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SCHOOL OF BUSINESS, ECONOMICS AND LAW

THE EFFECTS OF BASEL III ON THE SMALLER BANKS IN SWEDEN

Bachelor thesis in industrial and financial management

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Abstract – The Effects of Basel III on the Smaller Banks in Sweden

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Background: After the recent financial crisis, new regulations considering the banks' capital coverage, liquidity, leverage and risk management was presented in a regulatory framework called Basel III.

Purpose: The purpose of the research is to see how the smaller banks in Sweden have been affected by the Basel III regulations.

Method: The study applies a qualitative method with a deductive approach. The empirical data was acquired through interviews with employees at the banks.

Conclusion: The Basel III regulations have required the banks to allocate a relatively large amount of resources to understanding the new regulations and ensuring that they are followed. What has mainly affected the banks have not been the capital reserve requirements or the new liquidity rules, but instead following the financial reporting forms and comprehending the new regulations have been the largest challenges for the smaller banks.

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1 Introduction

This chapter intends to give an introduction of the subject and further presents the study's problem discussion, research questions and conducted hypothesis. The end of this chapter presents the disposition of the study.

1.1 Introduction and problem discussion

The banking system is of great importance for the financial market and a foundation for economic growth (ECB, 2001). It offers critical services to the public as it helps convey payments and turns deposits from people and corporations with a surplus on their budgets to loans for others who need financing (ECB, 2001). As the great cornerstone in the society as the banking system is, how they manage their risks is of utmost importance. If the banks start to fail, it affects the entire economy, as we saw with the recent financial crisis.

After the financial crisis, it was understood that stronger regulations for the banking sector had to be formed. The earlier international regulations for the banks, Basel II, which had been introduced before the crisis, had not been strict enough and did not cover the banks risks to an acceptable extent. Its successor, Basel III will be implemented globally between 2013 and 2019. The main changes that will come as a result of Basel III are that banks will have to maintain a higher base of capital that will also consist of higher quality and the rules for how the banks will be able to calculate their risk weighted assets tightens.

The new regulations that come with Basel III aim to improve the stability of the financial market but will also prove a challenge for the banks that are affected. The banks operate in a highly competitive market and their profitability depends on a range of factors such as their ability to earn money, their costs of holding capital and liquidity reserves, credit losses and their cost of personnel among other (Konkurrensverket, 2013). Depending on how the situation was at the banks before Basel III, the new regulations might force the banks to hold more capital and liquidity than before, and potentially hire more employees to manage the implementations.

The Swedish households have a rather unique culture when it comes to loans; today they have a record-high debt ratio that is one of the highest in the world in relation to GDP (DI, 2015). One of the reasons for this is the historically low interest rate that Riksbanken, the central bank of Sweden, has set in order to get the inflation levels to the set goal of an annual 2 % (Riksbanken, 2016). At the same time, every fifth household does not think they can manage an interest rate that is 3 % higher than it is today (Nordea, 2015). SBAB predicts that the interest rate levels will reach 5-5.5 % in 5 years and therefore there are concerns that a new financial crisis will occur in Sweden (DN, 2015). Due to this, it is important that the Swedish banks have stable financing and liquidity so that if the Swedish market faces a stressed scenario, the banks will be able to handle it without collapsing.

With the introduction of stricter capital reserve requirements, it is expected, all else equal, that the risks of the banks should decrease. The expected return for the shareholders of the banks should therefore, according to economic theory decrease, as the expected return should reflect the risk of the investment. With the new capital reserve requirements, the banks' ability to pay out dividends could also be affected since the banks have to retain part of its revenue in addition to the minimum requirements. If the banks can keep the same returns as before the implementation of Basel III it would then be a great development for the investors who would see the same returns at the same time as the risks are reduced.

Earlier research of the effects of Basel III has been done in Sweden and the results have seen the regulations as hastily produced. The respondents at the banks also described the implementation as a costly and complex process. Many of these studies were conducted in the early stages of the implementation and therefore primarily reflect the interpretations rather than the results of the regulations. The Basel III regulations will be continually implemented until 2019 but many of the new rules have now been applied on the Swedish banks. These studies were made on the larger banks in Sweden and a question that arises is if the regulations are too extensive for smaller banks with fewer resources. There has not been any earlier research done on how the new Basel regulations affect these banks.

With the currently low interest rates in the large Swedish banks, it would make sense for customers of the large banks to move to the smaller banks in order to gain a higher return on their deposited funds. All of the four large banks in Sweden today have interest rates on deposited funds at 0 % (Compricer, 2016), and according to Privata Affärer (2012) and Realtid (2016), the large banks are losing customers to the smaller banks. This means that the significance of the smaller banks is increasing relative to the large banks. In light of this we have chosen to explore how the smaller Swedish banks, often so-called niche banks (i.e. banks that focus on certain types of products, Private Banking 2012), have been affected by the Basel III regulations.

1.2 Purpose

The purpose of this study is to examine how the Basel III regulations have affected the smaller banks in Sweden. We want this research to answer the following question:

- How have the smaller Swedish banks been affected by the implementation of the Basel III regulations?

Our goal is to present a description that is as general as possible of what have been the greatest challenges for the banks to overcome and which consequences they have generated. We want to find which positive or negative effects that the new regulations have had on the smaller banks and try to present an overall image of how they have fared since the introduction of Basel III. With this study, we also want to contribute to the other research that has been conducted on the Basel III regulations in Sweden, so that comparisons between the effects on the smaller and larger banks can be made.

1.3 Delimitations

As the purpose of this study is to examine the effects on Swedish market we will not study how Swedish branches and operations abroad are affected. Also, foreign banks with branches in Sweden, for example Danske Bank, will be excluded from the research. Because some of the banks we are researching are fully owned subsidiaries, for example the ICA-bank being a part of the ICA-group, the new capital and liquidity requirement might affect all parts of the company. We have chosen to limit the study to only look at the effects that occur for the banking section of the companies and therefore ignore the effects that might occur for the other operations of the companies. Additionally, we have not included local savings banks, as we wanted to study banks that are operating on a national level.

1.4 Disposition

Introduction

- In the introduction, the backgroud to the study is presented along with a problem discussion. The purpose and research questions of the study are described here.

Framework

- In the framework section, we present the different risks that banks are exposed to. An introduction of the Basel Committee is found here accompanied by the different regulations that the committee have published.

Methods

- In the following chapter, our methods for conducting the study will be presented. This includes our collection of data, selection of strategy, sample selection, interview process, and method evaluation.

Analysis

- In the following chapter, the empirical data from our interviews will be processed and analyzed.

Results and Conclusions

- In this section, our conclusions will be presented and we will present an answer to our initially asked questions and hypothesis. We will also suggest subjects for future research within the topic.

2 Framework

The following chapter begins with accounting different types of risks that banks are exposed to. After this, we describe what the Basel Committee is, its history and a presentation of the different regulations that the committee have submitted.

2.1 Different types of risks that banks are exposed to

Managing risk effectively is a deciding factor on whether the bank does well or not. If a bank wants to increase its profitability, most of the time this will also result in an increase in risk. Finding a good trade-off between profits and risk is important in order to effectively maximize profits. Banks are exposed to a number of different types of risk. In the following section, some of the more prominent risk types will be defined in order to lay the foundation to the rest of the thesis. According to Saunders (2015), some of the main types of risk that banks in general are exposed to are: liquidity risk, credit risk, interest rate risk, operative risk, technological risk, insolvency risk, market risk, foreign exchange risk. Understanding what these risks are is important in order to understand why banks need regulation such as the Basel-regulations discussed later in the thesis.

2.1.1 Credit risk

When there is a probability that an expected cash flow from a credit, such as a loan given by the bank, will not be received in full, or in the worst-case scenario, not at all. Generally, banks that give loans with a long duration are more exposed to this type of risk than banks that do not have as long duration on their loans. (Saunders, 2015)

The average credit risk varies over time depending on the general health of the economy. When times are good, the credit risk is generally lower than when times are bad. During the recent financial crisis, many banks had to write off loans, i.e. assume that they would not get any money back. (Fdic, 2008) Despite this, banks continue to give out loans, even during economic downturns. The reason for this, according to Saunders (2015), is that banks can compensate for the increased risk by increasing the interest rate on their loans or taking out larger fees for issuing a loan. A bank can also diversify its credit risk by lending money to a lot of different customers, making the impact of a single customer's ability to pay much lower. What remains, though, is the systematic credit risk, which affects everyone in the economy.

2.1.2 Liquidity risk

When a bank's debt holders suddenly demand money from a financial claim that they have on the bank, for example a bank depositor taking money out of the bank, liquidity risk arises. If a high enough quantity of debt holders demands their money at once, it could become very expensive for the bank. It may then have to liquidate assets at below their market value in order to pay the debt holders, which is a loss to the bank. Luckily, this extreme situation does not occur often and is generally a response to a decline in the trust that the bank is able to manage the debt holders' funds. Under normal circumstances, daily withdrawals from the bank can be forecasted and be managed by holding large enough cash reserves to meet the demand. (Saunders 2015) The required capital reserves at a bank are an important topic regarding the Basel III regulations to which we will return later in the text.

2.1.3 Interest rate risk

When there is a difference in the duration of a bank's assets and liabilities, there is interest rate risk. The longer the (remaining) duration of an asset or liability, the larger impact a change in interest rate is going to have on the value that asset or liability (Berk & DeMarzo, 2014). This means that if the durations of a bank’s assets and liabilities differ too much, a change in interest rates could have large implications on the balance sheet. This risk becomes larger the more volatile the interest rates are.

2.1.4 Market risk

When banks trade with assets, liabilities and derivatives instead of keeping them in the bank for investment purposes, the banks are exposed to market risk. The element of risk arises from changes in prices, interest rates, and foreign exchange rates. (Saunders, 2015)

2.1.5 Foreign exchange risk

Foreign exchange risk occurs when a bank has assets or liabilities that are valued in a foreign currency. The risk associated with this is larger the more volatile the exchange rate is

(Saunders, 2015). That is, when the exchange rate fluctuates, the value (or price) of the asset or the liability changes, if measured with the domestic currency.

2.1.6 Technology and Operative risk

Operative risk, as defined by the Bank for International Settlements (BIS), is "the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events." (BIS, 2010) This type of risk plays an important role in the Basel III regulations.

Technology risk arises because it is uncertain whether an investment in technology will give the anticipated cost savings or not. (Saunders, 2015) Innovation in technology has been important for financial institutions, such as banks, during the recent years. By investing in technological innovations, a bank could potentially save money and thereby boost profits. Operative risk can arise when technology at the bank does not work as intended and is thereby related to technology risk.

2.1.7 Insolvency risk

Insolvency risk is the risk that a bank does not have enough capital to handle an unexpected decrease in the value of its assets compared to its liabilities. (Saunders, 2015) This may be caused by the other risks mentioned above. A bank can manage this risk by having a large enough capital reserve to better be able to manage potential future losses. The required capital that banks need to hold are further discussed when the Basel regulations are described later in the text.

