The Comparative Political Economy of Basel III in Europe

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Abstract

The Basel III Accord was the centerpiece of the international regulatory response to the global financial crisis, setting new capital requirements for internationally active banks. This paper explains the divergent preferences on Basel III of national regulators in three countries that approximate what are frequently presented as distinct varieties of capitalism in Europe — Germany, the United Kingdom and France. It is argued that national regulators setting post crisis capital requirements had to reconcile three inter-related and potentially conflicting objectives: banking sector stability, the competitiveness of national banks and short to medium term economic growth. The different national preferences on Basel III reflected how different national regulators defined and pursued these objectives, which in turn reflected the structure of national banking systems — specifically, systemic patterns of bank capital and bank-industry ties.

Keywords: Capitalism, varieties of, finance, regulation, banking systems

JEL classification: G21 Banks, G28 Government policy and regulation, P16 Political Economy

1. Introduction

The Basel III Accord on a 'Global regulatory framework for more resilient banks and banking systems' issued in late 2010 was the cornerstone of the international regulatory response to the global financial crisis. The accord was designed to set capital requirements for banks worldwide. Capital requirements have traditionally been regarded as the main instruments to ensure the stability of the banking sector. In 1988, the Basel Committee on Banking Supervision (BCBS) issued the Basel I Accord on 'International convergence of capital measurement and capital standards' (Kapstein, 1989, 1992; Simmons, 2001), which was updated by the Basel II Accord in 2004 (Tsingou, 2008; Underhill and Zhang, 2008; Wood, 2005). Over time, these 'soft' international rules have been incorporated into (legally binding) national legislation in more than 100 countries. In the European Union (EU) this has been done through the capital requirements directives (Underhill, 1998; Howarth and Quaglia, 2013).[1]

As noted in the introduction to this special issue (Bakir and Woo 2016: 1), recent analyses of the Basel accords had 'downplayed the role of the state as an economic actor' in the making of international banking regulation, stressing the influence of non-state actors, first and foremost transnational banks (see, for example, Tsingou 2008, 2010; Lall 2012). After the crisis, the attention shifted back to the state and the need for national regulators to 'design' policies at the national, regional and international levels that would prevent future crises (see also Howlett and Lejano 2013). With reference to the international level, this paper sets out to explain the divergent preferences of the national regulators of three main European countries — Germany, the United Kingdom and France — on Basel III.

These countries are selected principally because they are the largest financial, and specifically banking, systems in Europe and, with the United States, China and Japan, they are among the six largest in the world. They are also selected because, in the Varieties of Capitalism literature, Germany and the UK are frequently presented as the closest European approximations of distinct varieties — Germany, the Coordinated Market Economy; the UK, the Liberal Market Economy (Hall and Soskice, 2001); while France — a unique hybrid — is presented as a post-State-led, 'Mixed Market' or even State-enhanced economy (Schmidt, 2003). Furthermore, the German and UK positions on Basel III stood in strong contrast and contradicted more standard German and British positions on the reinforcement of financial regulation. While the Germans regulators effectively blocked an agreement on Basel III for several weeks in defence of their negotiating position, the British were amongst the leading cheerleaders of reinforced capital requirements. The US is not included in this analysis because the main purpose of the paper is not to explain the outcome of Basel III negotiations, but rather to map the configuration of the three largest national financial systems in Europe and explain how this configuration influenced the preferences of national regulators on the capital requirements they agreed at the international level.

The paper argues that national regulators engaged in post crisis policy design, had to set the policy instrument of post crisis capital requirements with the aim of reconciling three inter-related and potentially conflicting objectives: banking sector stability, the competitiveness of national banks and short to medium term economic growth. The preferences of European national regulators on Basel III were the result of the domestic political economy (for a similar argument that focuses more broadly on national political economies see Fioretos, 2010): the configuration of the national banking system — specifically, systemic patterns of bank capital and bank-industry ties — determined how national regulators defined and tried to pursued these objectives. The predictive framework developed in this paper can be applied to explain other national positions on international capital standards and, potentially, other areas of banking regulation.

