Basel III implementation in Russia

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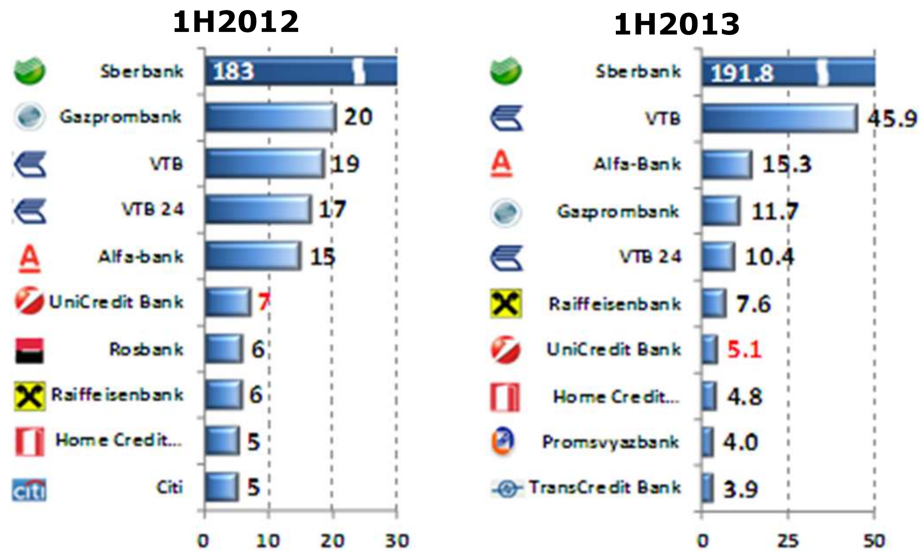
UniCredit Bank is one of most profitable, reliable and the largest foreign bank in Russia

Total assets, RUB billion

PL, RUB billion



Sources: CBR, the banks' balance sheets (RAS), UniCredit Bank's calculations,

UniCredit Group.
European Banking Network

- **Employees: over 150,000**
- **Branches: ~ 9,200**
- **Total Assets: €890 billion**
- **Banking operations in 20 countries**
- **International network spanning ~ 50 countries**
- **Market leader in Central and Eastern Europe leveraging on the region's structural strengths**

The wave of new regulation after 2008 crisis encompasses a wide range of initiatives/instruments

2008 FINANCIAL CRISIS

1

New Prudential requirements – Basel III

- Higher quantity and quality of capital
- Introduction of leverage ratio
- Introduction of liquidity metrics
- Improved counterparty risk measurement, CVA
- Supporting factor for SME

2

New requirements for too big to fail institutions

- G-SIFIs capital buffer
- Recovery and resolution plans

3

OTC derivatives market infrastructure

4

Risk and performance alignment of remuneration

5

Shadow banking

Impacts for banks

•Higher capital

•Higher liquidity and funding buffer

•New requirements for some activities

- **Potential significant impact on banks profitability and, in turn, on the real economy**
- **Avoidance of regulatory arbitration is the main task**

Basel II implementation in Russia. Key features

- **01.08.2011 Basel II STA simplified approach was implemented in Russia (with some local features) .**

