African Union for Housing Finance

Stability vs. Access? BASEL III in Southern Africa

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- Basel I and Basel II
- Towards Basel III
- Regulatory contribution to / implication of mortgage market obstacles in Africa
- Stability vs. Access?
- Appropriate regulation for a wider market

Basel I

The main objectives were to unify the playing field by introducing capital standards:

- Linking banks' capital requirements to the riskiness of its activities plus Off Balance Sheets risk exposures (risk weights).
- Coordinating the definition of capital, risk assessment and capital adequacy standards across nations.
- Increase integration of financial markets.

But, Basel I did not take account of:

- Risk diversification through portfolio formation.
- Assets maturity profile.
- Risk-mitigating techniques such as collateral.
- Degree of risk standings of individual borrowers.
- Operational and market risks.
- Strength of risk management functions of different banks.

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Basel II

Basel II encompasses qualitative and quantitative aspects of bank risk.

- Expected to address Basel I shortcomings
- A more comprehensive approach, placing more emphasis on banks' internal risk methodologies, supervisory review and market discipline
- Focuses more on sensitive measures of risk levels involved in a bank's positions & activities.
- More active role of bank supervision
- Harmonization of regulatory and economic approach
- Also took account of additional risk types (e.g. operational risks)

In Zimbabwe the Central Bank issued a guideline requiring banks to implement Pillar 1 by subscribing minimum options for Credit Risk as Modified Standardized Approach, Standardized Approach for Market Risk, and the Alternative Standardized approach for Operational Risk.

Benefits:

- Comprehensive vision of risks
- Higher specialization of functions
- Better allocation of capital and performance measurement
- Intensity of interrelations between units

Challenges:

- Complexity of organizational structure
- Formality of duties and responsibilities
- Lack of external credit ratings
- Needs of appropriate reporting
- Efforts on implementation

Almost 100% of financial institutions in Zimbabwe have now implemented Basel II (deadline was January 2013).

Basel III

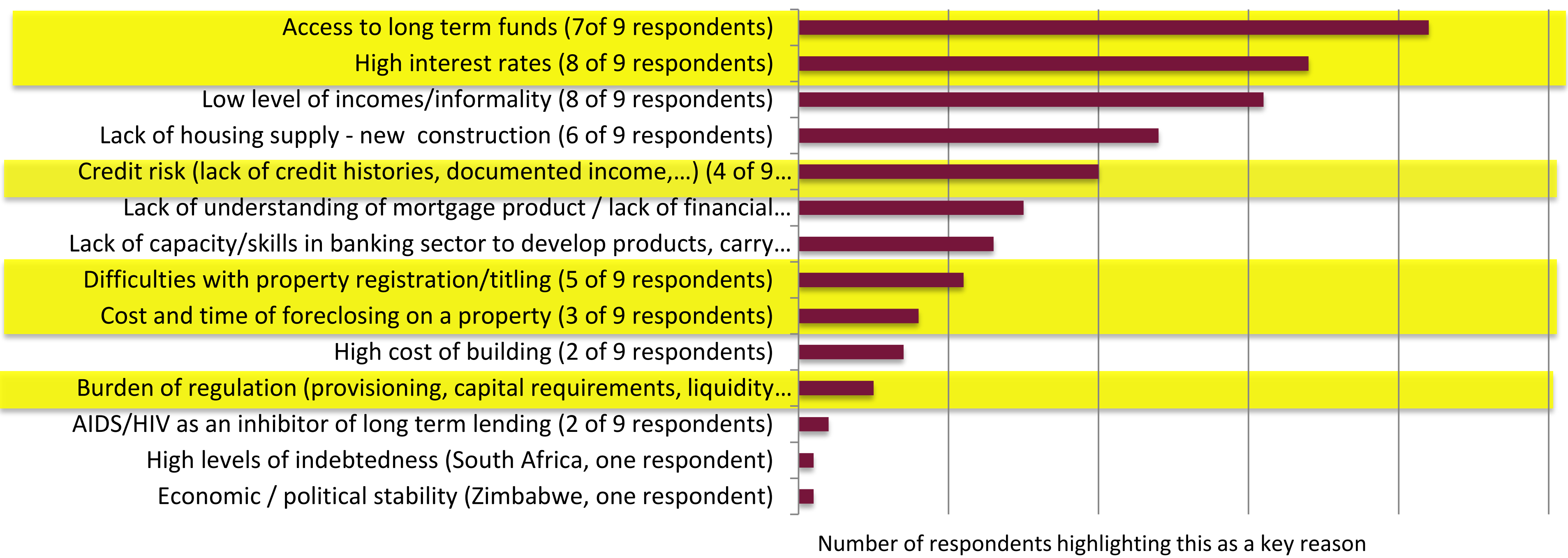
Basel 11 Ratio	Requirements	Basel 111
8%	Minimum Ratio of Total Capital/ RWAs	10.5%
2%	Minimum Ratio of Common Equity/RWAs	4.5%-7%
4%	Tier 1/ RWAs	6%
none	Capital Conservation buffer/ RWAs	2.5%
none	Leverage Ratio	3%
none	Cyclical buffer Ratio	2.5%

