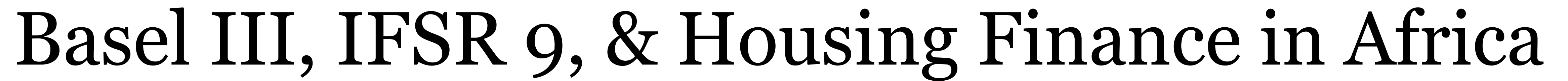
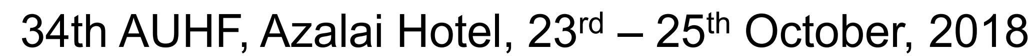

Basel III, IFSR 9, & Housing Finance in Africa


34th AUHF, Azalai Hotel, 23rd – 25th October, 2018

Outline

- Background
- Changes from Basel I, II, and III
- Likely impact of Basel regulations for housing finance
- Additional challenges posed by IFRS 9
- What can banks do differently?

Background

Underdeveloped housing market in Africa:

e.g., mortgage debt to GDP ratio = 83% in Netherland vs less than 1% in many African countries.

Regulation among the key factors that affect housing finance development

Basel III and IFRS 9: two major regulatory changes developed as a response to the lessons of the 2008 financial crisis.

There are potential advantages, but also potential adverse effects on lending. Our presentation will focus on the later and how best lenders can adapt

Basel III in a nutshell

An internationally agreed set of measures developed by the Basel Committee on Bank Supervision (BCBS)

Introduces new and more stringent capital and liquidity requirements for commercial banks, compared to Basel I & II

Objective is to make banking systems safer and more resilient to shocks

African countries have reacted differently to the changes: Partial implementation (Nigeria), Full implementation (South Africa), Adoption of stricter rules than the Basel III rules (BCEAO).

Changes from Basel I, II, and III

Basel I
1988

- Min Capital adequacy ratio: 8% of risk-weighted assets (RWA)
- Risk-weighting method: assign assets to one of five risk-weights (0, 10, 20, 50, and 100)%
- Eligible capital = Tier 1 capital (Min 50% of total capital) + Tier 2 capital

Basel II
2004

- New risk-weighting framework: standardised approach, supported by external rating; or internal-rating based method (IRB), subject to explicit approval of supervisor.
- This change makes risk-weights more risk sensitive.

Basel III
2010

- New definition of eligible capital: shift towards higher quality capital
- New types of capital requirements (capital buffers) resulting in higher overall capital ratio
- New Leverage ratio (Tier 1 capital at least equal to 3% of total asset)
- New Liquidity ratios (liquidity coverage ratio and net stable funding ratio, min 100%)

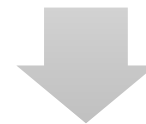
Likely negative impact for housing finance

Dependent on strategies banks will adopt to comply with the tougher capital and liquidity requirements

Higher cost of bank credit (lending rates and fees);