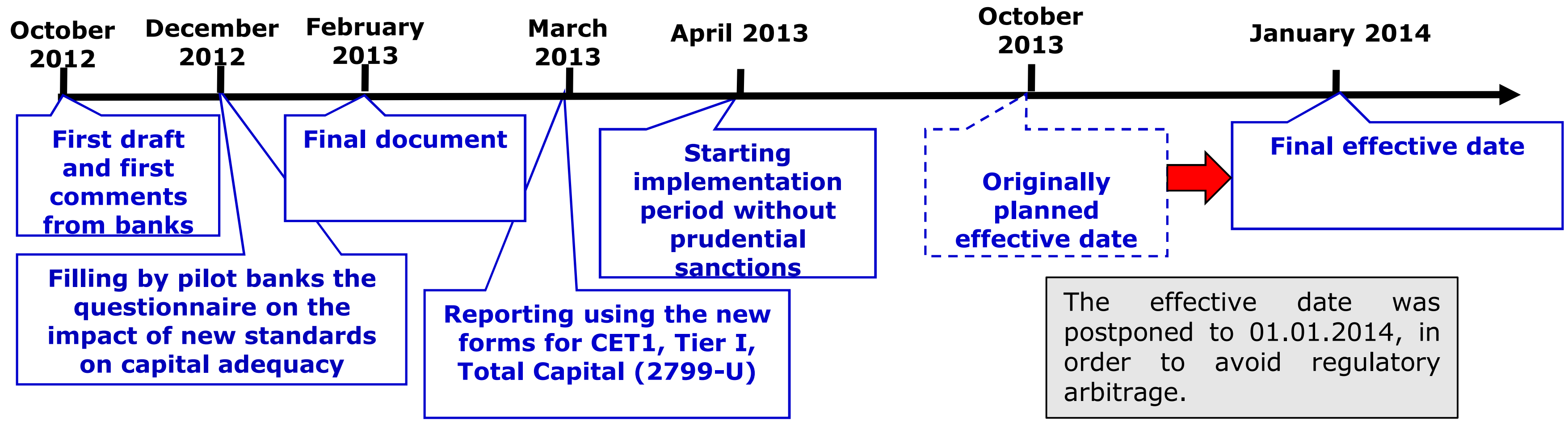
	Europe	Russia
Mortgages (covered part)	Risk weight 35%	Risk weight 70%-150%
SME	Risk weight 75% -100%	Risk weight 100%-150%
Corporate Loans with a credit rating below «B» or without credit rating: - for the purchase of securities; - for the investments in authorized capital of other legal entities; - for the acquisition of real property; - for refinance loans from third parties (except credit institutions); - for transfer to the settlement (current) accounts of borrowers in other credit institutions - for offshore residents	Not in a separate assets class. Risk weight of assets Corporate/Retail 75%-150%	Risk weight 150%
- Retail Consumer Loans in foreign currency	Risk weight of Retail assets - 75%	Risk weight 150%
- Loans without the borrower's consent to the disclosure of information to BCH (Bureau of credit history)	Not in a separate assets class. Risk weight of assets Corporate/Retail 75%-100%.	Risk weight 110%
- Consumer loans with high effective interest rate		Risk weight up to 200% (it may be significant ly increased in the future*)

There are more stringent capital adequacy requirements in certain aspects of Basel II adopted in Russia

1 New Prudential requirements – Basel III

Quantity and quality of capital

Central Bank of Russia regulation 395-P "Calculation the amount of own funds (capital) (Basel III)»: a detailed translation of CRD IV (Capital Requirement Directive adopted by European union) in terms of quality and quantity of capital