- Strengthens risk management
- Increased capital requirements put pressure on profitability and ROE
- Weaker banks will be crowded out; expect mergers & acquisitions
- Pricing strategies likely to be biased towards long-term arrangements

In Zimbabwe the Central Bank has taken a position to set the minimum capital adequacy ratio at 12%.

Regulatory contribution to / implication of mortgage market obstacles?

Key mortgage market obstacles (Survey of AUHF members in 2012)



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Basel III: Stability vs. access?

- **Increased costs to consumers**: cost pressures from meeting liquidity requirements will be passed on

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- **Inherent favoritism of higher value mortgages**: pressure on profitability will reduce attractiveness of smaller, entry-level loans

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- **Decreased market diversity** as lenders are forced to consolidate under the pressure of regulation

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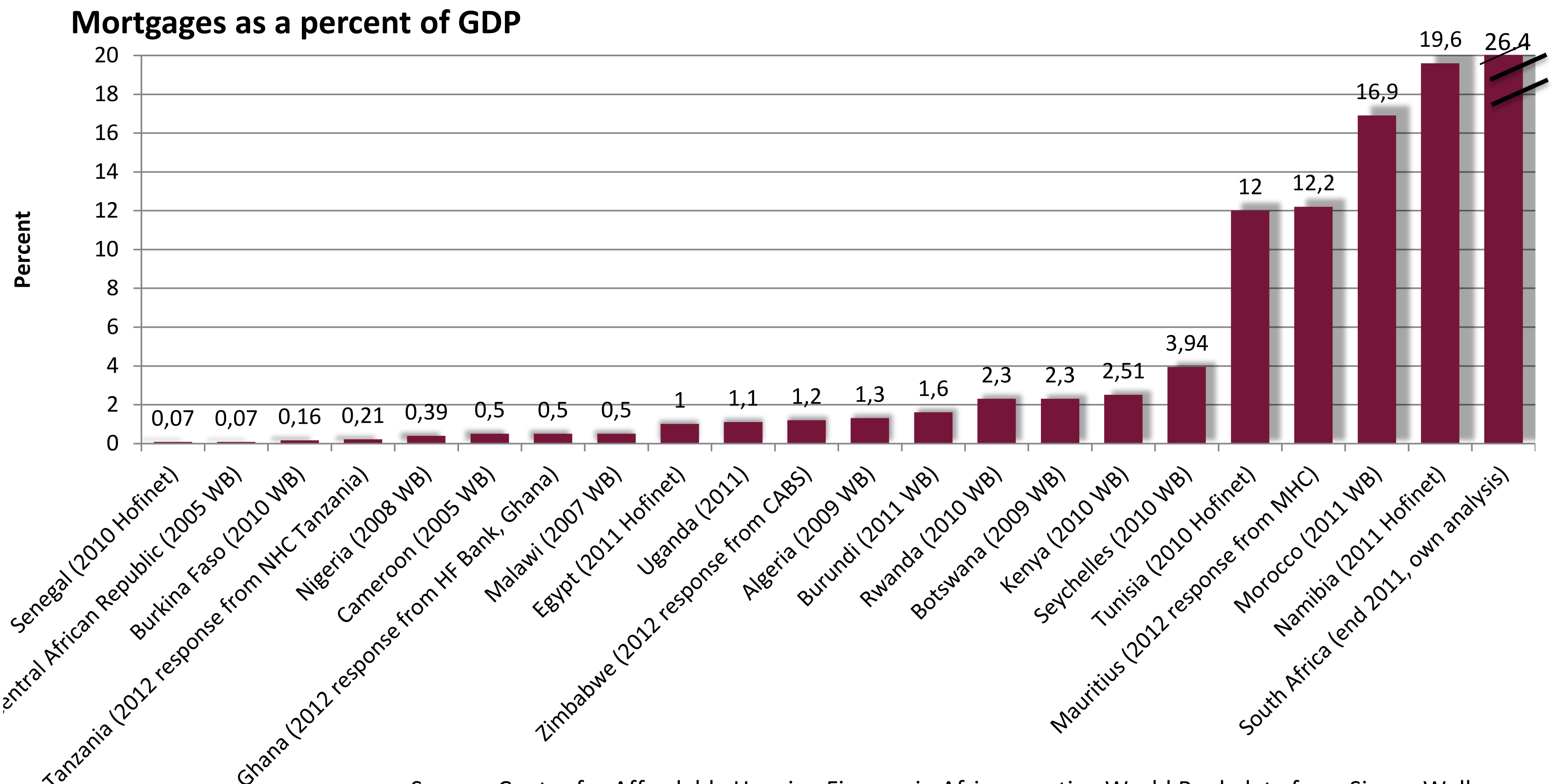
- **Pressure on financial inclusion & rising housing backlogs**

In South Africa, one author has suggested that the Basel III could have the impact of doubling the backlogs in the entry-level housing market

Basel III: Stability vs. Access?

- Regulatory reform critical to safety and soundness of the banking system
- But this puts pressure on financial inclusion goals
- Lending to low income earners is not by definition sub-prime! No African country has ever had a NINJA loan.
- Sub-market specific data critical to understanding risk
- Mortgage markets in many African countries are in their infancy
- The bulk of the demand is in the entry-level, lower value market
- Lending is critical to the growth of sustainable human settlements
- Appropriate and supportive international frameworks are necessary to enable growth in our markets.

Mortgage lending across Africa



Source: Centre for Affordable Housing Finance in Africa, quoting World Bank data from Simon Walley; email correspondence from country-level practitioners; Hofinet.