2. State of the art and research design

In most of the IPE literature, policy makers' preferences on international financial regulation, first and foremost capital requirements, are shaped by concerns for the competitiveness of national banks in international markets, and by the need to ensure financial stability domestically (Singer, 2004, 2007). This is the 'dilemma' of financial regulators (Kapstein, 1989). However, there is a third objective that policy-makers must consider as far as banking regulation is concerned, namely economic growth, because banks and banking rules — here capital requirements — have implications for the provision of credit to the real economy. We do not treat these three objectives as necessarily contradictory, nor must they necessarily be prioritised. Indeed, improving financial stability can improve competitiveness, especially in the post-crisis period in which investors were often more preoccupied with stability. Moreover, we argue that the manner in which regulators understand financial stability and competitiveness is shaped by the configuration of the national banking / financial system and thus will vary. Clearly though, short to medium-term trade-offs — perceived or real — might still have to be made and notably between financial stability and economic growth because, ceteris paribus, banks need to deleverage — and thus shrink their lending — to improve their capital position.

Most of the literature on the Basel accord has focused on the pervasive power of big transnational banks, which are influential lobbyists with plenty of financial, human and technical resources at their disposal (Baker, 2010; Tsingou, 2008; Underhill and Zhang, 2008). For example, Lall (2012, p. 7) argues that Basel II and Basel III were 'the product of regulatory capture by large international banks in G-10 countries'. By contrast, Young (2012, p. 663) qualifies the extent of 'regulatory capture' in Basel II, arguing that while private sector lobbyists had easy access to the regulatory process, this 'access' did not always mean 'influence' over the outcome. Yet, this literature often does not explore the underlying foundations of financial industry preferences, as our paper sets out to do.

A relatively recent body of work has brought insight from Comparative Political Economy and historical institutionalism into International Political Economy (Bach and Newman, 2010; Büthe and Mattli, 2011; Fioretos, 2010; Posner, 2010). The basic argument is that 'domestic regulatory institutions are the sources of both power and preferences on the global stage' (Drezner, 2010, p. 794). The Comparative Political Economy approach adopted in this paper is inspired by historical institutionalism: it considers banking and more generally financial systems as institutions that shape domestic preferences on international agreements. In so doing, the analysis developed in this paper adds to the Varieties of Capitalism literature, examining the financial underpinning of the national variety of capitalism, that is assumed and rarely explored in the literature (although there are partial exceptions: see for example, Busch, 2004). Our analysis teases out two main features of national financial systems that shape the preferences of policy makers on banking regulation (here capital requirements) and specifically their understanding of and quest for financial stability, bank competitiveness and economic growth. The two features are, first, system-wide patterns in bank capital positions and, second, bank-industry ties — specifically, the relative reliance of non-financial company external funding on bank credit and institutionalised bank-industry relations.

2.1 Research design

We focus on national regulators because countries are represented in the BCBS by authorities from central banks or other supervisory bodies. Most of these officials have limited or no power to adopt regulation at the national level but they will always be involved in the drafting of national legislation – and in the political economy literature they are generally referred to as 'regulators'.[2] National politicians were one step removed from the Basel negotiations. We assume that national regulators were aware that the agreement reached in Basel had to be acceptable to their respective political authorities – notably ministers of finance – back home, but this is not to say that the preferences of national regulators in the BCBS were the same as government leaders. We do not investigate the domestic implementation of Basel III which would involve an analysis of the interaction between regulators and governments / legislatures. We are also aware that treating the preferences of national regulators as monolithic is an oversimplification, especially in the UK, where there was a plurality of actors shaping banking regulation, as noted in Section 3. Nonetheless, in each of our three cases there was a dominant national position on capital requirements which was defended in BCBS negotiations.