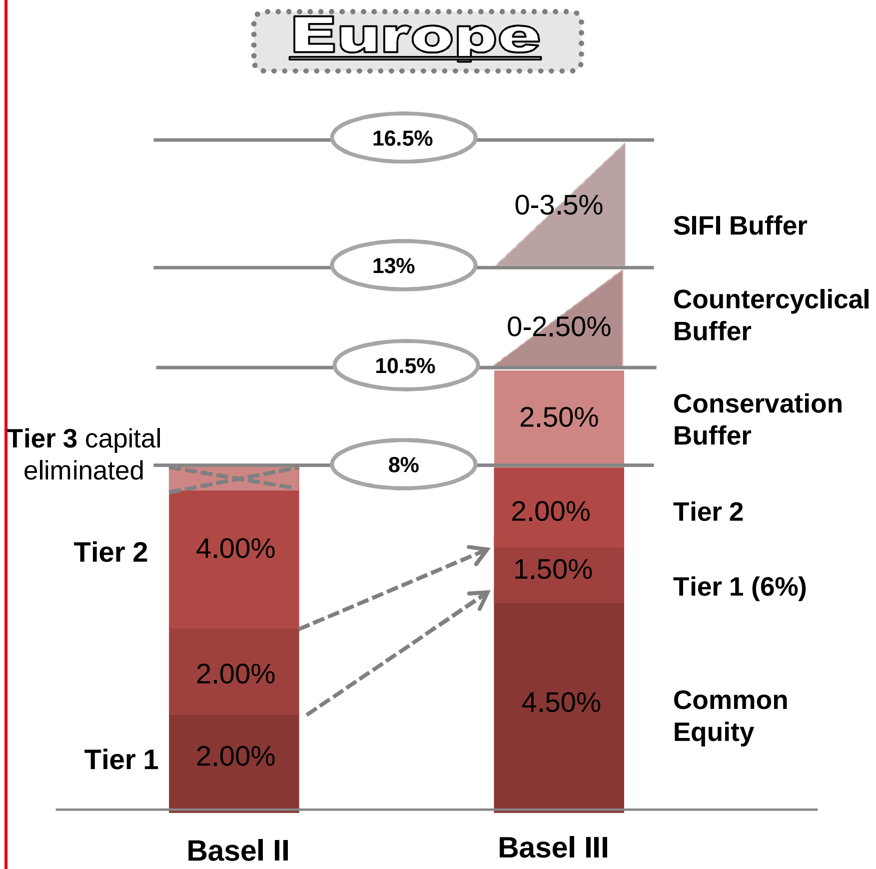


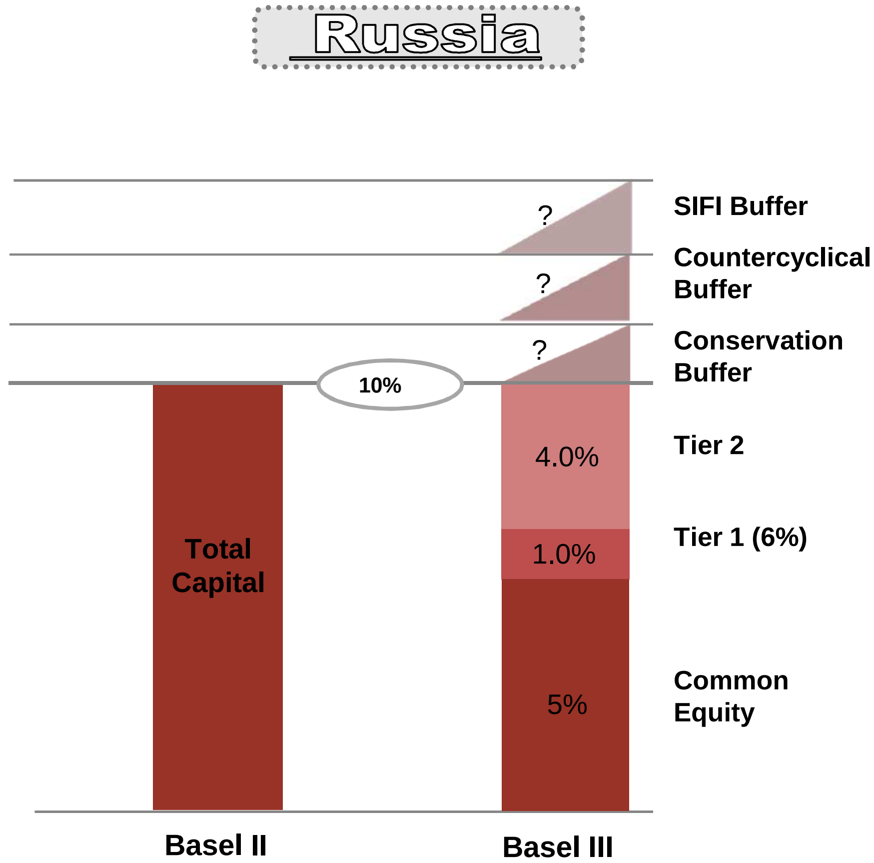
Hot Topics:

- **The discrepancy in quantity of capital.** Capital adequacy ratio: Russia -10%, Basel - 8%.
- **The discrepancy in quality of capital:**
  - Central Bank of Russia supervises banking system based on stand-alone basis as compared to consolidated supervision according to the Basel requirements.
  - Hedge accounting is not implemented under RAS (Russian Accounting Standards)
  - Significant investments in financial institutions (which are not deducted from capital) are weighted at 200% according to RAS as opposed to 100% RWA according to Basel III

