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Global rules for banking toughened to cut risk

BASEL, SWITZERLAND

Lenders to be required to more than triple reserves to avert crises

BY JACK EWING

Top central bankers and bank regulators agreed Sunday on far-reaching new rules for the global banking industry that would more than triple the amount of capital banks must hold in reserve as a shield against financial disasters. But the requirements could also dampen bank profits and strain weaker institutions.

Financial authorities from 27 countries reached agreement Sunday on rules that require banks to raise the amount of common equity they hold to 7 percent of assets from 2 percent, part of a series of measures designed to help avert crises of the kind that nearly plunged the world into depression in late 2008.

"The agreements reached today are a fundamental strengthening of global capital standards," Jean-Claude Trichet, president of the European Central Bank and chairman of the group, said in a statement. "Their contribution to long-term financial stability and growth will be substantial."

The recommendations by the group, which includes Ben S. Bernanke, chairman of the U.S. Federal Reserve, must be ratified by the Group of 20 advanced and fast-developing nations this year, then be adopted by individual countries before they become binding. The group set a deadline of Jan. 1, 2013, for member nations to implement the rules, known as Basel III.

While the American Bankers Association and other groups have complained about the provisions, other bankers have expressed support.

"Banks will unarguably be safer institutions," said Anders Kvist, head of the treasury group Skandinaviska Enskilda Banken, a bank based in Stockholm that is widely known as S.E.B. and that has operations around Europe.

While the new capital requirements represent a substantial increase, they are not as severe as some analysts had predicted. Some had expected the Basel group to raise the most bulletproof category of reserves, known as core Tier 1 capital, to about 8 percent of bank as-

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sets. In another concession to the banking industry, the central bankers and regulators left it up to individual nations whether to require banks to increase reserves by as much as an additional 2.5 percentage points in boom times.

But the group left in place a leverage ratio, a new requirement that would oblige banks to maintain reserves of at least 3 percent of total assets, including derivatives or other instruments that they might not carry on their balance sheets. The leverage ratio is an attempt to require banks to hold reserves against all their money at risk, with no leeway to game accounting rules.

Banks will have time to adjust. The rules on common equity reserves will be phased in through 2015, but the leverage ratio will not take full effect until 2018.

In a nod to Germany's public-sector Landesbanks, which had predicted they might need to raise €50 billion, or $63.4 billion, to comply with the new rules, the Basel group allowed banks to continue to apply government bailout money toward capital reserves through the end of 2017.

Some banks may face market pressure to bolster capital sooner, but the impact may be less than feared because many banks have already increased their reserves in anticipation of the new rules, or are planning to do so.

"The gradual transition phase will make it possible for all bank to fulfill the increased capital and liquidity requirements," Axel A. Weber, president of the German Bundesbank, said in a statement.

Analysts say that most U.S. institutions already comply with the new rules, but some European banks will need to raise more capital either by holding on to profits that they may have otherwise distributed to shareholders, or by selling new stock. Among the institutions that might need to raise more money are Société Générale in France and Lloyds Banking Group in Britain as well as Deutsche Bank, according to calculations by Morgan Stanley made before the new rules were announced. Other banks whose current capital reserves might not be sufficient under the new rules are Royal Bank of Scotland and Barclays in Britain, and Crédit Agricole in France, according to Nomura Equity Research.

Banks that have already increased their capital, like S.E.B. and UBS, will be in a better position and may be able to pay out profits to shareholders that they had been husbanding while policy makers debated the new regulations.

Mr. Kvist of S.E.B. said that the decision in Basel gave bankers more certainty about what to expect from regulators. "It is a milestone," he said by telephone, speaking before the accord Sunday in Basel.

The Group of Central Bank Governors and Heads of Supervision, under the chairmanship of Mr. Trichet of the E.C.B., met for most of the day in the headquarters of the Bank for International Settlements, which acts as a clearinghouse for the world's central banks.

The meeting was preceded by energetic last-minute lobbying by the banking industry, which fears the rules will hurt profits, and has warned that lending to business and individuals could suffer.

U.S. banks are particularly opposed to a plan to require banks to keep a "conservation buffer" as part of the capital they must hold. If the banks' capital levels dropped below the buffer, the banks could face new restrictions on the compensation they pay their executives or the dividends they pay their shareholders.

"A one-size-fits-all buffer is inappropriate in many cases and could have serious, negative unintended consequences," Mary Frances Monroe, a vice president at the American Bankers Association, wrote last week to the Basel Committee.

But many analysts and even some bankers say the rules could make the financial system more resilient, and ultimately help restore confidence in the industry.

The rules also include other provisions designed to make the financial world more transparent — for example, giving banks incentives to trade exotic derivatives on the open markets rather than secretly between institutions.

Underlying the continued fragility of the banking system, German officials said Friday that they would add an additional €40 billion in guarantees for Hypo Real Estate, a bank in Munich that is state-owned following a bailout. The additional funds bring the total guarantees to €142 billion.

Sewell Chan contributed reporting from Washington.