The analysis proceeds in two steps. It first outlines the content of Basel III, teasing out the preferences of regulators — the *dependent* variable — during the negotiations on the main issues at stake (Section 3). The preferences of regulators are understood and analysed through: i) semi-structured interviews with members of the BCBS and financial industry officials and representatives in the three countries, at the EU level and in other countries; ii) over a hundred position papers and official public responses to consultations by banking and other associations and individual banks posted on the BCBS website; and iii) a systematic survey of financial press coverage. The debate on the incorporation of Basel III into EU legislation and the legislative outcome are also examined because, on some of the core elements of the Basel III agreement, issues papered over and compromises reached behind the close doors of the BCBS meetings, unravelled during EU negotiations – hence, preferences on specific issues came openly to the fore in the EU debate (IMF, 2011a). The positions of stakeholders (banks) are also considered in this section.

Next, the analysis investigates the *independent* variable, namely the configuration of the national banking / financial system explaining how this configuration affected national preferences on Basel III (Section 4). Specifically, the independent variable consists of system-wide patterns in bank capital and bank-industry ties — the relative importance of bank credit to nonfinancial company external funding and institutionalised bank-industry relations. This Comparative Political Economy analysis of bank and nonfinancial company financial data in the three countries is enriched by semi-structured elite interviews in order to corroborate the data gathered and better understand the position of banks and regulators.

3. The Basel III accord and national policy makers' preferences

The BCBS put forward concrete proposals on Basel III in December 2009 (BCBS, 2009a, b), which were then subject to public consultation. Other documents (for example on the countercyclical capital buffer, BCBS, 2010a) were issued for consultation throughout 2010. A general agreement was reached in July 2010 (BCBS, 2010b) and a final agreement was eventually signed in December (BCBS, 2010 e,f). Compared to the Basel II accord, Basel III was negotiated in record time — less than two years — due to the political salience imparted to it by the recent international financial crisis. The Basel III rules are to be phased in gradually from January 2013 until 2019. The accord has to be transposed into national (and / or EU) law in order to become legally binding.

Table 1 summarizes the preferences of British (and by way of comparison American), German and French policy makers on the main elements of Basel III.[3] In a nutshell, UK and US regulators wanted a restrictive definition of capital and higher levels of capital, whereas

French and German regulators were keen to have a broader definition of capital and lower capital requirements. UK and US regulators supported a leverage ratio, French and German regulators opposed it and asked for longer transition periods to implement the accord. Let us examine these elements in more detail.

The accord provides for the first time a common definition of capital, on which there had been no agreement in the past. The main form of 'Tier 1 capital' must be common shares and retained earnings. The remainder of Tier 1 capital can include subordinated debt. 'Hybrid capital' instruments should be phased out (BCBS, 2010e, p. 2).[4] Many EU regulators, in particular the Germans, were concerned about the ban on 'hybrid' capital, which would considerably reduce the capital base of their banks that used these and similar non-equity instruments in their calculation of Tier 1 capital (*The Economist*, 23 January 2010). By contrast British and American regulators were keen to exclude hybrids from the definition of capital (interviews, US financial regulators, Washington, 5 August 2011). For example, a senior figure from the British Financial Services Authority noted that '…hybrid capital … acts like debt as far as the tax man is concerned, and … like equity as far as the depositor is concerned. This hybrid capital is junior to deposits, but senior to equity' (Huertas, 2009: 11). British and American regulators insisted that shareholders should take the losses for hybrids rather than the government having to cover it.

< TABLE 1 ABOUT HERE >

The total regulatory capital consists of Tier 1 Capital and Tier 2 Capital and it must be at least 8 per cent of risk-weighted assets.[5] Tier 1 must be at least 6 per cent of risk-weighted assets and the 'Core Tier 1', which comprises common equities, must be at least 4.5 per cent of risk-weighted assets (BCBS, 2010e, p. 12). The original proposals for higher capital requirements were watered down in a search for a compromise between the UK, the US and Switzerland, keen to set higher requirements, and several continental regulators, resisting them and asking for longer transition periods (*Financial Times*, 22 October 2010). Basel III introduces a 'capital conservation buffer'[6] of 2.5 per cent comprised of common equities, above the regulatory minimum. Capital distribution constraints are to be imposed on a bank when capital levels fall within this range (BCBS, 2010e, p. 55). On 'Core Tier 1', therefore, Basel III sets risk-weighted capital requirements of 4.5 per cent as compared to a pre-existing (Basel II) level of 2 per cent, plus a new buffer of 2.5 per cent, establishing a new effective floor at 7 per cent. National countercyclical buffers, designed to take into account the macro-financial environment in which banks operate, are also to be introduced (BCBS, 2010e, p. 57). These buffer requirements, to be decided by national jurisdictions, can vary between zero and 2.5 per cent of risk-weighted assets. Bank specific countercyclical buffers can also be imposed (BCBS, 2010 e, p. 58). Capital buffers are to be phased in between 2016 and 2019. Basel III also envisages a capital surcharge to mitigate the risk of systemic banks, to be agreed subsequently.