New Prudential requirements – Basel III

Quantity and quality of capital (1/2)





Hot Topics:

- New supervisory limits were set off for CET1 and Tier I. Limits for CET1 and Total Capital – more stringent than in Europe
- Additional capital buffers are not defined in Russia at the present time

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New Prudential requirements – Basel III
Leverage, liquidity, CCR and stress testing, SME supporting factor

Leverage ratio: Central Bank of Russia has developed recommendations for calculations of leverage ratio. Prudential limit is not set up. Starting date of public disclosure will be determined in 2014. In Europe, leverage ratio will be disclosed starting from January 1, 2015.

Liquidity ratio: At the moment, CBR requires compliance with N3 (short term) and N4 (long term) liquidity ratios. Bank of Russia issued the draft document on LCR (Liquidity Coverage Ratio), which is more strict as compared to Basel III requirements. Currently the Bank of Russia is a collecting comments from banks. The draft on NSFR (Net Stable Funding Ratio) is not yet developed.

CCR, stress testing & CVA:

- Currently stress testing is prepared by Russian banks ad hoc based on the separate requests from Bank of Russia. This stress testing is expected to be used in the recovery plans for D- SIFIs.
- Similar to Basel III requirements, CVA is also implemented in Russia

SME Supporting factor: Basel III provides SME supporting factor of 0.7619. Not available in Russia.

Hot Topics:

- No draft for NSFR (Net Stable Funding ratio) in Russia
- In Europe, liquidity ratios (LCR and NSFR) are monitored and supervised at the consolidated basis. In Russia supervision is based on stand-alone approach
- SME supporting factor is not introduced in Russia

New Prudential requirements – Basel III

Implementation date in Europe and in Russia

	Phases	2013	2014	2015	2016	2017	2018	2019
Capital	Leverage Ratio (Europe)		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015				Migration to Pillar 1	
	(Russia)		Draft is available, limit is not set up.					
	Minimum Common Equity Capital Ratio (Europe)	3,5%	4,0%	4,5%				**4,5%**
	(Russia)	5,0%	5,0%					**5,0%**
	Capital Conservation Buffer (Europe)				0,625%	1,25%	1,875%	**2,5%**
	(Russia)		isn't established					
	Minimum common equity plus capital conservation buffer (Europe)	3,5%	4,0%	4,5%	5,125%	5,75%	6,375%	**7,0%**
	(Russia)		isn't established					
	Phase-in of deductions from CET1* (Europe and Russia)		20%	40%	60%	80%	100%	**100%**
	Minimum Tier 1 Capital (Europe)	4,5%	5,5%	6,0%				**6,0%**
	(Russia)		5,5%	6,0%				**6,0%**
	Minimum Total Capital (Europe)		8,0%					**8,0%**
	(Russia)	10,0%	10,0%					**10,0%**
	Minimum Total Capital plus conservation buffer (Europe)		8,0%		8,625%	9,25%	9,875%	**10,5%**
	(Russia)		isn't established					
	Capital instruments that no longer qualify an non-core Tier 1 capital or Tier 2 capital (Europe and Russia)		Phased out over 10 year horizon beginning 2014					
Liquidity	Liquidity coverage ratio - minimum requirement (Europe)			60%	70%	80%	90%	**100%**
	(Russia)		The draft of rules for calculation and reporting is published, threshold value and an order of introduction aren't established					
	Net stable funding ratio (Europe)						Introduce minimum standard	
	(Russia)		Isn't established					

-- transition periods

* Including amounts exceeding the limit for deferred tax assets (DTAs), mortgage servicing rights (MSRs) and financials.

2 New requirements for "too big to fail" institutions.
Capital buffer

In Europe:

- During the G20 Summit in Cannes (2011), a list of global banks (G-SIBs) has been released.(G-SIB).
- The updated list (FSB and BCBS) of G-SIBs and related capital surcharges was published in November 2012 by FSB.

In Russia:

CBR Board of Directors made a decision to establish the SIBs Supervision Department starting October 1, 2013.