2.2 The Basel Committee on Banking Supervision, history and function

Today the Basel committee consists of national banks and supervisory authorities from 29 countries and unions where, among others, USA, Russia, China, Sweden, and EU are represented (Bis n.d.). Their main purpose is to encourage global financial stability through bank regulations and supervision but they also want to control how banks monitor and decrease their risks.

The committee formulates standards, guidelines and recommendations and their role can essentially be divided into the following areas: (Finansinspektionen, n.d.)

- To develop policy documents.
- To pose as a global network to supervisory authorities.
- To, through regional committees ensure the local cooperation of supervision.
- To provide education within the supervisory area.

One of the core functions of the Basel committee is to formulate minimum standards for the banks regulations (Niemeyer 2016). All the member countries have committed to apply the committee's standards I their respective financial regulations, but the countries themselves must put these standards into their own laws before it can see effect. Sweden, that is part the European Union, has some of the regulations implemented through the European Union law (EBA, n.d.).

The Basel Committee was founded in 1974 as a result of the termination of the Bretton Woods system with fixed exchange rates (Bis 2015). Uncertainties around the global financial stability rose as the internationally operating banks faced higher exchange risks. The 70s were categorised by floating exchange risks and high inflation, in addition to rapidly growing financial markets and money flows that were crossing borders (Bis n.d.). Many big banks had to close during this period due to the fact that their exposure to foreign exchange was multiple times larger than their own capital (Niemeyer 2016). This created great disruption in the global financial system. To create a forum for improving the financial stability, the managers of the national banks in the G10 counties decided to form the Basel Committee on Banking Supervision. Originally the purpose of the committee was to see that every bank that was operating internationally was under supervision and also that this supervision was satisfactory and looked the same in every country (Niemeyer, 2016).

Soon the committee members realized that the focus of the committee had to be widened due to uncertainties erupting from the financial crisis in Latin America during the 80s and many were afraid that the crisis would spread because a lot of the banks affected were operating internationally (Niemeyer 2016). This also highlighted the hazard of undercapitalised banks being overexposed to the sovereign risks that occurred (Bis n.d.).

Some minimum rules for international banks now saw a demand. The committee started to develop minimum rules for capital adequacy ratios (Niemeyer 2016). These minimum rules were created to generate stability and at the same time decrease the competitive advantages that occurred when different banks operated under different national rules.

Following these rules, the committee presented 1988 an agreement that is called The Basel Capital Accord (Bis 2015) or simply Basel I. With this agreement the banks should hold own capital that covered 8 percent adjusted to the risk of the banks' exposure. The credit risks for the exposures was divided into 4 categories that each got its own risk weight depending on how safe it was estimated to be. These categories were 100, 50, 20 and 0 percent (Niemeyer 2016).

For example, company loans were deemed very risky and were therefore required to be covered with the full capital adequacy of 8 percent. Housing loans were considered to be safer and got a risk weight of 50 percent. The calculation for the capital requirements for housing loans then becomes 50 percent of 8 percent, which is 4 percent. The same calculations were made for all of the banks exposures.

The accord was always intended to evolve over time (Bis 2015) and it has since developed with updated regulations as the financial sector is in constant change. During the mid-90s an addition came on how the banks should define provisions for losses and reservations for eventual future losses and also how the banks could calculate the net of their counterparty credit risks. The committee also wanted to take other risks that banks were exposed to into consideration. Accordingly, an agreement called the market risk amendment (Bis 2015) was formed for how much capital the banks needed to cover their market risks that could occur when the value of the bank's assets in trading could change.

2.3 Basel II

In most countries, banks are required by law to hold a certain amount of capital. The traditional requirement is that a bank should hold a minimum amount of capital (for example, a bank in the EU is required to have a minimum capital of €5 million) that is supposed to function as a safeguard against losses, but also as a disciplinary factor for the owners of the bank. Some countries apply a capital-coverage-ratio; a bank could, for example, be required by law to have capital covering at least 5 % of the bank's assets. (Lind, 2005) In this way, when the bank increases the value of its total assets (and its risks), the required capital increases.

Basel I had a risk based (risk weighted) capital-coverage-ratio of at least 8 % on credit risks. (Finansinspektionen, 2001) The amount of capital that the bank was required to hold was then calculated by multiplying the amount borrowed by its risk weight times 8 %. One problem with Basel I was that it had relatively few different risk weights. This could lead to the bank applying the same risk weight to a newly started firm as a large firm, such as Volvo (Lind, 2005), because the risk weights were, with a few exceptions, generalized across all business-borrowers.

Between Basel I and Basel II, several advances were made in the area of measuring risk and risk management. New financial instruments were also invented which increased the bank's ability to manage risk. There was also a development of larger bank groups, which spanned across the entire financial sector and over several countries. The difference between internationally active large banks and local banks had increased (Lind, 2005). With this in mind, something had to be done to the old capital requirements to reflect the new circumstances.

Basel II is built up around three pillars. The first pillar covers the capital requirements for credit risks, market risks and operative risks. This pillar allows banks to choose from several methods for calculating their capital requirements depending on how developed the bank is (Finansinspektionen, 2001).

Concerning credit risk, the easiest method to use is the so-called standardised approach. It is similar to the method used in Basel I in the sense that it uses risk-weights but it has a wider variety of risk-weights, established by authorities, to account for the shortcomings of Basel I, i.e. it more closely connects risk and capital requirements in each individual case. Banks may choose to expand the risk-weights by using credit risk assessments from credit rating institutes such as Moody's and Standard & Poor's. The next level of measuring the capital requirements for credit risk is the use of the internal method for credit risk. With the internal method, the risk weights are based on the bank's internal risk classification. There is also an advanced version of the internal method where a larger part of the capital requirements is decided by the bank's own calculations (Finansinspektionen, 2001).

With the internal method, the risks are calculated primarily by accounting for the probability of default (PD), the loss given default (LGD), the exposure at default (EAD) and the maturity (M). It is calculated by taking into account the maturity of the credit and multiplying PD * LGD * EAD. (Niemeyer, 2016) This will give the expected loss and the bank should cover these losses with fees and pricing. By calculating the expected losses, the bank can, given some assumptions from Basel II on how losses spread, calculate the unexpected losses; this is what the capital requirement is supposed to cover. If the bank is using the normal version of the internal method, the bank may calculate its PD by itself but LGD and EAD is legislated for every level of risk. In the advanced internal method, the bank may calculate its LGD and EAD (Finansinspektionen, 2001).

Because the internal methods generally lead to the banks lowering their capital requirements, a border minimum level of capital was established. The minimum value of the bank's risk adjusted assets is not allowed to go below 80 % of what would have been the minimum under the Basel I regulations. What this means is that the risk weights used by the banks are not allowed to decrease too much when the banks are using the internal methods. This so called Basel I floor was originally seen as a temporary fix, but it has not been removed, although some countries no longer apply it. (Finansinspektionen, 2013)

BaseI I did not have concrete assessments for how to measure the capital requirements from operative risks. In Basel II, there are three alternative methods for calculating the capital requirements considering operative risks: the base method, the standardized approach and the internal method (Lind, 2005). With the base method, the capital requirements are calculated as a fixed proportion of the bank's net interest revenues and other revenues, measured as the mean revenue during the last three years. With the standardized approach, all of the bank's branches of operation are split into categories and handed fixed risk-weights that are proportionate to the revenue generated by each activity. The total capital requirement is the sum of all the categories. With the internal method the capital requirement is based on the bank's internal system for measuring and handling its operative risks. The choice of method determines if the estimation of the bank's operative risks is precise or not. However, the main goal of these methods, according to Lind (2005), is to make the banks consider their operative risks more thoroughly when considering the total risk of the bank, and therefore its required capital.

Considering market risk, not much changed compared to Basel I (Lind, 2005).

The second pillar concerns the monitoring agencies' assessments, functions and authority, and accounts for their requirements on the banks' risk and capital management (Finansinspektionen, 2001). The agencies were given an expanded role in Basel II compared to Basel I. They should, among other things, approve single banks' systems for risks, internal auditing and capital, and control the application of these systems in the banking world (Lind, 2005). They should also assess all considerable risks, for example interest rate risk and concentration risk, and assess a bank's risks in relation to its available capital and, if necessary, take correcting action for example by demanding additional capital from individual banks. (Finansinspektionen, 2001) The second pillar represents a necessary development. As the bank's operations, instruments and organization becomes more complex, more advanced monitoring is required.

The third pillar describes the demand that the banks should make information public, in particular information regarding the bank's risk and capital management. It is important that customers and investors have enough information to be able to measure the banks' financial strength and risk exposure. (Finansinspektionen, 2001) By being transparent, the managers at the banks get less room to make potentially shortsighted decisions, which benefit only them. The more transparent the banks are, the more the managers at the banks will have to think before they act. If bad information gets out, people might pull their money out of the bank, which of course is bad news for the bank (and its managers). According to Lind (2005), the idea is that Basel II should increase the market discipline by requiring of the banks that they make public more relevant and frequent information than they do today regarding risks, capital and other aspects. The banks should not only make their results public, but also account for their strategies, management methods and control structures. The only secrets that a bank is allowed to keep in this context are the ones that are closely connected to its internal business strategy.

2.4 Basel III

As the financial crisis of 2007 broke out, it became evident that the Basel II rules were not enough to regulate the banks. There were several problems that Basel II did not manage;

- The banks’ capital reserves were too small to stand against the financial distress that came from the crisis.
- The debt level in the financial system was too high and the banks’ capital levels were too low to cover the risks that came with the high level of debt.
- The credit growth was too high and the pricing of risk was too low,
- The systematic risks and the spread-risks were higher than expected. Many financial institutions had risk exposures that were too similar and they were too dependent on one another. This meant that if one bank got in trouble, as a result of that, other banks would follow.
- The Banks' liquidity reserves were too small and the liquidity risks were too high.
- A lot of the financial instruments had become too complex for even the banks to understand the full risk that came with them.
- When credit rating firms lowered the credit grade of many banks it had pro-cyclical effects, meaning that it strengthened the financial downturn.

(Niemeyer, 2016)

In late 2010, the new capital requirements in Basel III were adopted. The new rules are supposed to correct the problems of the old regulation and will successively be implemented until 2019, though all of the changes are expected to be implemented by 2023. (Niemeyer, 2016) There are several new regulations and we will go through them in the sections below.

2.4.1 Increasing the quality and quantity of the banks' capital

A bank's capital can be categorized into three components; common equity tier 1 capital (CET1), other core capital (tier 1) and supplementary capital (tier 2). CET1 capital mainly consists of stock capital and retained earnings, and is the capital that most easily can be used to cover losses. (Bis, 2011) Defining tier 1 and tier 2 capital is a little bit trickier. Tier 1 and tier 2 capital lie somewhere between equity capital and traditional debt instruments and can be seen as so called hybrid capital.

