



# Basel II

## Evaluating the Impact of Current Proposals

Joint Conference ZEW / AEI

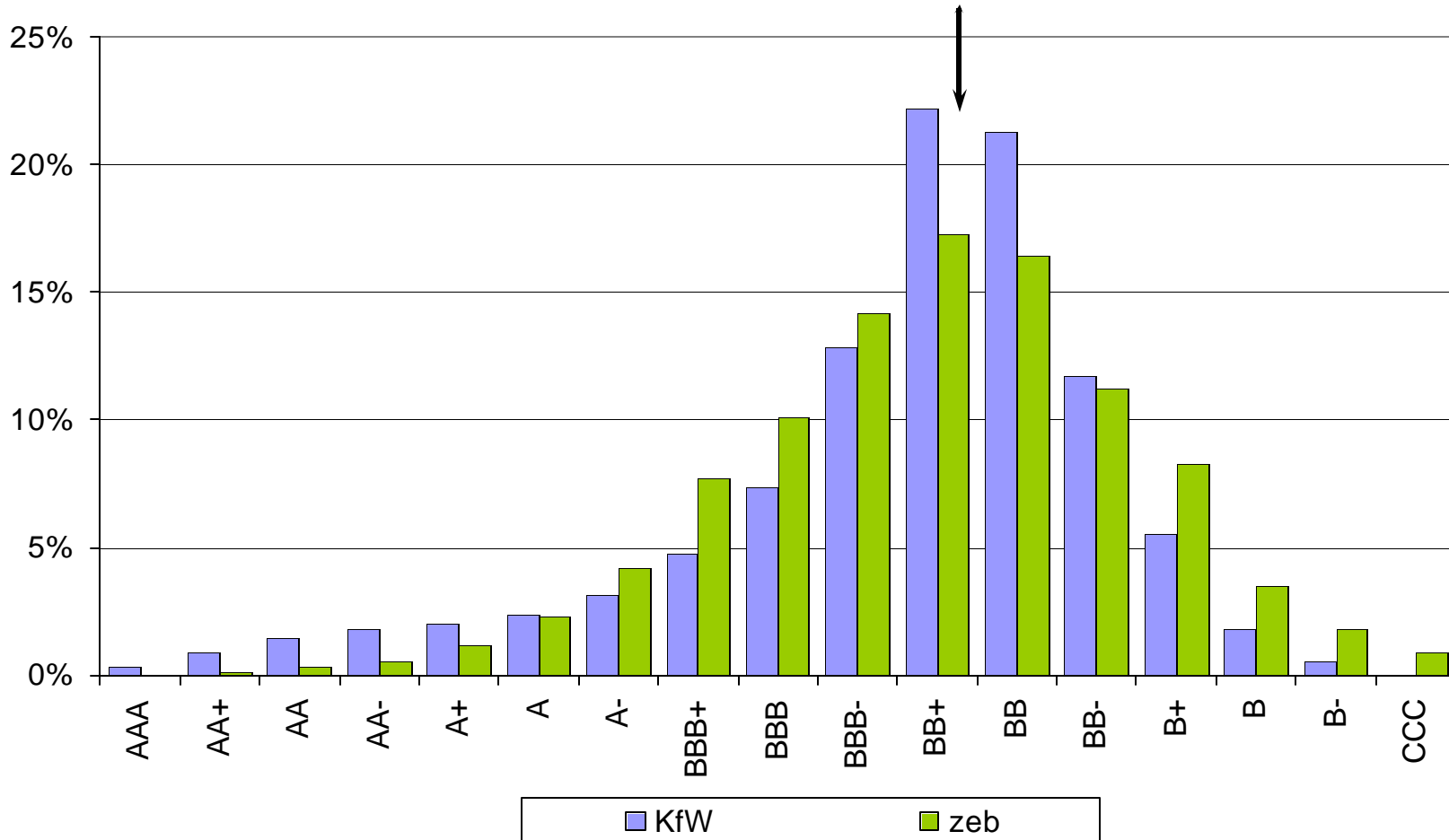
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**KfW** bankengruppe