Basel III introduces a 'leverage ratio', which is a non-risk based ratio calibrated to act as a supplementary measure to the risk based capital requirements. The BCBS would test a minimum Tier 1 leverage ratio of 3 per cent during the trial-run period from 1 January 2013 to 1 January 2017 (BCBS, 2010e, p. 61). This regulatory instrument was already in use in the US, but its introduction into Basel III was resisted by most continental European regulators, who argued that the riskiness of the activities of their traditional universal banks was lower than that of (largely Anglo-Saxon) investment banks and that this feature would not be captured by a crude leverage ratio (*Financial Times*, 26 October 2010; interview, French regulator, Paris, 7 July 2011). Having failed to prevent the inclusion of the leverage ratio in the Basel III rules, continental regulators lobbied hard for it not to be included in the European Commission's proposed legislation implementing Basel III.

If one considers the evolution of the negotiations, in its draft issued in December 2009, the BCBS took a surprisingly hard-line approach on capital and liquidity requirements, pushing for a higher adequacy threshold and a restriction on hybrids, with minimum capital to be composed of predominantly equity capital. Given the similarity of preferences of UK and US regulators, their remarkable financial expertise, the large size of their financial sectors and their chairmanship of key working groups,[7] they were able to leave a strong imprint on the initial Basel III draft of December 2009. However, the final December 2010 version was less strict: in particular, it contained longer transition periods. This relaxation owed in part to the extensive lobbying from banks and bank associations but also largely to the resistance of continental European and Japanese regulators to some of the most draconian provisions. Indeed, at the crucial meeting of the BCBS in September 2010, three months prior to the final agreement, German regulators refused to endorse the document prepared by the BCBS, asking for and subsequently obtaining important revisions (interview, German financial industry representative, Frankfurt, 18 April 2012, BCBS, 2010d).

4. National financial systems and the Comparative Political Economy of Basel III in Europe

This section engages in a Comparative Political Economy analysis of Basel III by focusing on two core features of national financial / banking systems in our three European countries. Our analysis first considers the capital position of banks; it then considers bank-industry ties, and specifically the relative reliance of non-financial companies on bank credit for their external funding needs and their relationship with banks.

4.1 Bank capital position

The first key feature of national banking systems concerns the capital position of banks — principally their holding of equity and other Tier 1 capital — with a requirement to reach 6 per cent by 2015 and 8.5 per cent, with the capital conservation buffer by 2019. Institutions with higher capital ratios were in a competitively advantageous position because they were less likely to have to deleverage (cut their lending) or raise equity. The weak capital position of systemically important German banks helps to explain German regulator opposition to the rigid tightening of capital requirements (see Figures 1 and 2), while the biggest British banks would have limited difficulties to meet the Basel III standards. Clearly, early recapitalization (both public and private from 2007 to 2009) improved the capital position of British banks, giving them a massive leg-up in their ability to meet Basel III rules. For example, in its response to the BCBS consultation, Barclays (2010, p. 2) argued that 'we … have pre-empted the anticipated change by increasing our capital ratios in 2008-9 … whilst also lowering our leverage and improving our liquidity positions'.