Tier 1 capital, as defined by Barclays Bank (2013), is: "Called-up share capital and eligible reserves plus non-controlling equity interests, less intangible assets and deductions relating to the excess of expected loss over regulatory impairment allowance and securitization positions as specified by the PRA." (PRA = prudential regulation authority)

Tier 2 capital consists mainly of different types of debentures. Debentures are loans that have a lower priority than other debt and will therefore cover losses in the case of a bankruptcy before the other types of debt. A bank is supposed to use CET1 capital first, then tier 1 capital and lastly tier 2 capital to cover losses. (Niemeyer, 2016)

During the financial crisis it was made clear that some forms of capital at many banks in different countries did not cover losses as expected. In several countries, the state had to intervene in order to cover the losses of the banks. As a result of this, according to Niemeyer (2016), stricter rules were made for the tier 1 and tier 2 capital for them to be able to be included in the capital requirement calculations. They must for example automatically be transformed into stock capital if the capital coverage drops too low.

In Basel II, there was a requirement that a bank had to have a total capital equal to at least 8 % of the risk-weighted assets of the bank. Additionally, at least 4 % of the bank's risk-weighted assets had to be in the form of CET1 and tier 1 capital. This means, somewhat simplified, that the bank could have 50 % of its capital reserves in tier 2 capital and only have 2 % of its capital reserves in CET1 capital because CET1 capital only had to make up half of the 4 % mentioned above. Under Basel III at least 4.5 % of the 8 % has to consist of CET1 capital and at least 6% has to be in the form of CET1 and tier 1 capital. (Niemeyer, 2016) This means that the minimum capital reserves may at most contain 25 % tier 2 capital.

2.4.2 Increased capital buffers

The recent financial crisis showed that the banks did not have large enough capital buffers beyond the minimum capital requirements. It was also not clear what the sanctions for banks that did not meet the minimum requirements would be. It was up to each country to decide what they would be which resulted in the banks not being fast enough to fix some of their problems and the agencies would sometimes be too late in applying action plans to assess the problems. (Niemeyer, 2016) With Basel III, an attempt was made to establish a common framework for what the consequences will be for the banks that do not meet the capital requirements. Basel III implemented an arrogation that the banks must have capital buffers exceeding the minimum requirements. This so called capital conservation buffer should equal 2.5 % of the risk-weighted assets, which means the total capital requirement, will be 10.5 % (8 % + 2.5 % = 10.5 %). (BMF, 2016) The buffer must consist of CET1 capital, which means that if the bank meets the minimum capital requirements but not the total capital requirements (including the buffer) it has to keep part of its revenue in order to build up the capital. This way the bank cannot use the revenue to pay out dividends to its shareholders or pay bonuses to its employees. (Niemeyer, 2016) This is supposed to give the banks incentive to hold more capital and therefore reduces the banks' risk.

When times are good, banks tend to take more risk and when times are bad, banks tend to overestimate the risks. This leads to increased cyclical fluctuations. In Basel III, actions have been made in order to minimize these fluctuations by introducing a contra-cyclical capital buffer. (Bis, 2016) The idea is that banks should build up capital in good times to better manage the bad times. During an economic boom, local authorities have the option to go in and increase the capital requirements for the banks in the country. The banks will then be better prepared for a down turn in the economy and lending to the real sector does not have to fall too much during a recession. The contra-cyclical buffer must, like the buffer previously mentioned, consist of CET1 capital and have a value up to 2.5 % of the bank's risk-weighted assets. (SFS, 2014:966) The level of the buffer depends on where the bank is exposed to risk. (Niemeyer, 2016) For example, if a bank is stationed in country A but has an exposure to a counterparty in country B, it is the contra-cyclical buffer in country B that is supposed to be used for that exposure. Basel III requires the bank to accept country B's buffer, up to 2.5 % of the risk-weighted assets. The bank measures its total contra-cyclical buffer by calculating a weighted average on its exposures to different countries with their respective buffers (Niemeyer, 2016). This means that at most, the bank has to hold a value of an additional 2.5 % of its risk-weighted assets in CET1 capital. This puts the total maximum capital requirements at 13 % of the value its risk-weighted assets.

Some banks are too large and too important to the financial system to be allowed to fall. Because of this, Basel III introduced an additional capital buffer for these banks. The Basel committee identifies these banks and there are around 30 global systematically important banks (G-SIBs) in the world at the moment, including the Swedish bank Nordea. (Niemeyer, 2016) The additional buffer for these banks should have a value of between 1 and 2.5 % (up to 3.5 % if the bank is seen as exceedingly systematically important) of the banks' respective risk-weighted assets. Like the buffers mentioned above, this capital buffer should also consist of CET1 capital. (Bis, 2013) The capital requirements for these banks could therefore be as high as 15.5 %.

2.4.3 Restrictions of the banks' leverage

During the crisis, one of the issues was that the banks liquidity was too low. Because of this, an addition in the Basel III agreement was to add two liquidity requirements for the banks (Niemeyer, 2016). The first is called Liquidity Cover Ratio, LCR, and has the purpose of making sure that the banks have enough liquidity for short-term stressed situations. The requirement is set as a ratio between the banks liquidity and the estimated amount of net outflow during a 30-day period in a stressed scenario.

$$\frac{Liquid\ assets}{Outflows\ during\ a\ 30{-}day\ period\ under\ stress - Inflows\ during\ a\ 30{-}day\ period\ under\ stress}$$

According to the agreement the ratio of this equation should be at least 100 %, which means that the banks are required to hold enough liquidity to cover 30 days in a stressed scenario.

The other requirement for liquidity is called Net Stable Funding Ratio, NSFR, and has a long-term purpose. The banks are faced with a special liquidity risk because of the nature of their balance sheet were they convert short-term deposits and financing to long-term loans. A problem occurs because the banks cannot recall their assets on the balance sheet in short notice (Niemeyer 2016). Therefore, the Basel Committee made a regulation for how much stable financing should be available. This is divided by the financing needed during 1 year of financial stress to form the NSFR ratio.

$$\frac{Available\ stable\ financing\ during\ 1\ year}{Demanded\ stable\ financing\ during\ 1\ year\ under\ stress}$$

This ratio is also required to be at least 100 %. This will, according to The Bank for International Settlements (2014), decrease the possibility that disruptions to a banks regular source of funding will erode its liquidity position on a way that could increase the risk of its failure.

Another regulatory change with the purpose of decreasing the banks debt was to institute a requirement for leverage ratios. A high debt ratio could be profitable for the banks, but the higher it is, the bigger the problem becomes when an eventual crisis occurs. In these situations, the weights for risks do not matter and the only thing of significance is the value of their assets (Niemeyer, 2016).

Some of assets that the banks have could be hard to evaluate the risk for. The banks can then request a permit to use their own models for measurement for evaluating the risk of their exposures. However, these models may be used to underestimate the risks according to Niemeyer (2015) and therefore cause the banks to hold less capital than they really should. Because of this, the risk adjusted capital requirement was complemented with a net equity ratio requirement of 3 percent that is not based on the risk-adjusted assets. The banks must then hold enough equity to cover the assets on the balance sheet and also a part of the assets off the balance sheet.

An additional change with Basel III was to regulate the banks concentration risks. Before the crisis most countries had some form of restriction of how big the banks exposures were allowed to be to certain counterparts, but a global framework for this was lacking. The banks now should, according to the regulations of capital ratios, have a well-diversified portfolio of loans (Bis 2013). If the loans are too concentrated toward a certain counterpart, the system with the risk-weighted capital becomes unbalanced. Because of this, Basel III sets limits that banks could not be exposed to a single counterpart or group with more than 25 percent of their tier 1 capital.

During the financial crisis it was revealed how comprehensive the flaws of the system for the banks' capitalisation for market risks and exposures on the trading books were (Niemeyer 2016). As of Basel III it will now be harder for the banks to transfer their exposures between the trading books and banking books. This change will hinder the banks to moving exposures to where the capital requirements are lowest and therefore minimize the required capital.

2.4.4 Harmonized financial reporting

With the introduction of Basel III, a framework for harmonised financial reporting in the EU was introduced. The CRD IV package, which is the implementing act of Basel III in Europe (EBA, n.d.), contains the capital requirements regulations (CRR), which in turn contains the reporting frameworks FINREP and COREP (FCA, 2015). These regulations cover the reporting that the Swedish banks have to make to Finansinspektionen and contain reporting regarding the capital requirements (COREP) and the financial reporting (FINREP). The goal of these regulations is to harmonise the regulations for reporting across the European Union.

2.5 Earlier studies

Several studies have previously been conducted regarding the effects of the implementation of the Basel frameworks on the Swedish banks. The studies have touched on different aspects of the effects of the regulations and have had different delimitations concerning the scope of the studies. Génetay and Rhenman made one of the studies in Uppsala 2010 when the Basel III regulations were in its initial stages. The results of the study reflected the respondents' views of how the introduction of Basel III would affect the banks and the market during the coming years. The conclusion of the study was that the greatest challenge for the banks would be the implementation of the liquidity ratios. Critique was aimed towards the regulations as they were thought to be hastily applied and not well thought through. According to the study, Basel III would come with a cost for the customers, and new businesses that only focus on loans could emerge as a result.

Another study, made by Olsson and Nord in 2011, focused on what possible effects Basel III could have on the profitability in the banking sector. As this study was also made in the early phase of the implementation, it could only read the initial effects of the regulations. The result of the research showed that the capital reserve requirements had not resulted in any measurable negative effects on the revenue of the banks thus far. The authors also came to the conclusion that the new leverage ratio regulations could be the change that would cause the most problems for the Swedish banks but the long term effects of the regulations would lead to higher profitability and maintained revenue of the banks at the same time as the risks were reduced. A study in Lund 2015 by Dedering and Söderqvist showed that the banks experience the regulations as rather complex but that the regulations probably will make the banks more stable and grant them better control over their risks.

All of the mentioned studies were made on the large banks in Sweden: Nordea, Handelsbanken, Swedbank and SEB. Even though we are looking at the smaller banks in our study, we have chosen to include these studies because they are studies made on the effects of Basel III, which is the regulatory framework that we are examining in our study. We could not find any studies made on the smaller Swedish banks and Basel III so we have chosen to include a study made on the smaller Swedish banks and Basel II in the empirical framework. The study was made by Attar and Gröndahl 2008, and covered how the smaller Swedish banks were affected by the implementation of Basel II. They concluded that the banks improved their risk management and that the smaller banks were not disfavoured by the regulations because the banks could choose the methods that most benefited them regarding the calculation of their risk weights. They also mentioned that the use of internal methods was an expensive process with high initial costs, but that the interviewed banks that had implemented internal methods expressed that the gains from using the internal methods would out-weigh the costs.