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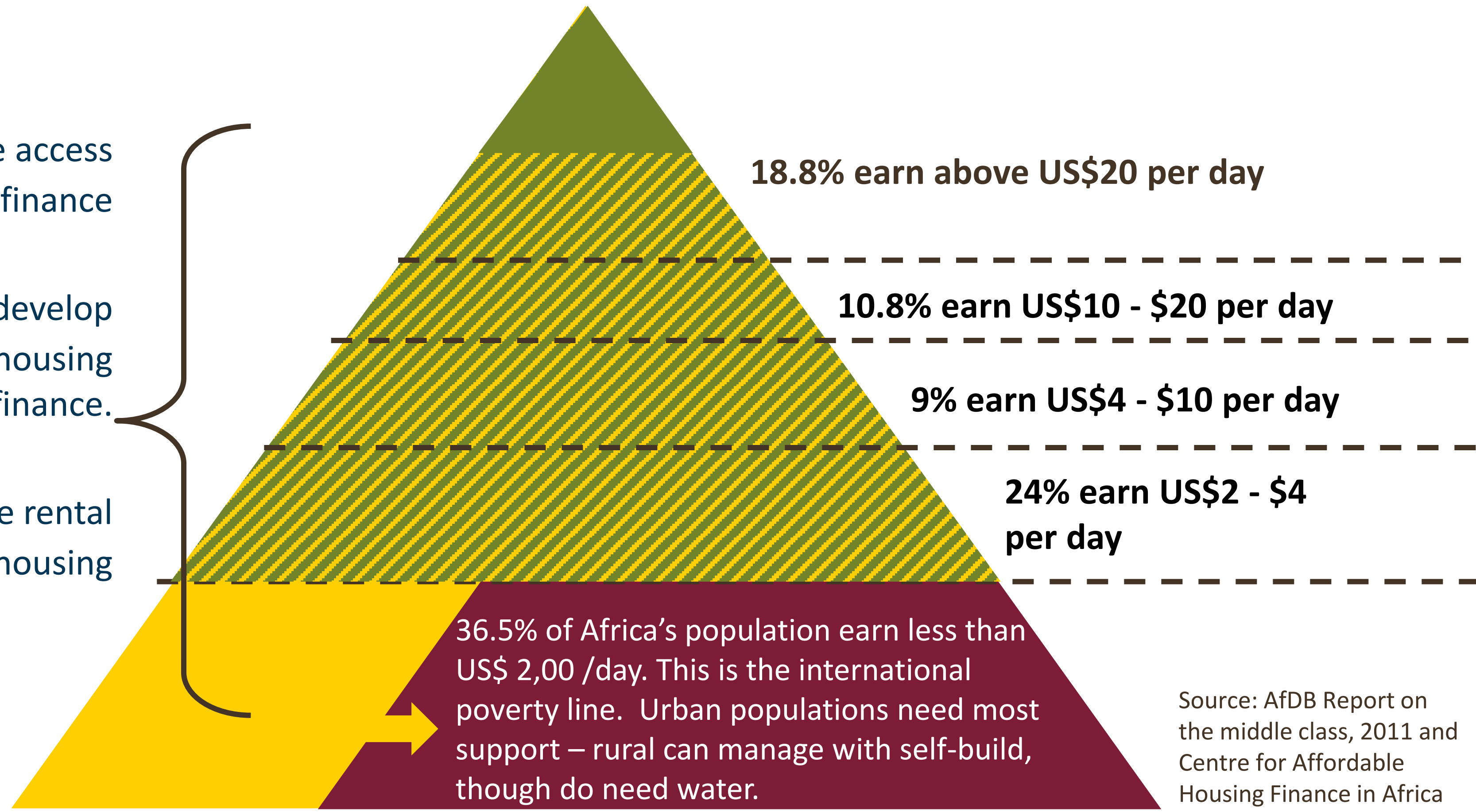
Appropriate regulation for a wider market

According to the World Bank, only 3% of the population in Africa has an income sufficient to support a mortgage: still, Walley (2012) estimates that growth to accommodate this market could raise the continental mortgage debt to GDP ration to 18%. Further growth from:

1. Increase access to mortgage finance
2. Grow & develop housing microfinance.
3. Finance rental housing



Source: AfDB Report on the middle class, 2011 and Centre for Affordable Housing Finance in Africa

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Appropriate regulation for a wider market

- Africa's housing finance markets are:
  - Younger: first time buyers with little or no equity
  - Newer: very little formal mortgage / ownership experience
  - Less formal: high percentage of informal employment and irregular / seasonal income
  - Opportunistic: growing quickly, often in the absence of city planning

Regulation must respond to local contexts, promoting growth, innovation and inclusive markets, while supporting long term stability and consumer protection.

Thank you!

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