With an eye to profitability and the competitive position, one senior British bank representative indicated that British banks would have preferred lower capital requirements, but also that 'they could live with the new levels set in Basel III' (interview, London, 15 March 2012). The British Bankers Association (BBA) expressed much stronger concerns in its documentation and official statements on Basel III. While tighter capital rules potentially strengthened the position of British banks in relation to undercapitalized European competitors, more stringent Basel guidelines, if adopted into EU legislation, could put British international bank champions at a competitive disadvantage in relation to non-European banks with headquarters in jurisdictions that either did not implement Basel III or did so only in part — notably the United States and China (Knight, 2010). The BBA called for a long transition period because of deleveraging pressures and the impact upon investor confidence in the event that banks retained earnings and cut dividends to share-holders to improve their capital position (*Financial Times*, 28 June 2011). British regulators thus effectively sought to balance stability concerns and the competition-related concerns of their biggest banks.

French and German banks had pressing concerns regarding the double counting of insurance subsidiaries, the use of hybrid capital and the inclusion of a leverage ratio. French bank data suggest their strong position but the double counting of capital in the banks' insurance subsidiaries — to be banned under Basel III but allowed in the EU legislation implementing Basel III — inflates the figures. In 2011, the IMF estimates that a ban on double counting would result in French banks losing a total of 28.9 per cent of their Tier 1 capital, preventing several from meeting the 6 per cent threshold and all from meeting the 8.5 per cent threshold — with the capital conservation buffer — from 2019 (IMF, 2011b). A ban would hit the three large French commercial banks particularly hard because of *bancassurance*. The French Banking Federation considered the BCBS proposal to exclude insurance subsidiary capital from Tier 1 capital as 'completely unacceptable' (Fédération Bancaire Française, 2010, p. 5). The French government then fought against the inclusion of the ban on double counting in EU capital requirements legislation. The *bancassurance* system predominates in certain other EU member states, including Spain and Austria. At least one British bank, the part state-owned Lloyds-TSB was also potentially exposed, as it was one of Britain's largest insurance providers.

<FIGURE 1 ABOUT HERE>

Banks which did not use equity to fund their activities — public sector, cooperative and mutual banks — faced particular difficulties meeting the new capital guidelines. These banks previously relied on other forms of capital to meet Basel guidelines, notably hybrids and specifically 'silent participations'. The ban on hybrids would hit hardest the German banking system, given the heavy reliance of public and commercial banks on 'silent participations', while the large French mutuals were also exposed. Also, EU implementing legislation of the two previous Basel accords applied the rules to all EU-headquartered banks — not just the internationally active ones — on the grounds of fair competition in the EU internal market. Without significant dilution then, Basel III would force major changes to the German banking system. It is no wonder then that the peak association representing all German banks asked for a grandfathering clause on Basel III capital rules of 'at least 30 years' (Zentraler Kreditausschuss, 2010, p. 3) and the German government demanded the inclusion of 'silent participations' as acceptable Tier 1 capital in the EU capital requirements legislation (see also Deutsche Bank, 2010).

The strong opposition of French and German regulators to the use of a leverage ratio reflected the higher ratios of their large commercial banks (compared to the UK) and in particular the difficult situation facing German LB and Sparkassen and French mutual banks given the lack of equity capital.[8] Basel III was drafted having in mind banks funded by equity finance (hence the emphasis on common equities in Core Tier 1 capital), whereas the external funding of many EU-based banks came from other sources. Despite the significant rise in their leverage ratios during the two years prior to the outbreak of the financial crisis, British banks had been among the least leveraged in the EU, well below the Basel III recommended assets to equity threshold of 33 (or equity to asset ratio of 3 per cent), holding on average over a third more equity as a percentage of assets than German banks (ECB Statistical data warehouse). On first examination, the three large French commercial banks appeared to have a similarly low leverage ratio but the ban on double counting would weaken their position.[9] The opposition of French and German banks and their regulators to a leverage ratio, as opposed to a calculation of risk-weighted assets, also reflects the relative importance of trade financing in their overall operations. Trade financing is high in terms of overall assets but low in terms of risk-weighted assets.

<FIGURE 2 ABOUT HERE>

To conclude this section, the stronger the capital position of banks, the weaker the concern with the impact of Basel III upon the real economy, as in the case of the UK. Higher capital requirements reinforced the competitive position of British banks at least in relation to most of their European competitors. A stronger bank capital position also allowed British regulators to play up stability-oriented concerns. A weaker capital position, as in the case of Germany, corresponded to greater concerns about the competitiveness of national banks and the impact of Basel III rules on the wider economy. France was in between these two positions.

