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Introduction and background

It is a great pleasure to speak in this high level conference. I would like to thank our host for giving me this opportunity to share with you our views on the impacts of the new reform of capital and liquidity rules on emerging economies.

Let me first to say that in the Central Bank of Morocco, we are supportive of this new reform proposed by the Financial Stability Board and the Basel Committee to promote effective financial regulation and enhance the soundness of financial systems.

I believe that emerging countries as Morocco are concerned by this new reform for at least two reasons.

The first reason is the great interdependence between emerging and developed economies. For example, Moroccan economic cycle is largely synchronised with the cycle of Euro zone with months of delay. Moroccan banking system was not hit directly by the financial crisis, but it has been affected by this crisis through the real economy.

Thus, in 2009 Moroccan banking system recorded a rise in non-performing loans, while they were in a downtrend during the past 5 years. This increase in non-performing loans has been caused by the downturn in the external demand.

However, the Moroccan banking system has showed its resilience and the interbank market and lending activity continued operating normally.

The second reason is that many emerging countries are home/host for large international active banks. Morocco for example is a home country of several banks operating in 20 countries from Africa and Europe. It is also a host country for many international banks. Since these international banks have not been strongly hit by the crisis, they did not represent a channel of contagion of the crisis effects to the Moroccan banking system.

Overall, banking systems in emerging economies have well resisted to the financial and economic crisis. However, we have learnt from experiences that these economies are often vulnerable and that the contagion effect could spread very fast from one region to another.

So, these countries should continue to reinforce the soundness of their banking system according to international standards in particular the new capital and liquidity rules proposed by the Basel Committee. However, in implementing these new rules, a number of emerging economies like Morocco could face several challenges.

First, I believe that some components of the new framework seem complex knowing that financial systems in many emerging markets are not sophisticated and lean to adopt simple prudential rules. Accordingly, the implementation of the new framework will require significant resources and appropriate timing.

Second, and according to some evidence, the new framework will require more capital and high liquid assets for many banks. Therefore, it should be taken into account the impact of these new standards on emerging economies.

Now, let me giving more details of these challenges and sharing with you a number of Moroccan experiences.

Financial systems in emerging countries

In several emerging economies, business activity is thoroughly financed by stable retail deposits and the business models of banks are based on retail and corporate activities mostly.

Moreover, derivatives products and securitisation transactions are not enough developed and domestic customers can not hold assets in foreign currencies because of restrictions by the exchange policy. Then, taking risk practices are not so important than those observed in developed countries.

On the other hand, several emerging countries are developing their financial markets that have not yet reached the required depth to finance the economy as expected.

Nevertheless, this does not justify to not adhering to the new framework, especially for emerging countries which are seeking to reflect the dynamism of their financial sector and better integrate their economic and financial system within the international environment.

Regulatory framework in the emerging countries

The emerging countries are at different stages in the implementation of financial reforms which have been undertaken in recent years, especially Basel II and IFRS norms. The progress observed in this area appears to be dependent on the level of development of banking sector and resources. This fact raises the questions about how these countries should adopt the new framework in the context of a comprehensive, consistent and optimal prudential policy.

Regarding the regulatory framework currently applied in these countries, it differs from one region to another. For example, a lot of countries have not yet implemented the Basle II standards, while others countries adopt theses rules. In Morocco, for instance, banks apply the standardised approach since 2007 and Central Bank is currently working with the banking industry to implement the internal rating based approaches by 2012.

Similarly, several countries adopt IFRS norms, others countries are doing it, while various other countries have not yet made a decision to implement them. In Morocco for example, we have adopted IFRS norms in 2008. However, regarding the provisioning rules used for financial statements on social basis, we decide to keep the rules based on past due that have applied for many years. These rules are simple and comprehensible and they contribute to the consolidation process of banking system.

The new framework proposes adopting the forward-looking provisioning based on expected loss approach. We welcome this new regime which is the way to reduce pro-cyclicality.

However, we should take into account national regulations relating the provisioning rules and think carefully on adequate implementation timing. Besides, we, as supervisors, should persuade the tax authority of the relevance of the new approach and its beneficial effects.

Implications of the new framework on emerging economies

Let me now moving to the implications on emerging economies of the capital reform and new liquidity framework

This framework should lead to put in place new capital requirements and may modify the banks' balance sheets structure. In this regard, I think it is important to find a right balance between the new regulatory framework and policies of countries to promote their financial systems in order to finance the development of their economies.

Thus, a number of emerging countries are undertaking major economic reforms which require substantial financing. In this context, banks are asked more that was seen in the past to contribute to finance many projects such as infrastructure and industry platforms. The time is also for a higher banking penetration for populations and larger funding for SMEs.

For these issues, let me share with you some comments on the new reform proposed by the Basel Committee to strengthen the capital and liquidity requirements.

Quality of capital

In many emerging markets, the capital base includes only the common equity and retained earnings that have the same quality as capital. The hybrid capital instruments seem to be less used. So, the impact of the new definition of capital should come essentially from deduction regime. This impact should cover banking groups with large activities mainly.

Buffers

I think that complying with the buffers requirements represents one of the greatest challenges that emerging countries could face. The experience shows that banks often maintain a capital ratio just above the minimum required even if they make substantial profits. In addition, banks fear that the non-distribution of dividends or decrease of distributed profits could not be appreciated by the capital market.

Furthermore to these practices that should be changed with the introduction of buffers' rules, another issue should be considered. The structure of ownership of financial institutions is fairly concentrated and the floating stock market is lower. In Morocco, for example, the floating stock market varies between 20% and 30%.

Also, the effort to meet the buffer requirements would depend mostly on the readiness of key shareholders, but also their status. The shareholders can be private groups, international banks or government. These three categories of shareholders have not necessarily the same policy in face of a decision to raise capital.

In Morocco, we experienced a very fast trend in credit growth in 2006 and 2007, and this lead the central bank to decide to raise in the end of 2007 the minimum solvency ratio from 8% to 10% to reduce the credit growth. The central bank's decision was subject of several reactions and comments from politics, banking industry and analysts. When the Moroccan banking was being affected by the real economy effects, the stakeholders found that this decision was made in good times.

I believe that the Basel Committee's buffer rules, when recognised internationally, would facilitate the decision-making by supervisors to build up these buffers.

Leverage ratio

The leverage ratio seeks to reduce the risk of excessive leverage building up in individual banks and in the banking sector. We know that most banks in emerging countries finance their activities through stable deposits and their off balance sheet exposures are less important. So, it is useful to think how to calibrate this ratio to be consistent with banks' business models.

Liquidity framework

According to our experience, the central bank has put in place since two decades the liquidity ratio requirements that banks must comply with in monthly basis. This rule is supplemented by daily monitoring of liquidity through the information provided by the monetary policy department of the central bank. This monitoring is also based on periodic meetings with the supervisors and bank executives of cash management and assets liabilities departments.

However, these framework and measures do not prevent the occurrence of transformation risk. Thus, the loan to deposit ratio have increased rapidly and reached a 100%.

The liquidity framework proposed by the Basel Committee would give more powers to national regulations and presents an opportunity for countries like Morocco to adapt it to the changing economic and financial environment.

Nevertheless, this new liquidity framework should increase the national discretions in order to take into account the local conditions in terms of depositors' behaviours, the structure of financial systems and their maturity.

Conclusion

Let me conclude by saying that the new framework will strengthen the resilience of banking system. It remains that the banking supervision and governance practices are also to critical elements to achieve this objective.