ON THE PRACTICE OF FINANCIAL STABILITY IN GREECE

THE IMPLICATIONS OF BASEL II

Bank of Greece

Financial Stability Structure in GR

Three separate supervisory bodies:

1. The Bank of Greece *authorizes and supervises*

- Credit Institutions
- Financial Institutions (Credit, Financial, Leasing & Factoring companies, F/x offices, money transfer companies)

Financial Stability Structure in GR

2. The Hellenic Capital Market Commission *authorizes and supervises*:

- Investment firms
- Collective Investment firms

3. The Commission for the Supervision of Private Insurance *authorizes and supervises*:

- Insurance companies

Financial Stability Structure in GR

Close cooperation between domestic supervisory authorities

Financial Sector Structure

Banks dominate the Greek financial sector

- They account for approximately 85% of the total assets of the entire financial sector
- The 5 largest banks control 65% of the total assets of the banking sector

Banking Sector - 2004

- Main risk → Credit Risk
- ROE (before taxes) → 16,1%
- ROA (before taxes) → 1%
- Capital Adequacy ratio → 12,8%

Assessment of the stability of the Greek banking sector

BoG approaches

- Analysis and evaluation of information from different sources
- Banking sector's capacity to absorb negative shocks

Credit Risk

From supervisory returns

1. Provisions
2. Exposure concentration ratios (by borrower, economic sector, country/region)
3. Changes in banks' internal ratings of individual exposures (credit migrations)

Credit Risk

From other sources

1. Households
   - estimation of the total household burden in relation to the disposable income.
2. Non – financial enterprises
   - ROA & ROE
   - The debt coverage & the leverage ratio

Market & Liquidity risks

From supervisory returns

1. Trading book capital requirements
2. Net open foreign currency position
3. Interest reprising gaps & average duration
4. Maturity mismatches of assets and liabilities
5. Liquidity ratios

Macroeconomic environment

Developments in:

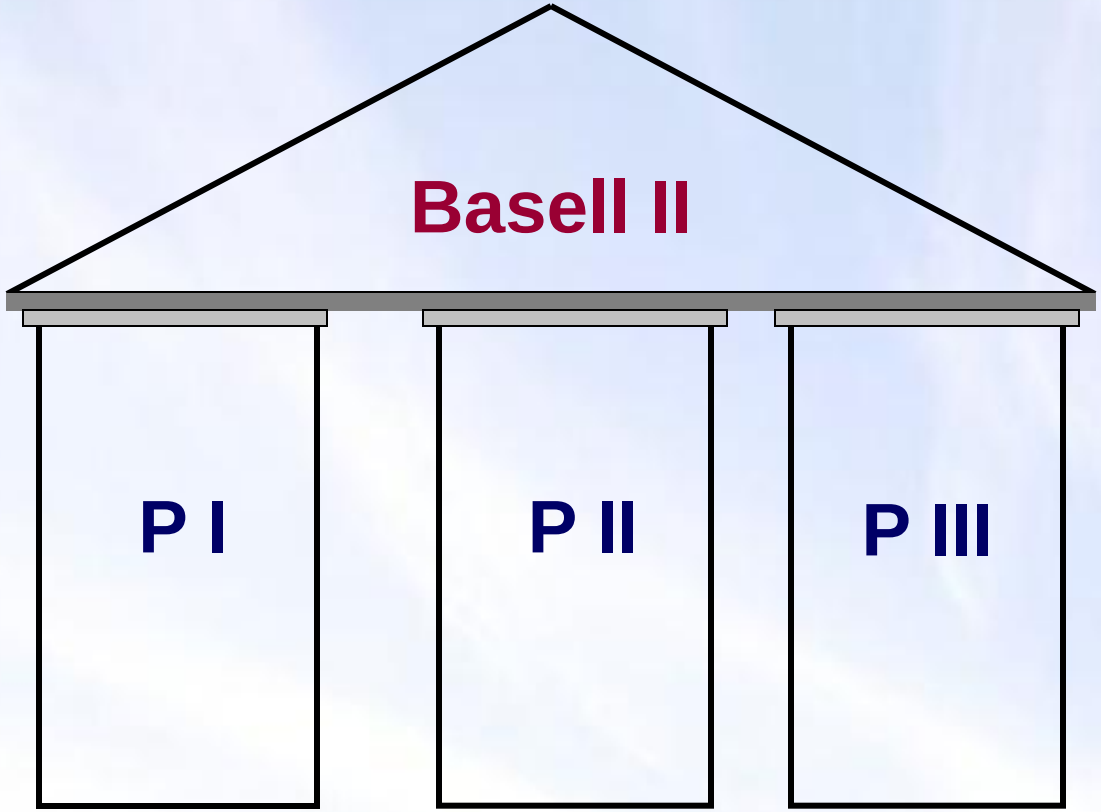
- GDP growth
- interest rates
- exchange rates
- the stock market
- the real estate market

