Preparing for Basel III:

What Corporate Treasurers Need to Know

A new set of banking rules is on its way, and corporate treasurers need to take notice. Called Basel III, these regulations are intended to strengthen bank capital and liquidity and help financial institutions better withstand economic shocks. However, stricter capital and liquidity requirements will impact the balance sheets of banks and, by extension, alter the relationships between banks and their clients. Corporate financial professionals can take action today by engaging their banks to prepare for any changes in the new environment.

Basel I, II, and III

Founded in 1974, the Basel Committee on Banking Supervision (BCBS) is a committee of banking supervisory authorities composed of central bank governors from major advanced economies. Named after the Swiss city in which it meets, the committee's objective is to improve the quality and consistency of banking supervision worldwide.

BCBS has produced three major sets of regulatory guidelines. The first two – Basel I (1988) and II (2004) – focused on credit risk and the establishment of standards and regulations for bank capital and loan loss reserves. The 2007-2008 financial crisis, however, highlighted significant weaknesses in the global regulatory system and financial institution risk management practices, specifically around liquidity and capital. In response, the Basel III framework (2010) seeks to improve the banking sector's ability to absorb shocks arising from financial and economic stress and to strengthen risk management. Specifically, Basel III includes:

- A stricter definition of capital to increase the quality, consistency, and transparency of the capital base.
- New global liquidity standards designed to ensure that banks have sufficient high-quality liquid assets to survive difficult economic conditions.

The final Basel III rules were phased in starting in 2014 and will be fully implemented in January 2017.

Key Takeaways

Basel III will help financial institutions better withstand economic shocks.

Companies need to have a solid understanding of their daily cash requirements in order to maximize liquidity, return on investment, and cost of capital.

Banks will be impacted by the regulation differently. Make sure to establish open lines of communication with bank partners to understand the implications specific to your business.

Basel III's impact on banks

Stronger bank capital and liquidity requirements can help in times of widespread financial stress, but these come at a price. Basel III's tougher capital requirements are in addition to other regulatory changes that have caused many banks to add capital since the financial crisis. Higher capital levels will require banks to either shed assets or raise additional cash from investors, a move that could constrain lending.

Basel III also includes a new liquidity standard called the Liquidity Coverage Ratio (LCR). The LCR requires banks to maintain a buffer of "high-quality liquid assets" to match a prescribed amount of liquidity outflows during a 30-day period of stress. In identifying liabilities subject to worst-case outflow calculations, banks must define commercial (or business) bank deposits with a maturity of 30 days or less as either operational or non-operational.

Since companies need operational balances for transaction purposes, Basel III assumes that they will be less volatile than non-operational cash. Because of this, the new regulations require banks to assume greater levels of outflows, and therefore hold more liquid assets against non-operational deposits, making them more expensive to a bank than operational deposits. As a result, banks are now assessing client relationships based on the type of deposit accounts held and their treatment under bank liquidity requirements.

What Basel III means to Corporate Treasurers

The impact of Basel III regulations will vary on a bank-by-bank basis depending on overall size, its mix of business, funding structure, and capital. That said, the Treasury Alliance Group ("Basel III: A Call to Corporate Action") identified some general points that are common to all banks:

- Services that were standard in a pre-Basel III environment, such as sweep accounts for Euro dollars and repurchasing agreements, may not be available to all companies post-Basel III implementation.
- Reflecting the need to improve return on capital, transaction costs are likely to increase.
- Credit availability may decrease and the associated costs and spreads will be higher.
- Banks will be sensitive to the nature and tenor of their depository business

> "Corporate finance professionals need to determine the impact that the new rules will have on their treasury operations. Basel III may not be well understood outside of the financial services industry and companies should act now to have their banks explain what it means and how their relationships will be affected."
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> Clark H. Khayat, EVP
> Enterprise Commercial Payments

Operational versus Non-operational Accounts	
Operational Deposit	• Unsecured wholesale or working capital funds where the bank provides operational transaction services to a commercial client • Requirements include: – Operational services are provided pursuant to a written agreement – Services are subject to a 30 calendar-day termination notice – No economic incentive is offered to attract excess deposits • Includes cash management, clearing or custody services, e.g., escrow
Non-operational Deposit	• Deposits held in excess of what is needed for operational services and deposits held by commercial clients where the bank does not provide operational services and deposits are not insured • Includes surge deposits and deposit accounts designed to create an economic incentive for the client to maintain a deposit

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Talking with your bankers – The first step in being prepared

While the new regulations will result in changes in bank relationships, corporate treasurers can take steps to prepare their companies to be in the best possible position in this environment. It starts with a conversation with your primary banks that covers the following topics:

Short and long-term cash flow. Companies need to have a solid understanding of their daily cash requirements (operational balances) versus long term investments (excess funds). Before meeting with your bankers, determine your cash flow history and projections, service expectations, and liquidity needs.

Bank relationship. It's also important to have your bankers provide you with a clear understanding of how they evaluate and value your relationship. Discuss the framework each of your banks uses and any changes contemplated. Inform your bankers of your company's plans, especially as these may impact the overall relationship and your need for credit and other services.

Pricing. Review pricing or rate changes that your banks may be contemplating, including:

- Relationship versus account level prices
- Interest rates and earnings credit rates
- Fee/service charge increases

Credit needs. Since Basel III rules will increase the cost and reduce the availability of untapped or underutilized lines of credit, talk with your bankers about your future borrowing needs and how to reduce unused credit facilities.

Treatment of deposits. Ask your bankers how they are defining operational and non-operational cash and about product options they either offer or plan to provide, including:

- Sweeps
- Term/time deposits
- Alternative investments

Basel III: Changing the rules of the game for Corporate Treasurers

Corporate treasurers have historically valued banks for the liquidity banks can provide. Soon, banks will value corporate treasuries for the kind of liquidity corporates can provide.

From the bank's perspective, companies that consume stabilizing products and services, and that provide stabilizing deposits, will be more highly sought after. Those with destabilizing products, services, and balances will almost surely pay a higher price—if they are banked at all.

Treasury Strategies, Spring 2015 Update

Gaining an edge

While Basel III changes are significant, taking the time to plan ahead can have a big payoff for corporate treasurers. By understanding how different types of deposits are going to be treated by their banks and the impact on the overall relationship, companies can position themselves to maximize interest earnings and minimize fees.

KeyBank is committed to helping corporate treasurers and finance professionals prepare for changes arising from Basel III. Our experts work with clients to ensure that they understand their priorities and provide them with integrated solutions to meet all their long-term treasury management needs.

To learn more about how KeyBank Enterprise Commercial Payments can help, contact:

Commercial Deposits and Liquidity

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