4.2 Bank-industry ties

The second key feature of national financial systems that affected national preferences on Basel III concerns bank-industry ties. In countries with less developed equity markets and greater reliance on bank credit, banks and more importantly national authorities were worried that tighter capital requirements would lead banks to reduce lending to industry. In most European countries there was relatively high dependence of non-financial companies (particularly, small and medium sized enterprises (SMEs)) on bank finance. Furthermore, in a number of European countries — notably France and the Netherlands — where equity issuance by non-financial companies had increased significantly in the 1980s and 1990s, the decade prior to the outbreak of the financial crisis in 2008 saw a rapid rise in the use of bank credit by non-financial companies (Hardie and Howarth 2013). The long-standing close relations between banks and industry in several continental European countries reinforced deleveraging concerns.

In Germany, relational (*hausbank*) banking effectively shaped the preferences of both banks and regulators on capital requirements — in spite of changes in recent years (Deeg 2010). French non-financial companies' reliance on equity was comparatively high, although French SMEs were more dependent upon bank credit than their British counterparts — which helps to explain French sensitivities (Howarth 2013). UK non-financial companies also came to rely much more on bank credit for their funding in the decade prior to the financial crisis, a development encouraged by low interest rates and the securitization of bank loans.

Bank lending to non-financial companies in the UK dropped by twenty per cent between 2007 and 2011 (ECB Statistical data warehouse), a refection of the massive deleveraging of British banks and the collapse of securitization markets (Hardie and Maxfield 2013). By contrast, lending by German and French banks to non-financial companies remained relatively strong – down in 2009 by only 5 per cent for German banks from a 2008 peak and approximately 2 per cent for French banks (ECB Statistical data warehouse). Credit provision was limited principally by slow economic growth as opposed to the deleveraging efforts of banks. Forcing French and, more significantly, German banks to deleverage during a recessionary period could result in a credit crunch if banks reduced their lending (cut their risk-weighted assets denominator) instead of boosting their capital (lifting their equity numerator) which was likely given the difficulty of attracting capital.

One IMF study from 2011 on the differential impact of Basel III rules on national banking systems echoes findings in a range of other studies: to demonstrate a particularly significant impact upon bank lending in Germany and a comparatively small drop in the UK, with France somewhere in between (Cosimano and Hakura, 2011). A BCBS study (2010c) noted differential impact but refused to be specific on countries. In France, the ‘national’ champions maintained lending to the real economy in the years following the international financial crisis under considerable government pressure. In Germany, the comparatively stable levels of bank lending owed principally to the savings banks and cooperatives which significantly their lending, while the big internationally-active commercial banks cut their lending considerably.

To conclude this section, the stronger the bank-industry ties, the stronger the concern of regulators of higher capital requirements hitting economic growth and more limited concerns about stability, as in the case of Germany. The weaker the bank-industry ties, the weaker the concern that higher capital requirements could undermined domestic lending and the greater (ostensible) focus on stability, as in the case of the UK. France, where bank-industry ties were weaker than in Germany but stronger than in the UK, had an intermediate position on Basel III.

5. Conclusions

After the international financial crisis, national regulators engaged in policy design with a view to preventing, or at least diminishing the severity of, future crises. At the international level, through the Basel III accord, they revised the policy instrument of capital requirements, with the aim of reconciling three different objectives. This paper has argued that a Comparative Political Economy analysis focused on the configuration of national banking systems has considerable analytical leverage in accounting for the preferences of European regulators on Basel III, explaining the disagreements that emerged in Basel and ultimately the weakness of the reforms eventually agreed by the BCBS, despite the severity of the international financial crisis. Banking system configuration shaped regulator understanding of stability, competitiveness and economic growth concerns. We stress the particular importance of systemic patterns in bank capital position and bank-industry ties to explain this understanding, while also recognising the potential relevance of other factors, including systemic patterns in bank internationalisation (see, for example, Howarth and Quaglia 2016) but also non-bank institutional factors, including the distribution of regulatory powers at the domestic level (see, for example, Lombardi and Moschella 2016) — the examination of which must be the subject of further analysis.