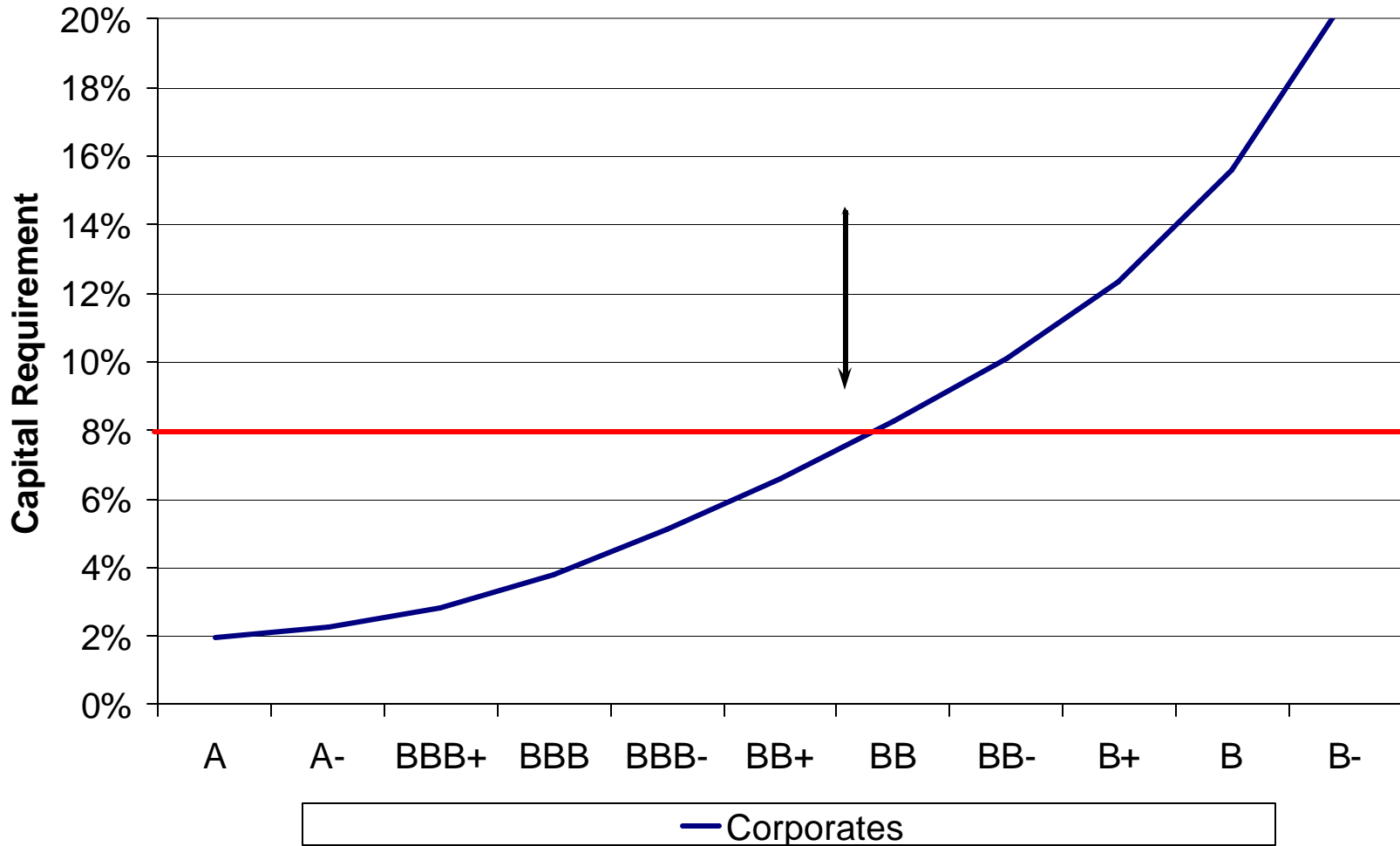
## Proposition 1:

Credit Standing for SMEs is near upper Non-Investmentgrade



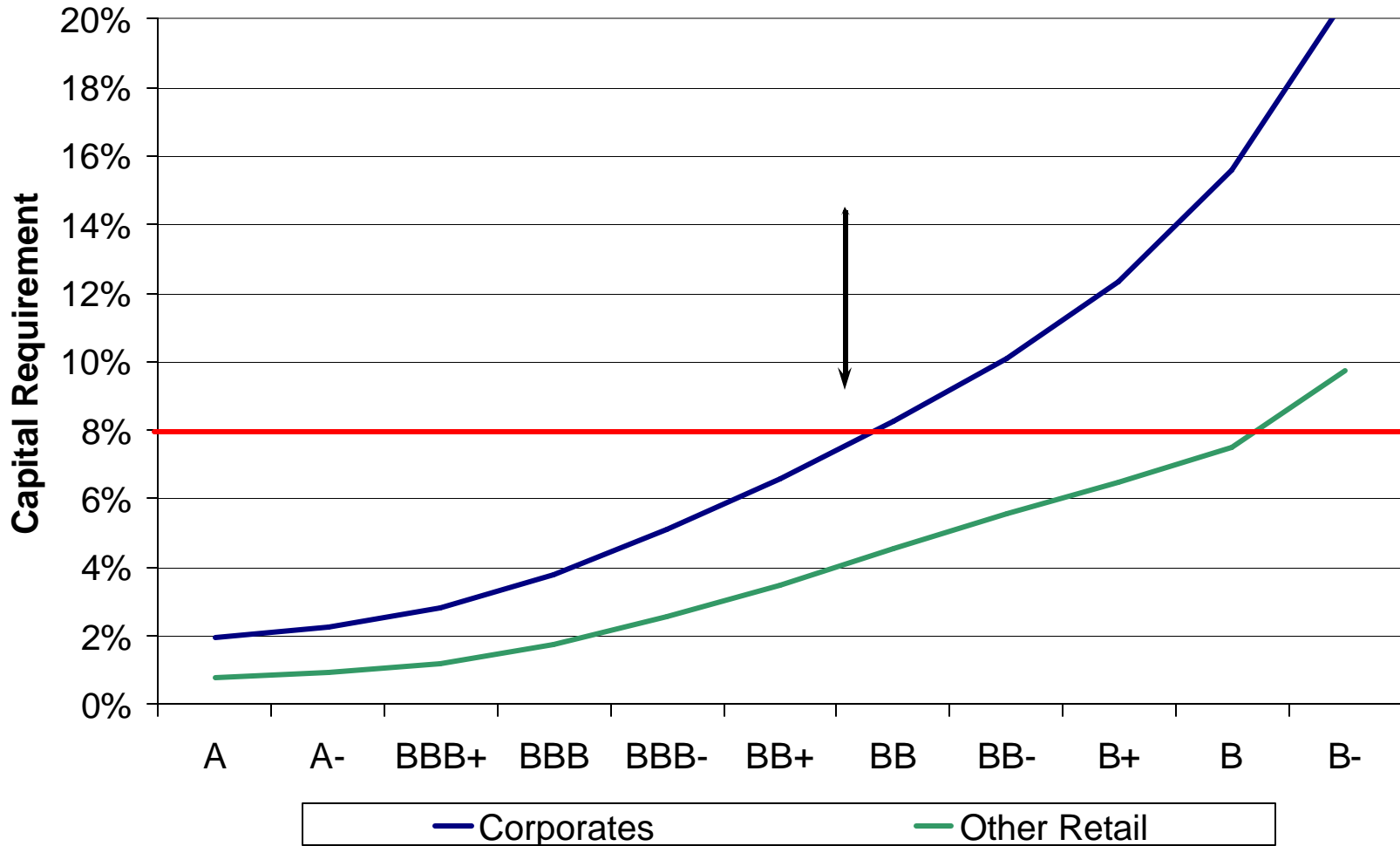
## Proposition 2:

Capital Requirements for Loan Finance will not generally rise



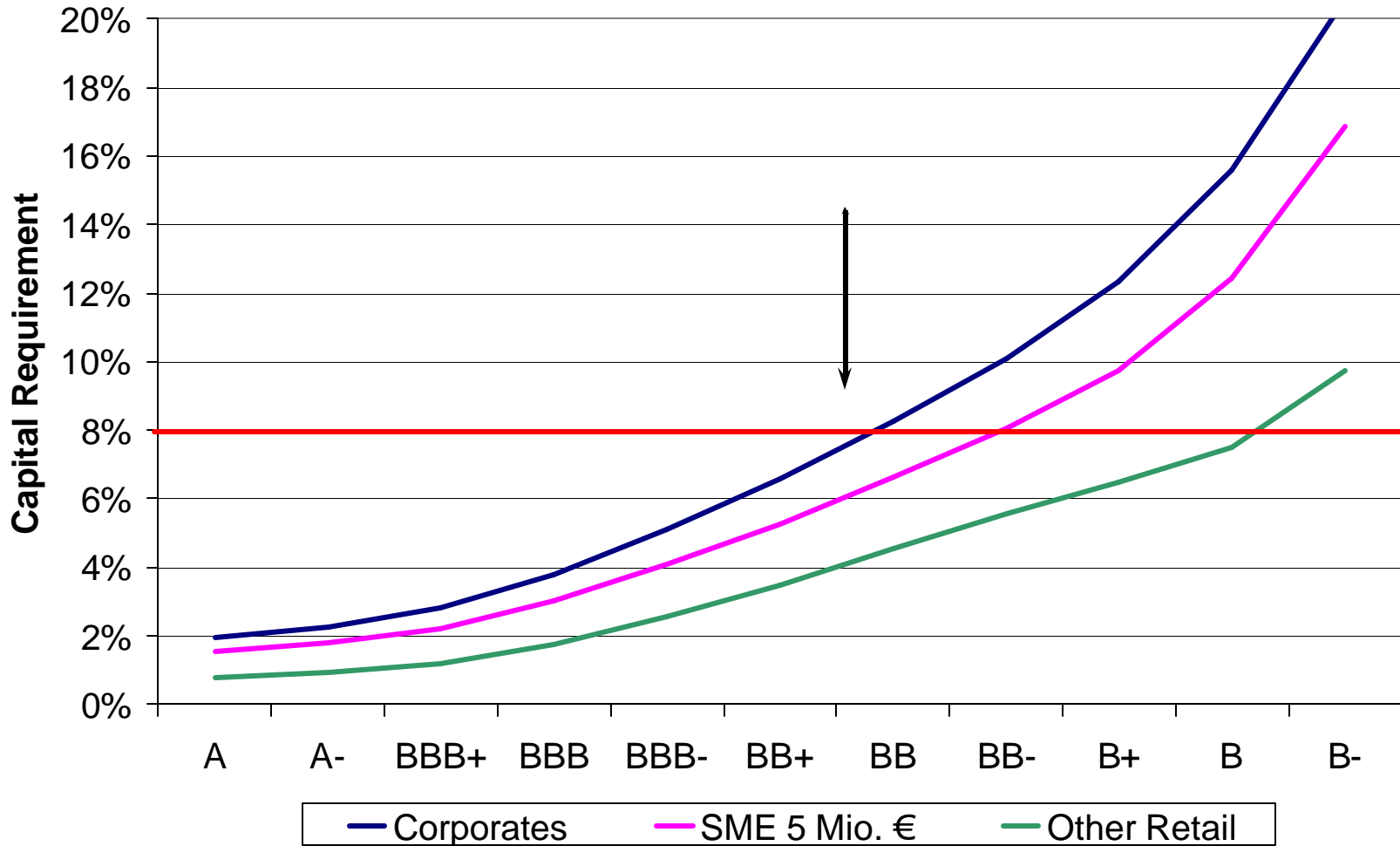
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### **Proposition 3:**