3 Methods

In the following chapter, our methods for conducting the study will be presented. This includes our collection of data, selection of strategy, sample selection, interview process, and method evaluation.

3.1 Data Collection

The sources for the information that lays the foundation for our study are divided into two categories; primary- and secondary data. Primary data is information that is gathered during the process of the study and secondary consists of already published information (Bryman and Bell, 2015).

In the beginning of this research we wanted to use longer, semi-structured interviews with a few of the banks to try to get a representative data to generalize the market. However, when searching for banks in the market we wanted to study, we found out that there were too many banks and that the method we had chosen was not the best approach. A problem that occurred was that niche banks by nature differ in their operations and it was therefore hard to draw general conclusion with a small sample size. It was also hard to determine how big their relative market share was when different banks focus on different areas, for example the ICA-bank focusing on private customers, Nordnet focusing on trading in securities and Amfa focusing on corporate customers. Instead, we chose to conduct structured interviews with more banks that covered a larger segment of the market. We decided to use this method because we believe that if we see similarities in the effects of Basel III between banks that operate in different segments of the market, we can draw conclusions on how all the niche banks on the Swedish market are affected. The research still falls more into the qualitative spectrum of strategies because, as Bryman and Bell describes; qualitative research puts more emphasis on words and not quantified data and focuses on how the respondents perceive and understands their social reality.

Our empirical data is presented through primary data assembled by structured interviews at 7 of the smaller banks in Sweden and interviews at Finansinspektionen and Riksbanken. We wanted to use interviews as the means of gathering information because we wanted to have the effects of Basel III described by someone who had experienced the implementation rather than reading what write in their financial reports. The practice of interviews when collecting data also gives a foundation for a nuanced empirical section and opens up the possibility for an evolving and analytical study according to Christensen et al (2001). Secondary data has also been collected from earlier studies within the subject to help design the background and problem discussion of this study. Secondary data was also used to describe the banks that we included in the research.

The theoretical section is conducted from secondary data that has been collected from the webpages of Finansinspektionen and Riksbanken where they have described the regulations of the Basel Committee and the committee itself. We have also collected information from publications of the Bank for International Settlements, which is where the Basel Committee publishes their reports and regulations. Originally, we wanted to double check our answers with the financial reports of the banks we interviewed. However, because of varying quality of these reports, we have decided not to because we could only gather sufficient information regarding Basel III from a few of the reports. Another problem was that, because some of the banks interviewed wanted to remain anonymous, referring to their respective financial reports would remove their anonymity.

3.2 Selection strategy

When selecting the sample of respondents that would present our empirical data, we have used a stratified systematic selection where the banks we interview operate in the different varieties of niche´s that exists on the Swedish banking market. This gives us a range of respondents that could represent the market as a whole. By choosing banks that differ in service focus and customer segments we hope to avoid bias data that could be produced if a specific niche was excluded when conducting the conclusions of the research.

When choosing individuals and organizations for interviews, we wanted to conduct a goal-oriented selection where respondents are chosen based on a direct reference to the research questions. The question that we wanted to answer was how Basel III affects the smaller banks in Sweden and therefore we have tried to include banks that are representing every type of niche.

According to Christiansen et al. (2001) it is of greater value to obtain respondents with knowledge and insight about the subject in hand than to receive statistically representative data. Therefore, when we were looking for individuals to interview, we wanted to make sure that the respondent was in a position within the bank that handled the question that we wanted to research. Because of this it was important that the respondent managed or had information about the management of risks and operations of capital structures and liquidity within the bank.

3.3 Interviewed banks and authorities

By the end of 2013, there were a total of 117 banks active on the Swedish market according to Swedish bankers (2014). 4 of these are the so-called big banks that are universal and offer a full range of services to both private customers as well as companies. In 2013, these banks accounted for 63% of the savings from the Swedish public (Swedish Bankers, 2014). Beside these big banks there were 34 other Swedish bank corporations by the end of 2013 that stood for 24 % of the public´s savings. Of these 34, 14 were reconstructed savings banks that act on local markets. Of the 20 remaining banks many are so-called niche banks that in one way or another specialize in one or more selected services. These niche banks tend to offer better conditions than the universal banks on the services they have chosen to focus on in attempt to win market shares on that segment in particular. The services they offer can range widely from security trading to household lending or factoring. Because of this, it is hard to compute these bank's respective market shares when they act on different segments of the market. Therefore, we only present how big the banks are in terms of customers, employees and their total loans to the public. A presentation of the banks can be found in appendix 2.

The supervisory authority that makes sure that the banks follows the Basel III regulations falls in the hand of the Finansinspektionen. We conducted a total of 9 interviews at the following banks and authorities; ICA-Banken, Amfa, SBAB, Nordnet, Finansinspektionen, Riksbanken and 3 other banks that requested anonymity (presented as Bank X, Y and Z) and will therefore not be described. Out of these banks, SBAB and Bank Z are focused on mortgages, Bank X and Ica Banken focus on household lending, Amfa Bank focuses on factoring, and Bank Y and Nordnet focus on securities trading. With this selection of banks, we believe that we are covering the majority of the categories of the smaller banks. However, we have not included local savings banks because we are only interested in banks that are operating nationwide in this study to not have local circumstances affecting our results.

3.4 Interview Process

In order to acquire the required information in order to analyse to which extent the Swedish niche banks have been affected by the introduction of the Basel III regulations, we have conducted a number of interviews with respondents from the banks that we want to examine. The interviews were conducted over phone calls, with one exception, which responded per e-mail, in which we asked the same predetermined set of questions to every bank in order to better be able to compare the banks. Prior to each interview the respondents were asked if it was ok for us to record the conversation, to which none of the respondents were opposed. Recording the conversations may have made the respondents more inclined to provide answers that would present the bank in a positive manner. We believe, however, that the gain from being able to better recite the interviews (through the recorded material) out-weighs the potential down-side of receiving polished answers. The questions that we asked are presented in the appendix. The questions were asked in Swedish and are therefore presented both in Swedish and English in the appendix in order to account for possible translation errors. Our purpose with the questions is to gain a greater understanding about the banks' situations and how they are coping with the new capital reserve requirement than we could get from reading their respective financial reports. Inspiration for our questions were taken from another study made regarding Basel III on the large Swedish banks (Dedering, Söderqvist, 2015) and a study regarding Basel II and its effect on the smaller Swedish banks (Gröndahl, Attar, 2007). These studies had a similar purpose and as our research falls into the same framework, the questions were relevant and applicable in our study. With the questions we wanted to gain a better understanding of how particular parts of the regulations have affected the interviewed banks. Our original interview guide was adapted after the first interview because the respondent mentioned that the new financial reporting had been a burden and our original interview guide did not mention the financial reporting. We included a question regarding how this implementation was affecting the banks after learning about this. In the sections regarding the interviews, the answers to our questions from each respondent will be presented and analysed.

We have found our correspondents by calling the banks' customer service or telephone exchange and asking for someone who could answer our questions. We believe that the bank's own personnel know more about the expertise of the employees of the bank than we do, and have therefore let them guide us to a suitable employee to interview.

The choice of banks, however, has not been random and we have tried to reach different types of niche banks so that similarities in answers cannot be entirely directed to the banks being too similar. Some random elements in our method do occur though, since not every bank wanted, or had time, to partake in the study. This means that we have systematically sought out banks, but only interviewed a respondent at the banks with which we were able to conduct an interview. In total we have attempted to contact the following banks: Nordnet, Länsförsäkringar Bank, Ikano Bank, Amfa Bank, Ica Banken, Forex Bank, Collector Bank, SBAB, and Resurs Bank. An additional three banks were contacted and interviewed (Bank X, Y, and Z in the text) but since they wanted to remain anonymous, they are excluded from the previous list. We also interviewed Finansinspektionen, which is the agency that monitors financial institutions in Sweden, in order to gain a better understanding of the impact of Basel III. We have also chosen to interview Riksbanken. Riksbanken does not monitor that the regulations are followed, but it does monitor the implementation of the Basel III regulations in Sweden and has several publications on the subject. (Riksbanken, 2016) The governor of Riksbanken, Stefan Ingves, is also on the board of directors of the Basel Committee on Banking Supervision. (Bis, 2016) Therefore, we believe that Riksbanken can provide valuable insight into the implementation of Basel III.

3.5 Method Evaluation

Some researchers deem the traditional criteria for research evaluation as non-applicable for qualitative research and encourage other principles when evaluating qualitative research (Bryman & Bell, 2015). They propose two underlying criteria that are the ones we use when we evaluate our research: trustworthiness and authenticity.

3.5.1 Trustworthiness

Trustworthiness consists of 4 different criteria: credibility, transferability, dependability and confirmability (Bryman & Bell, 2015). Credibility describes how well the empirical data conforms to the portrait of the reality described by the respondents and can be seen as the equivalent of internal validity. To make sure that what we include in our empirical chapter checks out with the respondents' view of the reality we sent a copy of the written down answers from the interview to give them a final say before we present it. Because of this the respondent have a chance to look over what we have written to make sure it describes his or her thoughts of real situation of the organizations. We also chose to interview respondents at Finansinspektionen and Riksbanken to receive information from external sources with insight in the banking market. This triangulates the data, which further increases the validity of the answers, as data collected from different sources reduce the risk of bias results. Because we did not double-check our answers with the financial reports of the banks because of the reasons stated earlier, the credibility of the received answers might have been compromised. However, we believe that our interviews with Finansinspektionen and Riksbanken are sufficient in order to give credibility to the answers from the banks.

Transferability is the equivalent of external validity and evaluates how well the results of a research could be transferred to another environment. The fact that we interview respondents from multiple banks should help us get a broader picture of the situation at the banks and will help us see if specific elements lay the foundation for the results. We hope the see a general picture of the situation of the banks that is transferable to the rest of the sector as a whole.

Dependability evaluates how trustworthy the research is and secures that all the phases of the research process are accounted for. To make our research more trustworthy we accurately describe our methods when searching for respondents and how the interviews have taken place. We describe who the respondent is and what assignments they have in their respective organizations to make sure that they have relevant knowledge to answer the research questions.

With confirmability, the researchers must make sure that their own subjective views do not underlie the execution and conclusions of their analysis. To make sure to minimize subjective views from our point of view, specific questions designed to answer our research questions were asked during the interviews. No leading questions are asked, as it would hinder the respondent from answering objectively. The analysis is made directly from the empirical data collected as the answers given lay as the foundation for the conclusions.

3.5.2 Authenticity

Authenticity consists of four criteria (Bryman & Bell, 2015). The first criterion is how fair the reflection of the reality that the research produces is. Does the image created reflect the situation for everyone involved? In our case, we only interviewed one person per bank and it is thus their image of the situation that is described. How their co-workers and external stakeholders experience the implementation of Basel III will not appear in the empirical data. The study can contribute to the participants in the study learning more about the general situation in the banking sector. This is called the ontological authenticity of the study. With the results of the study, the participants can see how they compare to the other organizations in the sector.