Impact of adverse disturbances

The evaluation of the banking sector's capacity to absorb the impact of adverse disturbances is based on analysis of:

- Developments on B/S and P/L
- The results of stress-test exercises

Basel II



Pillar I – Credit Risk

Majority of Greek banks will adopt the standardized approach.

Banks comprising a share of around 50% of the total assets of the banking sector, are expected to adopt the F-IRB approach.

Pillar I – Operational Risk

Majority of Greek banks are expected to adopt the basic indicator approach.

Large banks plan to adopt the standardized approach.

Impact on Capital Requirements

QIS 3 results 2003

Indicative results based on six banks using the standardized approach at the time

+ 7,5% increase in capital requirements

comprised of:

- 2,5% decrease in requirements for <u>credit risk</u>

+ 10% increase in requirements for <u>operational risk</u>

Pillar II

- Examination of accuracy of supervisory returns
- PIT evaluation of loan quality
- Technical calculation of capital requirements

Moving to →

- Risk based supervision
- Assessment of internal controls & risk management systems
- Analysis of risk profile of each bank & corresponding capital requirements

Pillar III

- Market rewards well managed and capitalized banks
- Supervisors will ensure that appropriate disclosures are made by the credit institutions to enhance market discipline
- Interaction with IFRS

Basell II and Stability

Favorable Effects

- Improvement of banks' risk measurement and management systems
- Development of contingency planning

leading to ⬇

- Prompt and effective reaction to disturbances affecting their risk profile
- Better evaluation of the banking sector's resilience by the Bank of Greece.

Basel II & Procyclicality

Concerns:

Capital requirements for Credit Risk will increase during cyclical downturns and decrease during upturns

Bank capital adequacy will deteriorate during downturns, given the difficulty of raising new capital in such conditions

Banks will be under pressure to restrict their lending during downturns, while during upturns they will tend to unduly expand it.

Basel II & Procyclicality

However:

bank lending is likely to be pro-cyclical to some degree, irrespective of the supervisory framework.

Basel II & Procyclicality

Procyclical effect can be mitigated by:

- Holding capital comfortably above individually set minimum requirements, under normal circumstances
- Banks being required to run rigorous stress tests in order to assess the adequacy of capital buffers
- Banks being encouraged to adopt a more forward-looking TTC approach.

Basel II & SMEs

Concerns:

- Increase in capital requirements
- Increase in financing costs or decrease in available credit

↓

Adverse effects on their financial condition

↓

Negative consequences for economic growth, employment, stability.

Basel II & SMEs

In Greece, significant part of SMEs exposure qualify for retail treatment.

Standardized approach

➡ RW 75% vs 100%

IRB approach

➡ Firm - size adjustment

➡ Lower RW function

Market- based indicators

- Increased transparency to enhance market discipline.
- Enhancement of the information content of banks' share prices and spreads on subordinated debt.
- Increase in the accuracy and the predictive power of fragility indicators based on market data, which can be used as supplement to supervisory data.

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