Increasingly Risk-oriented premiums may have more severe effect on Loan Terms than Basel II Equity Costs

	<b>Average PD</b>	<b>Typical MCR</b>	<b>equity costs (ROE 15%)</b>	<b>Dequity costs</b>
<b><i>Status Quo</i></b>		8,00%	1,20%	
<b>Small Companies</b>	2,00%	5,54% (Retail)	0,83%	<b>-0,37%</b>
<b>Medium sized Companies</b>	1,20%	7,24% (SME)	1,09%	<b>-0,11%</b>
<b>Large Companies</b>	0,20%	3,60% (Corporate)	0,54%	<b>-0,66%</b>

### **Proposition 3:**

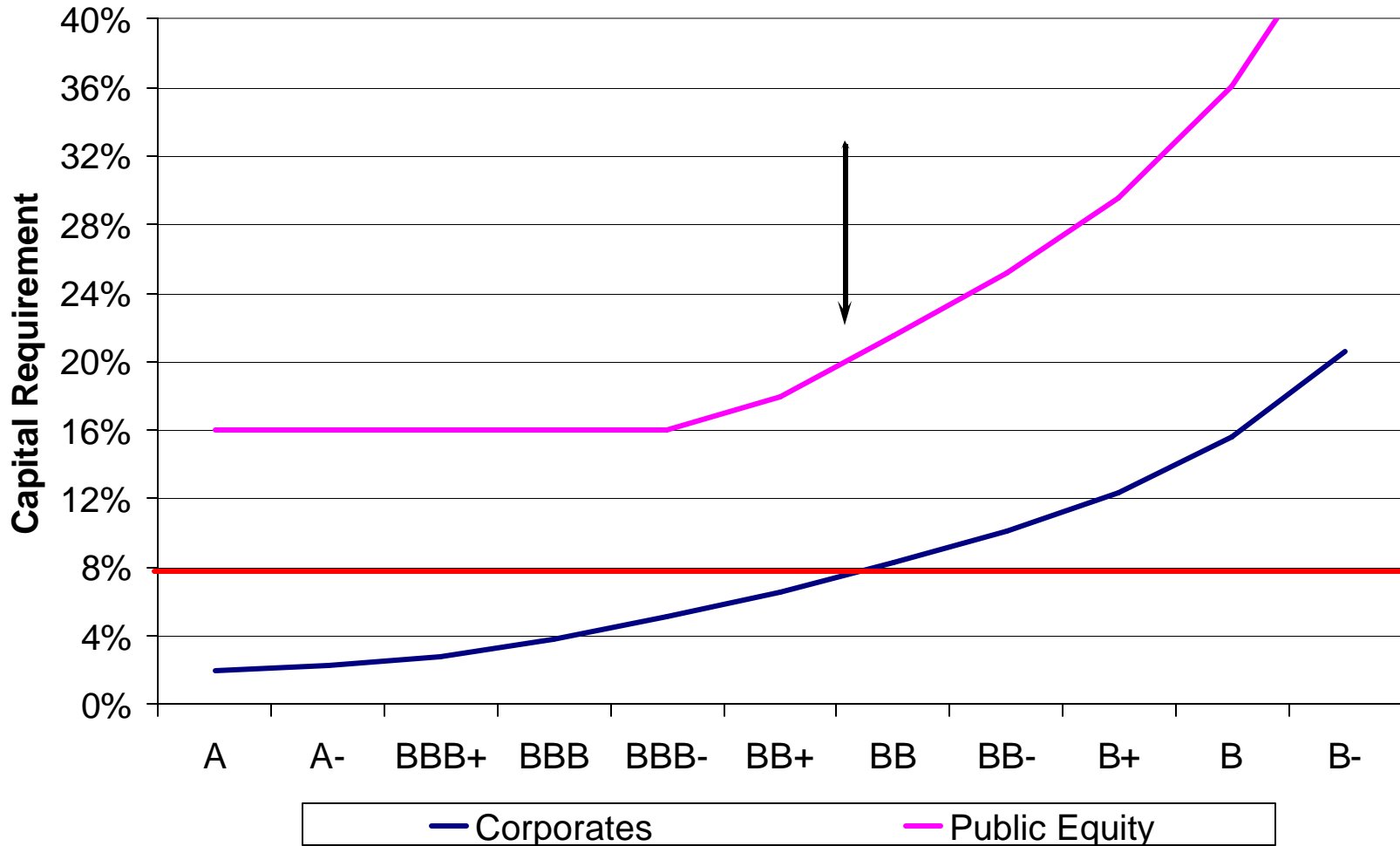
Increasingly Risk-oriented premiums may have more severe effect on Loan Terms than Basel II Equity Costs



