the Basel III capital adequacy regime. The Committee's Secretariat is located at the Bank for International Settlements (BIS) in Basel, Switzerland, from where it gets its name and is staffed mainly by professional supervisors and regulators on secondment or undertaking temp work from national member institutions such as the BdF.

Matherat is also a member of the BIS Committee on Payment and Settlement Systems (CPSS) and of the European Central Bank (ECB) Payment and Settlement Systems Committee (PSSC), as well as being on a number of Financial Stability Board (FSB) working groups which are endeavouring to deliver more stability. Previously deputy director and then director of research and policy for the French Prudential Authority, Matherat was placed in charge of the predecessor Basel II implementation there and the International Financial Reporting Standards (IFRS) implementation. Before working in the public sector and at central banks, she was employed in the private sector on structured finance lines for a large banking group. In October 2007, she joined the Banque de France (BdF) to head up its Directorate of Financial Stability and was latterly appointed to her present position of Deputy Director General of Operations BdF in January 2011.

About: Banque de France

The Banque de France (BdF) is the central bank of France. It is linked to the European Central Bank (ECB). Its main charge is to implement the interest rate policy of the European System of Central Banks (ESCB), which represents all the national central banks (NCBs) in the European Union (EU), including those not in the eurozone single currency bloc such as the UK. It plays a key role in the formulation of continent-wide economic policy and in eurozone rate-setting within the EU via the separate Eurosystem, which is abody within the EU comprising only of NCBs within the eurozone. As France is also one of the largest economies in the EU, and traditionally seen as its driving force alongside Germany, its national bank carries considerable weight. The BdF is headquartered in Paris, France.