- Supervision of all SIBs by the Department is expected since October 1, 2014.
- The final list of SIBs supervised by the Department will be determined at the end of 2013- beginning 2014.
- The number of SIBs may range from 20 to 200.

Hot topics

- The adoption of capital add-ons for national SIBs shall be carried on **keeping in mind that several national SIBs belong to global SIBs**, to which a global SIBs surcharges will apply.
- It will be crucial that the D-SIB framework will be implemented with the highest degree of homogeneity. **National discretions pose always a risk to the promotion of a level playing field**

2 New requirements for "too big to fail" institutions.

Capital buffer.

For Unicredit group the capital buffer is defined

G-SIBs as of November 2012 allocated to buckets corresponding to required level of additional loss absorbency

Bucket[4]	G-SIBs in alphabetical order within each bucket
5 (3.5%)	(Empty)
4 (2.5%)	Citigroup Deutsche Bank HSBC JP Morgan Chase
3 (2.0%)	Barclays BNP Paribas
2 (1.5%)	Bank of America Bank of New York Mellon Credit Suisse Goldman Sachs Mitsubishi UFJ FG Morgan Stanley Royal Bank of Scotland UBS
1 (1.0%)	Bank of China BBVA Groupe BPCE Group Crédit Agricole ING Bank Mizuho FG Nordea Santander Société Générale Standard Chartered State Street Sumitomo Mitsui FG Unicredit Group Wells Fargo

2 New requirements for “too big to fail” institutions.
Recovery and resolution plans

EUROPE	RUSSIA
«Key attributes of Effective Resolution Regimes for financial institutions‟, developed by the Financial Stability Board (hereinafter - FSB) and approved by "G20"	«Methodical recommendations on development of recovery plans by credit institutions ‟ developed by CBR (193-T) on the basis of Key attributes”

Recovery Plan (to be prepared by the Bank itself):

- In going concern - showing how the firm will use a series of predefined recovery options in order to recover in the face of a set of negative shocks.
- The recovery plan should be integrated into the firm’s existing governance framework and processes; it should be regularly reviewed and updated; and be overseen and approved by the firm’s board/senior governance committee

EUROPE	RUSSIA
In the framework of Crisis management concept, ***G-SIFI should have*** recovery and resolution plans	At present Central Bank of Russia recommends to develop recovery plans to ***all credit institutions, primarily the biggest one.*** Central Bank of Russia is planning to transform recommendations of **193-T** into **obligatory requirement.**

Resolution Plan (to be prepared by the Regulator):

- In gone concern - showing how the firm intends to wind-down in an orderly manner minimizing the impact on financial stability and the need for government support.

EUROPE	RUSSIA
The banks need to provide to the regulators a complete set of information on: - **details of significant entities in the group** and the key structural and operational issues relevant to the separation of significant entities - **key metrics on economic functions** to illustrate the relative importance of those functions - **Critical Function Contingency Analysis** covering separation and/or “controlled wind-down” for each critical function of the firm	After changes in Russian legislation, CBR is expected to make requirements for the providing of all necessary ***data for the development of restructure plans of credit institutions***, which list will be defined.

- It should help the regulator to assess the possible consequences for financial stability, to define their acceptability and to identify possible obstacles which can be eliminated.

3 OTC derivatives market infrastructure

In Europe (EMIR):

- an **obligation to clear "all standardized OTC derivatives" through Central Counterparties** (CCPs)
- an obligation to report the details of any derivative contracts to a registered **trade repository**
- **financial counterparties entering into an OTC derivative contract not cleared by a CCP (not eligible for compensation) would be mandate to set up risk mitigation techniques** and timely, accurate and appropriately segregated exchange of collateral/additional capital

In Russia:

2011-2012

Significant changes in federal legislation, introduced definition of:
- **39-FL - derivative**
- **127-FL –close-out netting**
- **7-FL – clearing**
- **Final version of RISDA is approved**

December 2012

Further significant changes to regulatory &supervising legislation

February 2013

- **The beginning of work of a repository on repo transactions and a currency swap**

September 2013

FSFM is abolished. Mega-regulator is set up on the basis of CBR.