The main findings of this research can be generalized to other cases (i.e., countries). The (inductive) analytical framework centred on two core features of national banking / financial systems can be wielded to explain the preferences of policy makers in other countries on Basel III and, potentially, in other areas of bank regulation. In countries, such as Germany, where strong bank-industry ties persist, policy makers will be particularly concerned about the effects of stricter banking regulation on economic growth, especially when banks have a weak capital position and thus stricter capital rules will be detrimental to lending to the real economy. In countries, such as the UK and the US, with weaker bank-industry ties, economic growth considerations are more likely to be downplayed in policy making on capital requirements, especially if domestic banks start with a good capital position.

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Endnotes

[1] When the financial crisis broke out the US had not yet implemented Basel II into national legislation.

[2] Throughout this article we use the term ‘regulators’. This is standard in the literature on the BCBS. However, it is understood that these ‘regulators’ are in fact representatives from supervisory bodies, many of whom have limited or no regulatory power at the national level — unlike US supervisors who also possess significant autonomous regulatory powers. In the context of the BCBS, however, these supervisors gain decision-making power over the setting of the Basel guidelines.

[3] We do not consider the Basel III liquidity guidelines in this paper given limited space but we recognise that they are an important dimension of the attempt to reinforce bank stability.

[4] Hybrids are instruments that have some features of both debt and equity.

[5] Tier 2, or supplementary capital, consists of undisclosed reserves, revaluation reserves, general provisions and subordinated term debt.

[6] This buffer is intended to promote the conservation of capital and the build-up of adequate buffers above the minimum that can be drawn down in periods of stress.

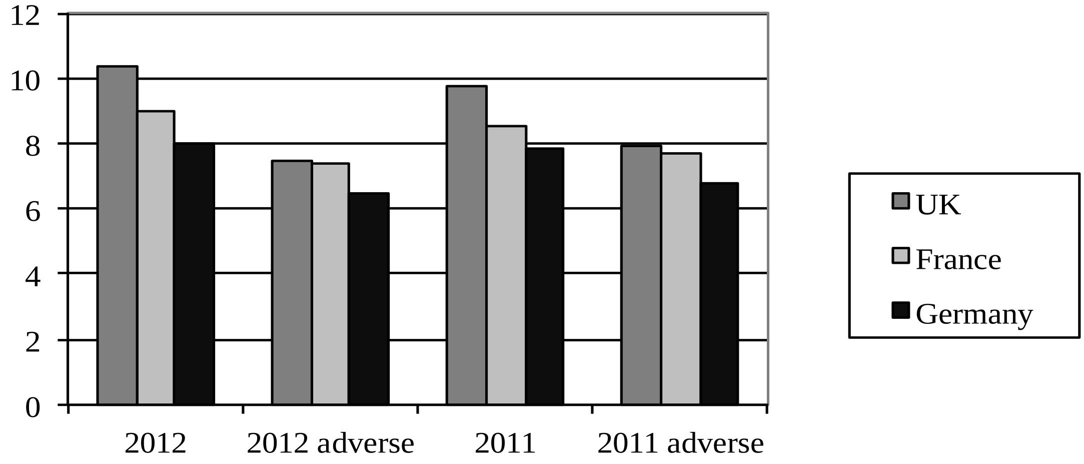
[7] For example, the working group on liquidity was chaired by Nigel Jenkinson of the Bank of England; the working group on the trading book was chaired by Alan Adkins of the British Financial Services Authority.

[8] For example, the Zentraler Kreditausschuss rejected the concept of the leverage ratio (2010, p. 30) and the Fédération Bancaire Française wanted to limit the use of the leverage ratio to Basel Pillar II (2010, p. 2).

[9] The largest French bank, BNP Paribas, argued that the ‘leverage ratio…has proven failures [sic] or flawed definitions wherever it has been applied, in particular in the US. Application should be based at most on a pillar 2 approach’ (2010, p. 2).