To further improve the validity of this research we wanted to widen the approach of the interviews. If data was only collected from respondents at the respective banks studied, we might get biased answers. This risk should be taken seriously because the respondents are employees of the banks and it could therefore be in the banks and their own best interests to make the bank look good. To make sure the answers we get checks out with the reality of the banks we wanted to make a data triangulation and therefore contacted Finansinspektionen, which handles the supervision of the banks, and Riksbanken, the national bank of Sweden. With this triangulation we believe that if the answers we receive from the respondents at the bank is similar to the answers from the authorities supervising, the validation of the research would become greater.

4 Analysis

In the following chapter, the empirical data from our interviews will be processed and analysed. We have compiled our answers under five headlines in order to give the analysis a clearer structure. The interviews are presented in appendix 3.

4.1 Categorizing the banks

We have presented the interviewed banks in a two by two matrix in order to more clearly categorize the banks. By doing this we are also able to better present the anonymous banks without compromising their anonymity.

	Private customers	Corporate customers
Smaller range of services	SBAB, Nordnet, Bank Y	AMFA, Bank X, SBAB
Wider range of services	Ica-banken, Bank Z, Bank X	Not represented in our sample

Figure 1 Interviewed banks divided by customer focus and offered services. By 'wide range of services', we mean that the bank offers a range of services that is representative of a large bank and can be used as the main bank for the customer. Note that Bank X and SBAB are present in two fields.

4.2 Increased capital reserve requirements

Following the implementation of Basel III the quality and quantity of the required capital reserves have been increased. Despite this, most of the interviewed banks have not had to make any major changes in their capital reserve policies. According to Niemeyer, smaller banks tend to have a better capital coverage and liquidity than the bigger banks. The only bank that had to make said changes is Amfa bank. Because we do not have access to the bank's financial information it is hard to tell what the reasons for this could be. However, we believe that, because factoring is a large part of the bank's business, the assets of the bank are not as safe as the assets of, for example, SBAB, which mainly manages mortgages. This increase the risk weights of the assets that Amfa bank bases its capital requirements on, which in turn requires them to hold more high quality capital. Because Ica Banken, SBAB, Bank X and Bank Z all have mortgages or household lending as their primary products, they are in general in a good spot regarding the new capital requirements. Bank Y has only had to make some minor changes in their capital structure that did not deviate far from what they otherwise would have done. Nordnet, which has securities trading as its core operation (Nordnet, 2016), has not been that affected by the capital requirements but the respondent stated that the leverage ratios could affect the bank. This is because when the bank's customers buy and sell stocks or bonds, the liquidity on the balance sheet adjusts accordingly. When the bank has a surplus of liquid funds, they use this to buy treasury bonds or covered bonds. These are low-risk assets, but since the leverage ratio does not consider risk weights, the bank may have to hold a relatively high amount of liquid reserves.

4.3 Methods for calculating risk weights

In Basel III there are essentially two approaches the banks can use when calculating the risk weights for the capital requirements; they can use a standardised approach where the risk weights are given or use internal methods where the banks calculates the risk weight internally. In our study of the smaller Swedish banks, it has become evident that the majority of them use the standardised approaches when calculating their respective risk weights for credit, operative and market risk. The reason for this, according to our conducted interviews, is that the methods are easy to implement and that the use of internal methods simply is too expensive for the majority of the Swedish banks. According to several of the interviewed respondents, the gains from implementing an internal method, and thereby lowering the risk weights, does not outweigh the costs of establishing the system required for the internal methods. Another reason stated in the interviews for not using the internal methods was that some of the banks were not exposed enough to some types of risk. While Ica Banken, SBAB, Bank Z, and Bank X were exposed to a (respectively) relatively large amount of credit risk, they do not take much (or any) market or operative risk. Because of this, it would not make much sense to even consider using the internal methods for these types of risk. Out of the banks we interviewed, only one of them used an internal model for calculating their risk weights. SBAB uses an internal model for its credit risks and is able to profitably do so because of its size (it is the sixth largest bank in Sweden but still around ten times smaller than the large four, Swedish Bankers, 2014) and access to resources. The respondent from SBAB also pointed out that, because of its size on the Swedish mortgage market, the bank has to incorporate internal model for credit risk in its business in order to stay competitive. This is because its competitors are using the internal methods and thereby can offer a lower price on their products.

According to Finansinspektionen, receiving permission to use internal methods for calculating risk weights is a tedious process and is one that the smaller banks cannot afford to go through. In order to gain from implementing and using the internal methods, the banks need to already have rigorous systems in place for managing risk, something that the smaller banks in general do not have. Niemeyer (Riksbanken), noted that the internal risk management methods probably lead to lower risk weights and better risk management, but that the banks need to weigh these gains against the cost of investing in and implementing these methods.

4.4 Changes in operations

Regarding changes in operations the respondents were consistent concerning the new forms for financial reporting being a large burden to overcome. The banks had to assign a large amount of resources to the financial reporting which in some cases redirected focus from other important projects to being able to manage the new reporting forms. As, for example, Bank Z pointed out, the regulations are not adapted after the size of the bank implementing them, which leads to the smaller banks having to use a relatively large amount of resources to dealing with them. The respondent at Nordnet also added that, as a relatively small bank, a disproportionate amount of resources had to be used in order to understand the regulations and the effect they will have on the bank. Regarding the increased capital reserve requirements, none of the banks interviewed expressed that they experienced any major changes in operation, and were roughly able to continue operating as usual, apart for Bank X, which had to develop its operative risk management. This corresponds with what Finansinspektionen said on the matter. According to our respondent at Finansinspektionen, the capital coverage regulations themselves should not have been cause for much trouble at the smaller Swedish banks. What has happened, however, is that risk has been brought further up on the agenda for most of the interviewed banks, especially for SBAB that uses an internal method for its credit risk. According to Niemeyer, the scope of the Basel regulations is the banks that are operating internationally and those are the banks that were intended to be affected by Basel III. The decision to apply Basel III on every bank was made by the European Union. Because of this, some of the requirements that were aimed towards the large banks were also applied on the smaller banks as well.

4.5 Positive and negative aspects of the regulations

Most of the interviewed respondents pointed out that there have been both positive and negative effects of the regulations so far. What has been restrictive is the increased resources that the banks have had to allocate to their risk management. Because the regulations are not slimmed down for the smaller banks, some of the banks have had to put a disproportionate amount of resources toward ensuring that the regulations are followed and that everything is up to date, which is expensive. For example, the respondent at Bank Z pointed out that because of their limited workforce, they were put under a lot of stress when implementing the regulations. The respondent at SBAB noted that a lot of work has had to be done in order to keep their databases up to date and running smoothly. Bank Z and SBAB also noted that, because of the scale of the implementation of the new regulations, the banks have had to deprioritize other projects in favour of the implementation of the regulations.

In general, according to our respondents, the positives of the new regulations have been that the banks have learned and matured in relation to their risk management. For example, Bank X pointed out that, even though the actual risk of the bank might not have changed following the implementation of the regulations, the bank is now more aware of its risk taking and has more control over the details of its risk. The respondent at Amfa bank also pointed out that the increased financial reporting could be a positive in the long run because with standardised regulations across countries, it will be harder to find arbitrage opportunities form establishing operations in a specific country. The respondent at Bank Z also points out that even though the implementation of the regulations has been an expensive process, he believes that the new regulations have been a step in the right direction. The respondent at Nordnet added that the regulations have been targeted at ensuring a stable financial system at the expense of the banks' customers. The regulations may create a financial system that is safe but unnecessarily expensive, which may motivate regulations going in the opposite direction in the future.

One effect of the increased expenses that have come with the new regulations is that it will be harder to enter the market due to increased entry barriers. This could in the long run potentially lead to lower competition on the market according to Niemeyer.

4.6 Required returns from shareholders

According to the respondents, there probably have not been any changes in the required return on equity at the banks following the implementation of Basel III. It is, however, important to note that the majority of the respondents were not in positions where the return on equity was their highest priority, and therefore may not have been the correct persons to ask in order to get an informed answer on the subject. Another thing worth noting is that many of the banks interviewed still are relatively new banks in their developing stages. According to the respondent at Ica Banken, any changes in the return on equity would probably be a result from strategic decisions rather than a change in risk management. Also worth noting is that, out of the interviewed banks, Ica Banken and Bank Z are fully owned subsidiaries and SBAB is owned by the Swedish state. It is also possible that the return on equity actually has remained unchanged, but our circumstances make it hard for us to draw any relevant conclusions.

5 Results and Conclusions

In this section, our conclusions will be presented and we will present an answer to our initially asked question. We will also suggest subjects for future research within the topic.

5.1 The impact of Basel III on the smaller banks in Sweden

The purpose of this study was to see how the smaller Swedish banks have been affected by the implementation of the Basel III regulations. The question we asked ourselves in the purpose section of the study was:

How have the smaller Swedish banks been affected by the implementation of the Basel III regulations?

From our study, we have come to several conclusions. First, according to the interviewed respondents at the banks, the increased capital requirements have generally not been a problem for the banks that we interviewed. This stands in contrast to the earlier studies on the large Swedish banks, presented under *Earlier Studies* in the text, which showed that the liquidity and leverage ratios were thought to become the largest problems for the banks. One reason for this is that the smaller banks generally have a better liquidity and capital coverage than the larger banks, which are the banks that the regulations were made for. Four of the smaller banks that we interviewed had household lending or mortgages as their products. According to our research, this kind of banks is in a favourable position regarding the new capital and liquidity requirements. One reason for this could be that, because of the low risk that these products generally have, the risk-weights should be on the lower end of the spectrum, which means the banks have to hold relatively low capital reserves. The larger banks have a more comprehensive part of their balance sheet consisting of corporate loans that bear a higher risk-weight and therefore require larger capital reserves. Among the banks we interviewed, Amfa is the only bank that expressed having to make relatively considerable changes to its capital structure. Amfa Bank focuses mainly on corporate customers and according to our analysis; this could be the reason why they were more affected by the capital coverage regulations. Because Amfa Bank is the only bank in our sample that has a main focus on corporate customers, drawing general conclusions about that type of small banks is not possible. However, looking only at our sample and the conclusions we have drawn, the banks focusing on mortgages and deposit accounts for private consumers seem to have an easier time managing the new capital requirements than banks focusing on corporate customers (and riskier products).