October 2013

Launching of 4 types of derivative instruments through CC:
- **OVERNIGHT INDEX SWAP**
- **INTEREST RATE SWAP**
- **XCCY SWAP**
- **FX SWAP**

November 2013

Starting of obligatory reports to a repository (NRD) on repo transactions and a currency swap

January 2014

Starting of clearing OTC derivatives through CC with reporting to repository (NRD)

Hot Topics

- The issue of extra-territorial application of clearing legislation in transactions between EU and Russian counterparties
- Possible double-reporting in repository for transactions between EU and Russian counterparties

4 Risk and performance alignment of remuneration (Europe)

April 2009

FSB has published 9 principles of remuneration in credit institutions

January 2010

Basel Committee has developed a methodology of efficiency assessment based on FSB principles

October 2013

Basel Committee has developed recommendations on methodologies of remuneration alignment:

- Methods for risks and performance alignment of remuneration
- Deferred bonus
- Risk-tolerance

February 2013

EU made the decision to cap bankers' bonuses to their annual salary

EU made the decision to cap bankers' bonuses at a maximum of their annual salary:

- Bonuses can not exceed the annual salary, in exceptional cases - two salaries (requires approval by shareholders).
- This decision will affect bonuses paid in 2015 on the results of 2014.
- Greater emphasis on discounted and deferred five years bonuses based on long-term performance, less cash orientated.

Purpose:

- To reduce perverse incentives to risky behavior.
- To focus on the deferred bonus payment based on the performance results and to encourage long-term planning and performance management.

4 Risk and performance alignment of remuneration (Russia)

- In 2012, Bank of Russia introduced the new component of the assessment of banks financial standing - financial management motivation PU7 "2005-U," "On the assessment of the economic situation of banks ‛
- Bank of Russia Letter 38 -T "On the recommendations of the Basel Committee on Banking Supervision ," Methods of compensation adjustments taking into account the risks and performance results. ‟
- Involvement of Internal Audit (IA) in the process of compensation (242-P)
- Bank of Russia on a permanent basis is monitoring the Corporate Governance of Russian banks, including short-term and long-term bonuses .
- Banks are obliged to disclose detailed information on the payroll , the short-term and long-term bonuses to employees (2089- A) in the annual report.

UniCredit

5 Shadow banking

In Europe

Global Level: Several work streams at the FSB/BCBS/IOSCO are investigating – among other things (Money market funds, Securitization, Securities lending and repos) – on banks' interactions with shadow banking entities.

EU Level: On March 28th, Green Paper on Shadow Banking has been released for Consultation focusing on the following approaches: **i)** indirect regulation; **ii)** extension of existing regulation to new entities or activities; **iii)** new regulation for shadow banking entities.

In Russia:

In accordance with the Federal Law on 23 July 2013 №251-FZ «About the transfer to the Central Bank of Russia authority on regulation, control and supervision in the financial markets," since September 1, 2013 a mega-regulator was set up with supervision responsibilities over:

- banking institutes
- insurance companies
- pension funds & microfinance organizations
- professional participants of the financial market

Hot Topics:

- To improve control, market transparency, set up of single regulation and supervision for all participants of the financial market.

Conclusions

Basel II (STA simplified) was implemented 01.08.2011 with some local features:
- Higher risk weights on certain assets
- More stringent capital adequacy requirements

New Basel III prudential requirements:
- Since 2012 Russia began the active implementation of Basel III. Regulatory requirements for quality and quantity of capital are established.
- LCR NSFR are developed, however will be applied on stand-alone basis.
- Leverage ratio is set up. The exceed limit hasn't been determined yet.
- CVA is set up similar to Basel.
- Additional capital buffers are not defined.

New requirements to "too big to fail" institutions
- The Bank of Russia established the Department of supervision on SIBs
- The list of SIBs is not yet defined.

OTC derivatives market infrastructure

• Russian regulator actively supports the development of OTC derivatives market infrastructure - CC and the repository were set up based on the principles similar to Europe.

Avoidance of regulatory arbitrage and maintenance of level playing field remain one of the key tasks for Russian regulator.

Questions

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