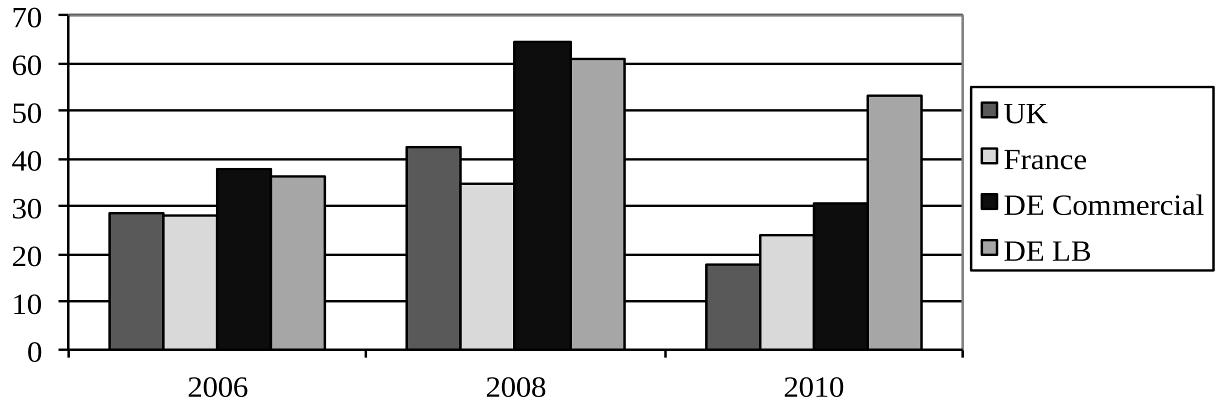
Figures and Table

Figure 1: Tier 1 capital (as a percentage of total assets) main British, German and French systematically important banks (non-weighted average)*



Source: EBA. Stress tests undertaken in 2010 and 2011. Recall: Target of 8.5% in 2015 (including capital conservation buffer); 11% in 2019 with discretionary buffer. *Including some hybrids ('silent participations' only) and double counting of insurance subsidiary capital. Results of the stress test based on the full static balance sheet assumption without any mitigating actions, mandatory restructuring or capital raisings post 31 December 2010 (all government support measures fully paid in before 31 December 2010 are included). UK banks: RBS, HSBC, HBOS (not 2010), Lloyds, Barclays. French banks: Société Générale, BNP Paribas, Crédit Agricole, Caisse d'Epargne (BPCE in 2010). Figures exclude Banques Populaires and Crédit Mutuel. German banks : Desdner (not 2010), Commerzbank, Deutsche bank.

Figure 2: Leverage ratio for British, German and French systemically important banks (non-weighted average) (assets to equity)



Source: Bank balance sheets.
UK banks: RBS, HSBC, HBOS (not 2010), Lloyds, Barclays.
French banks: Société Générale, BNP Paribas, Crédit Agricole, Caisse d'Epargne (BPCE in 2010). Figures exclude Banques Populaires and Crédit Mutuel.
German banks : Desdner (not 2010), Commerzbank, Deutsche
German LB: HSH Nordbank, LB Berlin, LBBW, Heleba, Bayerische LB, West LB. (LB Sachsen excluded).

Table 1 National preferences on the capital provisions of Basel III

	United Kingdom (and United States)	**France**	**Germany**
Definition of Capital	Ban on hybrids for all tier 1.	Tolerance on hybrids (esp. for non-core tier 1).	Need to include hybrids ('silent participations').
Level of Capital	Higher level needed. Exclude double counting of insurance subsidiary capital.	Full double counting of insurance subsidiary capital.	More cautious and gradual rise; double counting of insurance subsidiary capital.
Leverage ratio	Inclusion. Push for lower ratio than 33.	Exclusion / Or voluntary if included.	Exclusion / Or voluntary if included.
Transition periods	Rapid: by 2015 at the latest.	2015 / 2018 manageable with qualifications intact.	Lengthy: >decade.