	Average PD	Typical Segment	D equity costs	Corresponding S&P	Risk premium approx. (LGD 50%)
Small Companies	2,00%	Retail	-0,37%	BB-	2,10%
Medium sized Companies	1,20%	SME	-0,11%	BB	1,00%
Large Companies	0,20%	Corporate	-0,66%	BBB	0,20%

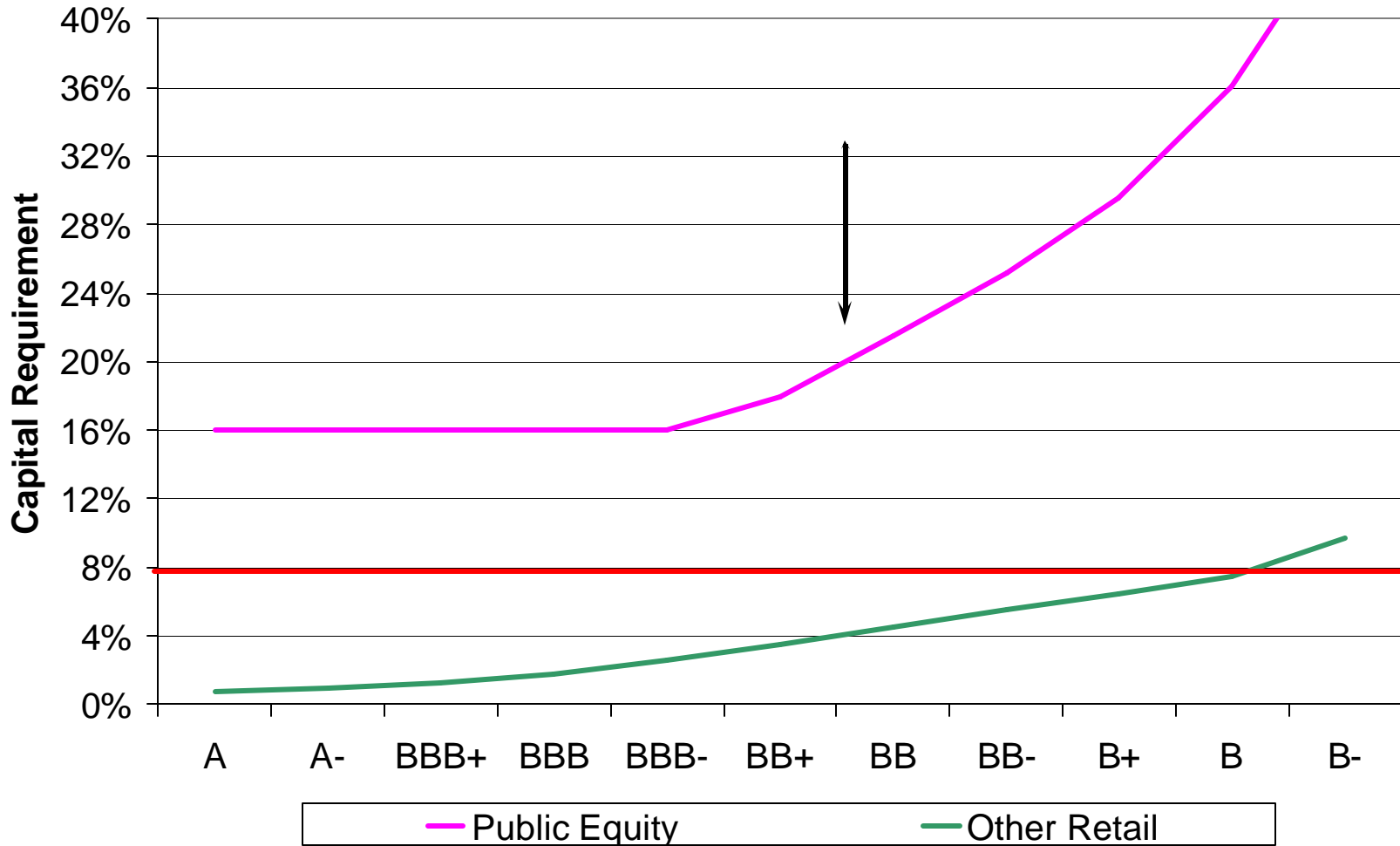
## Proposition 4:

Capital Requirements for Equity Finance will rise significantly



## Proposition 4:

Capital Requirements for Equity Finance will rise significantly



## **Proposition 5:**

Basel II may cause problems for certain types of companies

- ➔ Rating and transparency will increase within financial relations
- ➔ Trend towards risk adjusted pricing / market oriented finance!
  - *Shift of the spread curve*
- ➔ Basel II is part of this trend!
  - *Growing importance of indirect effects*
- ➔ Most of the companies will be able to cope with this trend
- ➔ Problems possibly for
  - *Companies with poor collateral or credit standing*
  - *Younger / newly founded retail companies requiring loan capital*
  - *Larger companies looking for long term finance*
  - *Companies looking for venture capital from the banking sector*
  - *Companies unwilling to share information!*

## **Proposition 6:**

### Basel II challenges Promotional Banks

- Keep promotional loans attractive for companies and increase the banks' willingness to channel loans
- „Streamlined promotion“ (standardization, automatization, new “KfW-Mittelstandsbank”)
- Transparency for SMEs: rating advice
- Supporting the banks via loan securitization
- Promoting equity and mezzanine capital (“Kapital für Arbeit” Programme)
- Market conformity and risk differentiated conditions (“Kapital für Arbeit” Programme)

## **Proposition 7:**

Companies should take Basel II into account

- ⇒ Position of retreat to “Standardised bank” likely for limited time only
- ⇒ Financing outside the banking sector (venture capital, mezzanine capital, direct access to capital market)
- ⇒ Optimization of capital structure, corporate processes,...
- ⇒ Transparency + communication with financial partners, search for rating advice
- ⇒ Understand Basel II not just as risk, but also as chance!

## **Proposition 8:**

Supervisory Authorities can mitigate adverse effects

- Use scope of national discretion to deal with national particularities
- Careful use of pillar 2 / Supervisory Review Process
- Maximum freedom for banks to develop a consistent risk management strategy
- Assistance for promotional programmes for SME
- Further discussion of treatment of equity finance
  - ⇒ Retail treatment for small participations?

## **Proposition 9:**

Promotional Banks need political support

- Limited access to information on borrowers resulting from the on-lending principle should be taken into account in operational risk management requirements
- Wide scope of interpretation regarding the eligible “national promotional programmes” in equity financing
- No obstruction of loan securitization



# **Thank you for your attention!**

Dr. Gregor Taistra

Additional Information under  
[www.kfw.de](http://www.kfw.de)

KfW-Research / aktuelle Themen