Second, all of the interviewed banks, apart from SBAB, used the standardised approaches when calculating their risk weights. According to our research, the reason for this is that the internal methods are too expensive for the smaller banks to establish because of the amount of internal infrastructure that needs to be invested in. Many of the respondents pointed out that the costs from implementing the internal methods would not be covered by the gains from potentially lowering the risk weights. The reason SBAB can profitably use an internal method for its credit risk is that it is a large player on the Swedish mortgage market. Because of this, SBAB probably has more to gain from lowering its risk weights compared to the other banks in the study. Based on our research, a deciding factor on whether to use an internal method or not, is the scale of the operations in the area that the method would be used for. Because of the high up-front costs of gaining a permission to use an internal method, the method needs to result in large value of products' risk-weights being lowered for it to be profitable.

Third, regarding the capital requirements, the banks' general operations have remained largely unchanged. However, the banks did express that the increased financial reporting has been a burden. The financial reporting has been harmonized across the EU and has increased in frequency and level of detail and does not differ between larger and smaller banks. Because of this, the respondents at the smaller banks that we have interviewed expressed that they had to allocate a large amount of resources to understanding and implementing the reporting regulations. Compared to the earlier studies on the large banks, presented under *earlier studies* in the text,

Fourth, what seems to have been the hardest part about implementing the new regulations for the smaller banks interviewed is reading and understanding the regulations. Because the smaller banks do not have access to as many employees as the large banks, quickly learning and adapting to the new regulations has been a tedious process. Despite this, however, some of the respondents expressed that the regulations are good for the financial system as a whole and that the long term effects would be good in the sense that the banks will have better understanding of their own risks and a generally more comprehensive risk management.

Finally, we also wanted to find out how the Basel III regulations may have affected the banks’ required returns on equity. However, the respondents have not seen any major changes to the required return, and were generally uncertain about the underlying reasons for the potential changes.

To conclude, the Basel III regulations have required the banks to allocate a relatively large amount of resources to understanding the new regulations and ensuring that they are followed. What has mainly affected the banks have not been the capital reserve requirements or the new liquidity rules, but instead following the financial reporting forms and comprehending the new regulations have been the largest challenges for the smaller banks. We can also see that the interviewed banks that focus on deposits and private lending are not heavily affected by the extended capital and liquidity requirements. Overall, the interviewed banks have improved the control over their risks and the change in operations deriving from the increased financial reporting has been a costly process. We believe that, because of the variety of banks that were interviewed, the study presents a fairly general description of how the smaller banks in Sweden have been affected by the Basel III regulations so far. It is, however, important to note that the results of the study are the most representative of banks that are similar to the interviewed banks, and caution should be made when drawing general conclusions.

5.2 Future research topics

In this study, the focus has been on how the smaller nationwide banks in Sweden have been affected by Basel III. The results are based on interviews and are therefore undoubtedly affected by the respondents own views. It would be interesting to conduct a more quantitative research on the subject where the financial reports of the banks are studied. However, we are aware of that the financial reports at the smaller banks do not always contain information that is detailed enough to conduct a study, but maybe that will change in the future as the banks mature. It would also be interesting to find a break-even level of development for implementing the internal methods regarding the different risks and which circumstances that level is based on. Another interesting topic would be to compare how the larger and smaller banks have been affected by the new regulations and try to find if any factors in particular decide how the banks are affected.

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Appendix 1

A1 Interview Questions

A1.1 Swedish

Vem är du och vilka är dina uppgifter på banken?

De nya likviditetsreglerna och kapitalkraven som kommit i och med Basel III, hur påverkar de Er verksamhet?

Det finns enligt Basel III olika metoder vid beräkning av kapitalkrav. Vilken metod eller vilka metoder använder Ni vid beräkning av Ert kapitalkrav för kreditrisk, marknadsrisk respektive operativ risk?

Varför har Ni valt metoden eller metoderna?

Har det funnits några svårigheter i användandet och implementeringen av dessa?

Hur har Er verksamhet förändrats till följd av att Basel III-regelverket implementeras?

Upplever Ni att Basel III hittills har varit utvecklande eller hämmande?

Kan Ni se någon skillnad i avkastningskravet från Era aktieägare till följd av implementeringen av de nya reglerna?

A1.2 English

Who are you and what are your assignments at the bank?

The new liquidity regulations and capital requirements that have come through Basel III, how do they affect your operations?

There are, according to Basel III, different methods when calculating the capital requirements. Which method or methods do you use when calculating your capital requirements for credit risk, market risk and operative risk respectively?

Why have you chosen the method or methods?

Have there been any difficulties in the use and implementation of the methods?

How has your operation changed because of the implementation of the Basel III regulations?

Do you think that Basel III so far has been evolving or repressive?

Can you see any differences in the return on equity following the implementation of the new capital requirements? Considering potentially reduced risk.

Appendix 2

A2 Interviewed banks and authorities

A2.1 SBAB

Founded: 1985
Number of customers: 1 000 000
Number of employees: 429
Total loans to the public: 297 000 000
SBAB is an independent bank owned by the Swedish state. It is the parent company in the SBAB concern that also contains SCBC and Booli among other subsidiaries. They offer services to both private and corporate customers and their core product is their housing loan. In 2016 the total amount of these loans to the Swedish public represented 7.87 % of the total market share.

A2.2 ICA- Banken

Founded: 2001
Number of customers: 660 000
Number of employees: 338
Total loans to the public: 7 779 816 000
The ICA Bank is a part of the ICA Group that aside from banking consists of grocery stores and real estate. The ICA Bank´s prioritized segment is private customers and offer savings accounts, housing mortgage loans, savings in securities and credit cards amongst other. In 2016 they will start up new operations offering services to companies as well.

A2.3 Amfa Bank

Amfa is a bank focusing on corporate customers offering services in form of factoring, export factoring, corporate accounts and debt collection amongst other. Amfa Bank does not present a public annual report and therefore we cannot present any numbers from the bank.

A2.4 Nordnet

Founded: 1996
Number of customers: 490 400
Number of employees: 490
Total loans to the public: 7 278 083 000
Nordnet is a fully digitalized bank that focuses on private saving and trading in securities. In later years they have extended their service to savings accounts, pensions and security mortgages.

A2.5 Finansinspektionen

The Financial Supervisory Authority in Sweden, In Swedish Finansinspektionen, is an authority owned by the Swedish state with the core purpose to handle the supervision of the financial markets in Sweden. They develop own rules and apply international rules and verifies that the actors on the Swedish market follows them. They also analyse risks that could have effects on the stability on the financial markets. If companies do not comply with the rules set by Finansinspektionen, they have been given rights to hand out sanctions to the companies breaking them.

A2.6 Riksbanken

Riksbanken is the central bank of Sweden and is an authority standing below the Swedish parliament. They give out the coins and bills that works as payment in Sweden. Riksbanken tries to encourage financial stability and has the responsibility to control Sweden’s monetary policy and tries to control the Swedish inflation.

A2.7 Bank X

Bank X offers services to private customers as well as corporations. The main part of the bank’s financing comes from deposits from the general public.

A2.8 Bank Y

Bank Y is a Swedish niche bank that primarily focuses on private saving. It is a digital bank, which challenges other Swedish banks and insurance companies on the Swedish savings market.

A2.9 Bank Z

Bank Z is a relatively large Swedish niche bank which focuses on mortgages and private savings, and offers a wide range of services to the private market.

Appendix 3

A3 Interviews

A3.1 Amfa

This interview was conducted with Amfa bank, a bank that originally focused on factoring but now also offers other banking services, such as savings accounts and credit consulting. (Amfa Bank, 2016) The respondent is Erik Fagerland, who works as a risk manager at the bank and is responsible for independent risk control and compliance.

How have the new capital requirements affected the bank?

In order to meet the LCR requirements, the bank had to purchase 3 000 000 SEK worth of treasury securities, which is a cost since the interest rate on them is negative. The reason for this is that the bank needs to hold a certain level of high quality capital and the treasury securities qualify as such. The bank has an abundance of liquidity, but it cannot use these funds to meet the requirements. According to the respondent, the reason for this is that in a case of a system wide failure of the financial system, funds in bank accounts is not particularly safe anymore. He adds that the banks could have their liquidity reserve at another financial institute, which in turn takes it into account when calculating its own capital reserves. This could lead to severe domino effects.

Which method(s) for calculating the capital requirements is/are used regarding credit risk, market risk, and operative risk respectively?

Amfa bank uses the base method for operative risk and the standardised approach for credit and market risk. The reason for this is that the methods are easy to apply and does not require the bank to apply for permission at Finansinspektionen. Another reason is that, according to the respondent, the gains from using more advanced methods do not outweigh their cost.

Have there been any changes in operations following the introduction of Basel III?

According to the respondent, the financial reporting has been a lot of work and through that, the operations have changed slightly. But the business processes themselves and the way in which the bank conducts business and to who the bank lends money has not changed.

Has Basel III been restrictive or developing so far?

According to the respondent, Basel III has mostly been restrictive so far. The required capital reserves must have higher quality and so bank is required to hold more capital on its balance sheet. In addition to this there has been increased financial reporting as mentioned before because the financial reporting has been normalized across the European Union. The normalization of the financial reporting, though, could also be seen as a positive, according to the respondent. With normalized reporting in the EU, there are no arbitrage opportunities from establishing operations in a specific country because of differing legislation within the union.

The respondent does not think that the new regulations have decreases the risks at the bank. Both Basel II and III have brought risk up on the agenda in a different way than before, but that has not resulted in lower risk taking, rather it has just increased the awareness of the bank's risk taking.

Has there been a change in the required return from the shareholders of the bank as a result from the implementation of the new regulations?

There have not been any changes in the required return from the shareholders, but the amount of capital available to be distributed to the shareholders has decreased. This is because of the higher costs of keeping up with the regulations. More resources than before have gone to risk control and compliance for example. Additionally, you also have to hold more equity capital on the balance sheet.

A3.2 Bank Y

Our respondent is the CFO of the bank. Since we were only able to conduct the interview per e-mail, the answers are a bit shorter in this interview than the others.

How have the new capital requirements affected the bank?

According to the respondent, the new capital requirements have not affected the bank's operations other than that they measure and make sure that the liquidity at the bank is placed so that the bank meets the requirements. However, the respondent points out that the new requirements have not resulted in a major difference compared to how they would otherwise operate.

Which method(s) for calculating the capital requirements is/are used regarding credit risk, market risk, and operative risk respectively?

According to the respondent, the bank uses the standardised approach for these types of risk. The method was chosen because of its simplicity and there have been no difficulties in implementing and using the method.

Have there been any changes in operations following the introduction of Basel III?

According to the respondent, changes have been made, but they have mostly been small adaptations.

Has Basel III been restrictive or developing so far?

The regulations have been more restrictive than developing, according to the respondent. The respondent also points out that the new financial reporting forms have been a burden.

Has there been a change in the required return from the shareholders of the bank as a result from the implementation of the new regulations?

The respondent has not noticed any changes in the required return.