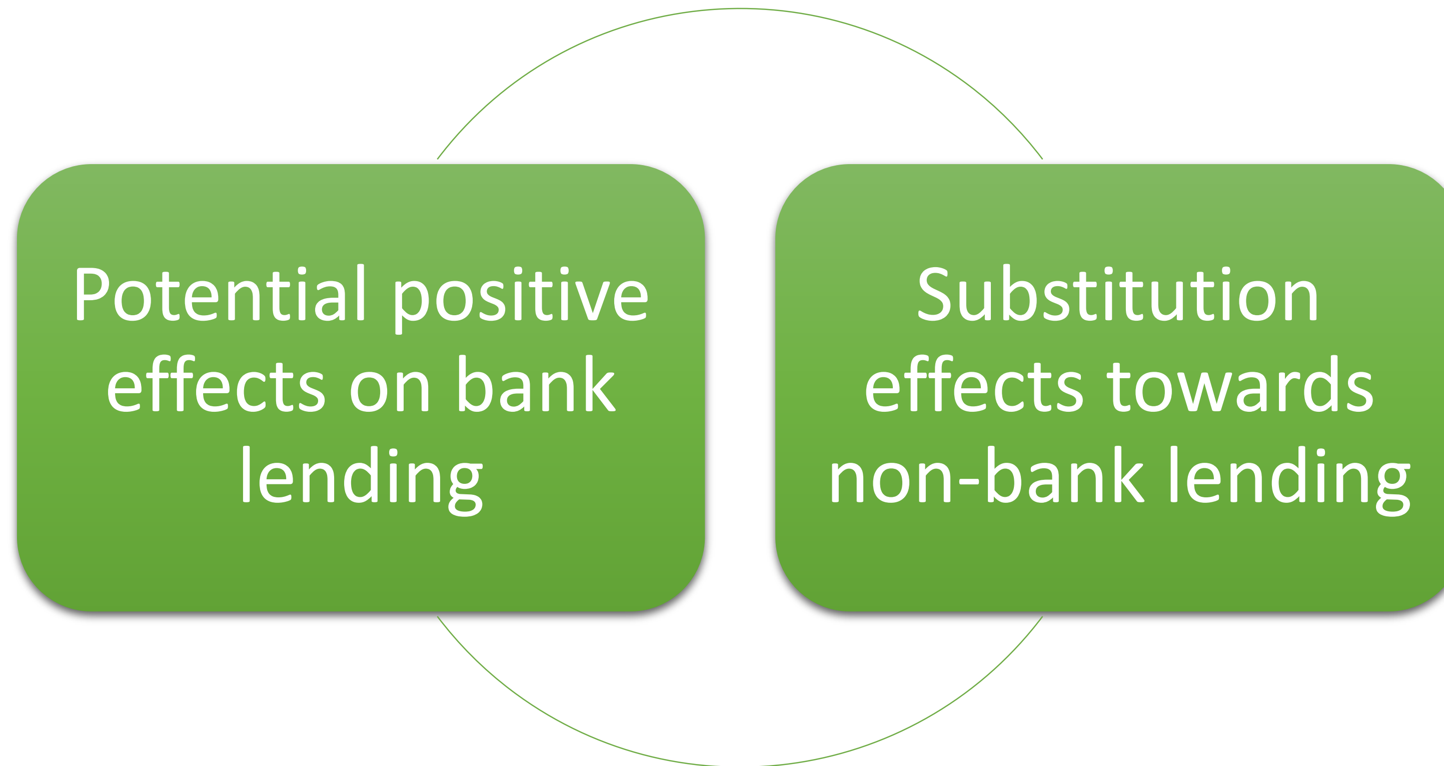
Lower lending volumes;

Reallocation of lending from high-risk to low-risk borrowers;



May vary substantially across banks and countries, reflecting differences in factors such as pre-reform levels of bank capital and liquidity, monetary policy response, and the length of the transition period.

But assessing the overall impact of the Basel regulations on lending should also consider the following:



IFRS 9

IFRS 9 in a Nutshell

New accounting rules for financial instruments (debt instruments, derivatives, equity instruments).

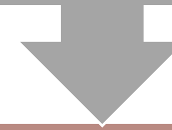
Published in 2014 by the International Accounting Standards Board (IASB), to replace IAS 39

Three focus areas: classification and measurement of financial instruments, impairment, and hedging.

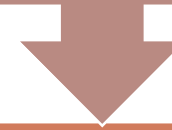
Required for accounting periods beginning on or after January 2018

IFRS9 and impact on housing finance

Forward looking provisioning based on expected credit losses (vs incurred credit losses based on past and present information under IAS 39)



Early recognition of credit deterioration (vs delayed recognition under IAS 39)



Increase in loan-loss provisions on performing exposures (vs “too little, too late” under IAS 39)

Increase in risk costs which could make some clients that are currently part of business no longer profitable.

Conclusion

- Basel III and IFRS 9 basically mean a tightening of regulations to reduce the risk of financial crisis.
- But this also means that bank lending activities may be adversely affected.