A3.3 Ica Banken

The name of the respondent at Ica Banken is Christer Törnqvist. He handles questions regarding the capital planning and works with risk management questions regarding credit risk, market risk, and liquidity risk. Among other things, he makes the internal capital evaluation and works with following up on liquidity risk measures, such as LCR and capital coverage in general.

How have the new capital requirements affected the bank?

According to the respondent, the new capital reserve requirements have not affected the bank that much because it has a business model that allows it to generally come out favorably concerning the new capital requirements. This is, for instance, because the entire debt side on the balance sheet consists of household lending. Something that does affect Ica Banken a little is that the bank has to have to have a certain allocation of assets in order to satisfy LCR and that the bank each year has to meet a new level of LCR. The reason for this is that LCR will gradually be scaled up to its intended level until 2018. There has also been some adaptation to be made regarding the financial reporting. To conclude, there have not been any large changes in the operations of the bank and the business model of Ica Banken has generally fit pretty well in with the new capital requirement regulations from the start.

Which method(s) for calculating the capital requirements is/are used regarding credit risk, market risk, and operative risk respectively?

Regarding credit risk, Ica Banken is using the standardised approach. Regarding operative risk, the bank uses the base method, which means that the capital requirement is based on a percentage of the turnover that the bank has had during the past three years. Regarding market risk, the bank is also using a base method because they are not that exposed to this type of risk. This is partly because Ica Banken does not trade financial instruments that would cause market risk.

Regarding credit risk, Ica Banken has loans without collateral at first hand and there is by and large no one that uses internal methods for this type of products. The incentives for using internal methods are in this case low. The risk weights for the capital requirements could potentially be lowered but doing so would cost more that you could gain from it. Because of different floor rules regarding the capital requirements and the development that has been happening regarding mortgages, the internal methods has not been as attractive as it was probably meant to be. The case for the internal methods has in essence diminished every year that has passed since 2007; today the incentives for using an internal method are small.

Regarding operative risk, the situation is similar. The base method is the easiest method to use and using a more advanced method may decrease the risk weights slightly. However, the cost would be larger than the gain to use a more advanced method for calculating the capital requirements for operative risk.

Because Ica Banken does not trade with any financial instruments that would cause market risk, there is not any reason to use advanced methods when calculating the capital requirements for market risk.

Ica Banken has not directly changed its methods apart from the financial reporting. Regarding the financial reporting there has been some work to be done when adopting to the new form, but in the perpetual risk assessment and capital coverage calculations the additional work has been limited. This is in part because the bank has a fairly simple business model and balance sheet so the new capital reserve requirements have not caused Ica Banken much hassle. What has taken time is adapting to new financial reporting but now that the employees of the bank have become used to it, it should work well.

Have there been any changes in operations following the introduction of Basel III?
There have not been any major changes in operations apart from some additional resources that the bank has had to allocated to making sure that the new regulations are followed and that the financial reporting follows the new form. All in all, the new regulations have caused a certain increase in resources required.

Has Basel III been restrictive or developing so far?
According to Törnqvist, it is hard to tell. It has required some extra resources and it is possible that the bank has learned from it and expanded its risk management in some sense, but Törnqvist did not have a clear answer to this question.

Has there been a change in the required return from the shareholders of the bank as a result from the implementation of the new regulations?
Ica Banken has not had that much focus on the return on equity as other banks because the bank is completely owned by the Ica Group. According to Törnqvist, the return on equity should have adapted to the reduction in risk but it is unclear what causes the change in return on equity. Because Ica Banken is a relatively new bank and is in its growth phase, the return on equity has surely been more affected by strategic initiatives rather than a change in risk from increased capital requirements.

A3.4 Bank X

The respondent is the chief risk officer (CRO) at Bank X, which is a well-known Swedish niche bank, and works with managing all types of risk.

How have the new capital requirements affected the bank?

Since the bank has a major part of its financing through lending from the general public, the bank is in a good spot concerning the LCR and NSFR measures. What has been done at the bank is that they try to acquire more long-term debt with fixed interest rates. Other than that, the new capital requirements have not affected the bank that much.

Which method(s) for calculating the capital requirements is/are used regarding credit risk, market risk, and operative risk respectively?

The bank uses the standardised approach when it comes to credit risk and market risk. Regarding operational risk, the bank uses the base method.

The bank has chosen these methods because they are standardised methods and because the bank is too small to benefit from using internal methods. The reason for not using internal methods is, according to the respondent, that it would cost more than there was to gain from it.

Since the methods in use are rather basic, there have not been any major difficulties in the implementation and use on them. It has just been important to know about all the details concerning them.

Have there been any changes in operations following the introduction of Basel III?

Considering the implementation of the entire Basel III regulations, it has been a comprehensive process. This is mainly because of the extensive financial reporting details that the banks have had to adapt to, which has led to an extension of the bank's financial reporting capacity. The main reason for the large amount of new forms to follow is, according to the respondent, that the reporting regulations do not make a difference between smaller and larger banks. This means that the niche bank has had to adapt to the same financial reporting as the larger banks, which has led to the bank having to allocate a lot of resources to reading about and learning the entire new system, even though much of it does not apply to them specifically. All in all, a lot of resources have had to be allocated to learn the new system and adapting to it. The bank has had to make changes and adjustments to its financial reporting and has had to develop its operational risk management with basis in the new regulations.

Has Basel III been restrictive or developing so far?

The positive aspect of the regulations has been that the bank now has a more comprehensive control of the details of its risk. However, the costs of acquiring the information about these details and adapting to the financial reporting have been large and have not been offset by the gains.

Has there been a change in the required return from the shareholders of the bank as a result from the implementation of the new regulations?

According to the respondent, the return on equity has not changed as a result of the implementation of the Basel III regulations. The reduced risk could result in a lowered return on equity. However, since Basel III requires the bank to hold more equity capital for the same level of lending, the required return, as a result, will increase, which leaves the return on equity rather unchanged.

A3.5 SBAB

Our respondent at SBAB is Karl Rudarp, who is the manager of credit risk and capital at the bank. He has, among other things, worked on the bank's IRB models for credit risk and manages credit risk and capital assessment.

How have the new capital requirements affected the bank?

According to the respondent, in general, the bank has reduced its short term financing. When it comes to large debt maturing, to bridge the loss of capital, the bank takes on temporary debt in order to lessen the impact that the large outflow of capital when they have to repay the large debt. This way, the bank remains stable regarding the liquidity measures from Basel III. Another effect that the new capital requirements have had on SBAB is that they have altered the way the bank assesses risk in the sense that the bank works more actively with the parts that it has to measure and report. The bank currently works more with regular deposit accounts than before, which according to the respondent, can be attributed to the current liquidity measures.

Which method(s) for calculating the capital requirements is/are used regarding credit risk, market risk, and operative risk respectively?

The bank uses the standardized approach when calculating the risk weights for market risk and operative risk. Regarding credit risk, the bank has full IRB (which is the internal model for credit risk) permission on its retail portfolio and calculates its own PD, LGD and credit conversion factor, CCF, which corresponds to EAD (Business School, 2013), regarding individuals. For businesses, the bank has a so-called foundation-IRB, which means they may calculate PD themselves, but have to use standardized values for LGD and CCF.

According to the respondent, the main purpose of SBAB is to take credit risk. Because of this, the bank uses an internal model only for its credit risk. Because SBAB mainly takes credit risk, the other types of risks (here, market and operative risk) are relatively small and do not constitute the use of internal models. One of the main reasons SBAB chooses to use the IRB approach regarding credit risk is that its competitors use it in order to reduce their risk weights regarding credit risk. If SBAB does not also do this, they risk being put out of business because of their competitors offering a lower price on their products. Another reason for the use of the IRB approach is that it helps SBAB gain a larger understanding of its credit risk management, which, according to the respondent, is very important considering SBAB, is very knowledge driven when it comes to risk management.

The main difficulty that SBAB experiences with the methods it uses is that the regulations regarding them still changes fairly quickly over time. Because the bank's databases are built around how the regulations were at the time they set up the databases, the system has to me altered every time the regulations change. According to the respondent, even small changes may require a considerable amount of work.

Have there been any changes in operations following the introduction of Basel III?

Risk is currently very high up on the management agenda because of the capital requirements and the visualization of risk that the regulations have brought. The bank has also matured a lot considering the risk coverage in the entire organization, especially regarding the advanced models. According to the respondent, the increased financial reporting has been a burden and changes are constantly made to it. This means that it has been a very large project to make all of the databases function smoothly so that the bank can make its financial reporting quickly while making sure that everything is correct according to the regulations.

Has Basel III been restrictive or developing so far?

According to the respondent, the new regulations have been developing in the sense that it drives the dialogue around risk and increases the bank's maturity regarding risk. To discuss, analyze and reflect around different risk assessments has been very positive. What has been restrictive about the regulations is that a lot of time and energy has gone toward risk and reporting in the bank as a whole. The bank has had to deprioritize other projects in order to meet the regulations.

Has there been a change in the required return from the shareholders of the bank as a result from the implementation of the new regulations?

The owner of the bank is the Swedish state and, according to the respondent, the bank has long had a required return of 10 %. The respondent cannot see any changes in this required return at this time and has not heard anything from the owners regarding a possible change of the required return in the future.

A3.6 Bank Z

The respondent at Bank Z works as a risk analyst at the department for risk control at the bank.

How have the new capital requirements affected the bank?

What has affected the bank, according to the respondent, is that there has been a lot of new regulations, which they have had to read up on and learn in order to make sure that they satisfy the new rules. Because Bank Z is a relatively small bank, and because the regulations do not differ based on bank size, the implementation has been very resource heavy for the bank since the bank does not have as much employees as the larger banks to handle the implementation. In addition to this, some projects related to the normal business have had to be deprioritized in favor of managing the implementation of the new regulations. Regarding LCR and NSFR, the bank regularly follows up on the regulations and has done so for quite some time. Because the bank already had a conservative liquidity regulation before the implementation of Basel III, it has not been affected that much by the regulations themselves, but the implementation has been resource consuming.

Which method(s) for calculating the capital requirements is/are used regarding credit risk, market risk, and operative risk respectively?

Regarding credit risk, the bank uses the standardized approach, regarding operative risk, the bank uses the base method, and regarding market risk, the bank uses the standardized approach. Because the bank's products mainly consist of mortgages, around 80 % of the balance sheet according to the respondent, it would maybe make sense to implement an internal model regarding credit risk in the future. However, for operative and market risk, because of the bank's relatively simple business model, the respondent could not see any reason to use more advanced models regarding these types of risk. According to the respondent, there have not been any direct difficulties in the implementation and use of the methods, but the implementation has required a lot of resources.

Have there been any changes in operations following the introduction of Basel III?

According to the respondent, there have not been any major changes in operations following the implementation of Basel III because the bank already had well-functioning monitoring of the risks. According to the respondent, the increased financial reporting from the regulations has been a burden. Since he is not directly involved in the reporting, he did not know to which extent, but it has required a lot of extra resources.

Has Basel III been restrictive or developing so far?

Personally, the respondent thinks that the regulations that have come are positive for the financial system as a whole. While it has been expensive for Bank Z to implement the regulations, because of the size of the bank, he still thinks that the regulations are a positive change in the right direction.

Has there been a change in the required return from the shareholders of the bank as a result from the implementation of the new regulations?

The respondent could not see any changes in the required return following the implementation of Basel III. One reason for this, according to the respondent, could be that Bank Z is a fully owned subsidiary, and is not publicly listed.

A3.7 Finansinspektionen

The respondent is Gunnar Dahlfors, who is the manager of the bank analysis unit at Finansinspektionen.

How has the implementation of Basel III been so far?

The new regulations have been implemented and the banks follow the rules so, according to the respondent, the implementation has gone well so far. The financial reporting has become more extensive, which is a major change from before. This has primarily got to do with the standardized reporting in Europe, that is Finrep and Corep, which is far more extensive than the national reporting. According to the respondent, implementing Basel III is synonymous with implementing CRR and CRD4, which contain Finrep and Corep (Wolters Kluwer, 2016).

Difficulties in the implementation

According to our respondent, the smaller Swedish banks should not have had much trouble with the capital coverage regulations themselves. However, the financial reporting has increased and the banks are required to look further into their risks than they otherwise would. What could be a problem for the banks is that they might have to upgrade their compliance and risk management divisions and put extra resources into financial reporting. Aside from this, the respondent does not think that the regulations have affected the smaller banks that much.

Which method(s) in general do the smaller banks use when calculating their risk weights?

There are essentially two ways that a bank can calculate its risk weights; the standardized approach and the use of internal models. Essentially, you could say that the smaller banks cannot choose which methods to use. Even if they would like to use an internal model, in order to reduce their risk weights, the cost for doing so would be too high. According to the respondent, for a smaller bank, the standardized approach is generally the only option. In order to be granted permit to use the internal methods, the banks have to show that they have rigorous processes for managing risk and they need a section at the bank that follows these processes. The banks also need to be able to show that they have a history of managing risk so that they can show that they have genuine processes. This, according to the respondent, is expensive. Additionally, building the infrastructure required to use the internal models could be very expensive. What a smaller bank would gain from having lower risk weights, it could lose by having to hire more staff for managing risk.

The monitoring of the banks

Each quarter year, the banks must report in to Finansinspektionen. The information in this reporting lays the foundation for the first control. According to the respondent, it is fairly easy to see if a bank does not meet the capital requirements. Other than this Finansinspektionen also conducts visits at the banks. The ten largest banks are yearly thoroughly audited by Finansinspektionen; other banks are audited at least once every three years. Additional audits are made if Finansinspektionen notices that the bank is lacking in regard to the regulations.

Positive and negative effects of the regulations

The respondent thinks that the new regulations may have short term negative effects on the banks because many new rules must be applied which can be seen as a burden. However, as the banks get use to the regulations, this negative side effect will disappear. The respondent also points out that an effect of the regulations is that it helps the banks to better grasp the risks they take and therefore helps them get more structure in their risk management, which is a good thing.

Do the regulations affect the required returns of the banks?

The respondent could not see any significant changes in the required return of the banks as a result of the implementation of Basel III.

A3.8 Nordnet

The name of the respondent is Jacob Kaplan. He is the CFO of the bank since 2010 and the Basel III regulations are his responsibility.

How have the new capital requirements affected the bank?

The bank has a good liquidity situation, so the capital requirements themselves have not resulted in any direct limitations for the bank. What has been a bit restrictive is the agency reporting and there has been a lot of work to be done in learning and monitoring that the regulations are followed. However, the respondent added that the leverage ratio requirements have had effects on the bank. Nordnet mainly has customers who save in stocks and bonds. When the customers of the bank sell or buy stocks or bonds, the assets on the bank's balance sheet are affected. The stocks or bonds of the customers of the bank are not assets of the bank, only the liquid capital that the customers currently hold shows up on the balance sheet. When the bank has a surplus in capital it uses this to buy treasury bonds or covered bonds. These are very safe but since the leverage ratio does not take risk weights into consideration, the bank may have to hold a lot of capital reserves. Depending on how the leverage ratios are implemented in the future, the bank may have to change its operations slightly.

Which method(s) for calculating the capital requirements is/are used regarding credit risk, market risk, and operative risk respectively?

Nordnet uses the standardised approaches for all types of risk. The respondent points out that the internal methods are expensive to implement and that the gains from implementing them would not out-weigh the costs at this time. The bank currently has two main products, security backed borrowing, where the bank has virtually no losses because the collateral is very liquid, and a private lending portfolio where the bank expects credit losses. The respondent adds that the use of internal methods would make sense to use with low risk lending, but as of now, the bank does not deem it profitable to use internal methods.

Regarding the implementation and use of the methods, Nordnet has not had much trouble but the respondent notes that the new regulations and the new reporting have required a lot of resources. Specifically, he pointed out that the interpretation of the regulations has been time consuming, partly because they change over time. The bank has roughly the same regulations to follow as the large banks but does not have a large compliance department, as the large banks do, and therefore has to make due with a smaller workforce.

Have there been any changes in operations following the introduction of Basel III?

No significant changes have been made, other than the increased resource requirements. Some changes could be made concerning the leverage ratio mentioned before but we will have to see where that lands, according to the respondent. Has Basel III been restrictive or developing so far? Because the bank has had to allocate more resources to the regulations, other projects have had to be deprioritized. However, the respondent adds that it has not been too restrictive since they can still operate more or less as usual. Regarding positives, the respondent noted that on a macroeconomic level, the regulations help reduce and visualize risk. Even the smaller banks benefit from this because they gain a better understanding of their risk management.

Another thing that the respondent mentioned is that the main objective of the regulations is to ensure the stability of the financial system. This, however, is accomplished at the expense of the banks' customers. The regulations are not aimed at what is best for the customers and how you ensure that the financial market stays competitive. The respondent thinks that regulations aimed at the customers and the competition in the market will be developed if the regulators realize that they have created a very stable, but unnecessarily expensive financial system. In this type of system, it is hard for new banks to enter and if the banks have to use a lot of resources in order to uphold the regulations, the prices that they offer the customers will be affected.

Has there been a change in the required return from the shareholders of the bank as a result from the implementation of the new regulations?

Generally speaking, banks today are holding more capital in relation to their operations. Because of this, the respondent thinks, maybe not directly, but indirectly, that the regulations may have increased the absolute required return. However, because the banks are holding more capital, the required return may have declined.

A3.9 Riksbanken

Formally I am a senior advisor. My work assignments are in the first hand regulatory questions and bank regulations. A big part of this is the Basel committee’s operations to produce global banking regulations for internationally active banks. I am a part of one of the sub groups of the committee and act as an advisor for Riksbanken´s representative and also for Stefan Ingves who currently is the chairman of the committee.

If you look at it historically, the Basel I and Basel II regulations have only focused on the banks holding enough risk-weighted capital. With Basel III, in addition to increased capital requirements, also regulates what kind of capital the banks can include in the calculations. Furthermore, the new regulations include leverage ratios that are not measured for risk. This decreases the possibility of the banks having excessive leverage in the banking system, which tends to generate large debts that in turn worsens crisis if they should occur. Additionally, two liquidity ratios were included in the new regulations that makes the banks have enough liquidity to manage 30 days under stress and do not have a significant durational mismatch between debts and assets.

These additions complement the earlier rather thin regulations. This new framework will restrict the banks in some ways but the probabilities or the risk for future financial crisis decreases.

How do you experience that the implementation of Basel III has worked out?

The Basel Committee have no formal coercive tools for applying the rules but aims towards implementing the agreement into the respective countries' laws. After the agreement was made, the committee has agreed to perform evaluations of how the regulations have been implemented. This have proved to be a rather effective method to make the countries apply the regulations and to receive a harmonised implementation. The most countries have been eager to introduce the regulations and a sort of name and frame phenomenon occurs if they do not follow the rules.

Have the new regulation been mainly favoured or restrictive for the smaller banks.

The scope of the Basel regulations are the banks that are operating internationally and these are the ones that are intended to be affected by these rules. Basically the banks need operate internationally for the regulations to be applicable. EU, on the other hand, have decided when implementing the Basel III framework that the regulations should be applied on every bank. Therefore, this is not a Basel decision but a decision made by the European Union.

You can look at the EU's implementation of the regulations from two perspectives. Because these regulations decrease the probability of a banking crisis, all the banks are favoured since every bank is affected by a crisis, guilty or not. A discussion can be made in the topic that the increased legal demands benefits the smaller banks in the way that it harder and more expensive to start up new banks. This could further lead to decreased competition in the market. Regarding the new reporting systems, it will prove costly as they have to produce new systems to cope with the frequency and the level of detail of the reporting

Which one of the new requirements has been hardest for the smaller banks to comply with?

That is hard to generalize and depends on what bank you ask. If you look at the smaller banks it is probably the costs of the reporting that is the biggest concern. The smaller banks tend to possibly have better capital coverage and better liquidity than the large banks if you generalize. We do not monitor the smaller banks to the same extent as the large banks and therefore i can only generalize and the situation can vary between the banks.

How have the new regulations affected the risk management at the banks?

The risk management have generally improved because they have to comply with the new regulations on a more systematic level compared to the earlier regulations. The risk management have surely been improved the banks now need to monitor a higher number of risks and in a better way than before.

This is mainly a question for the owners but you can discuss the fact that if regulations decreasing the probability for losses, all else equal, should reflect in decreased expected returns. How big the changes are can be discussed and it varies between banks but the direction should be clear with a lowered required rate of return.

Does Riksbanken control that the regulations are followed?

Riksbanken is not a supervisory authority; it is Finansinspektionen who controls that the banks comply with the rules. We collaborate with Finansinspektionen and collect data from them to monitor and observe the large banks and some medium-sized banks like Skandiabanken and Länsförsäkringar. We run stress tests on these banks so we have a pretty good picture of the risks of these banks and how they develop over time but it is not our role to make sure that the rules are complied with.

Can you see any flaws with Basel III and in what way can it be improved?

You could go through a lot of details where we believe that the regulations were tot optimal but you should take into consideration that there are 27 countries that needs to approve the regulations. Since the committee lacks legislation rights the regulations often presents some sort of lowest common denominator. We would have liked to see stronger rules in some areas and that fact that Sweden has implemented stronger rules than the Basel Committee presented reflects that we think that the regulations are too low and we estimate that the risks in Sweden are high enough to apply stricter requirement than the global standard.

Also, some of the rules are not optimally formulated in the published agreement. Some definitions should in my opinion be expressed differently but this is a global negotiation and thus the countries need to agree upon these.