Banking Capital, Liquidity and Leverage

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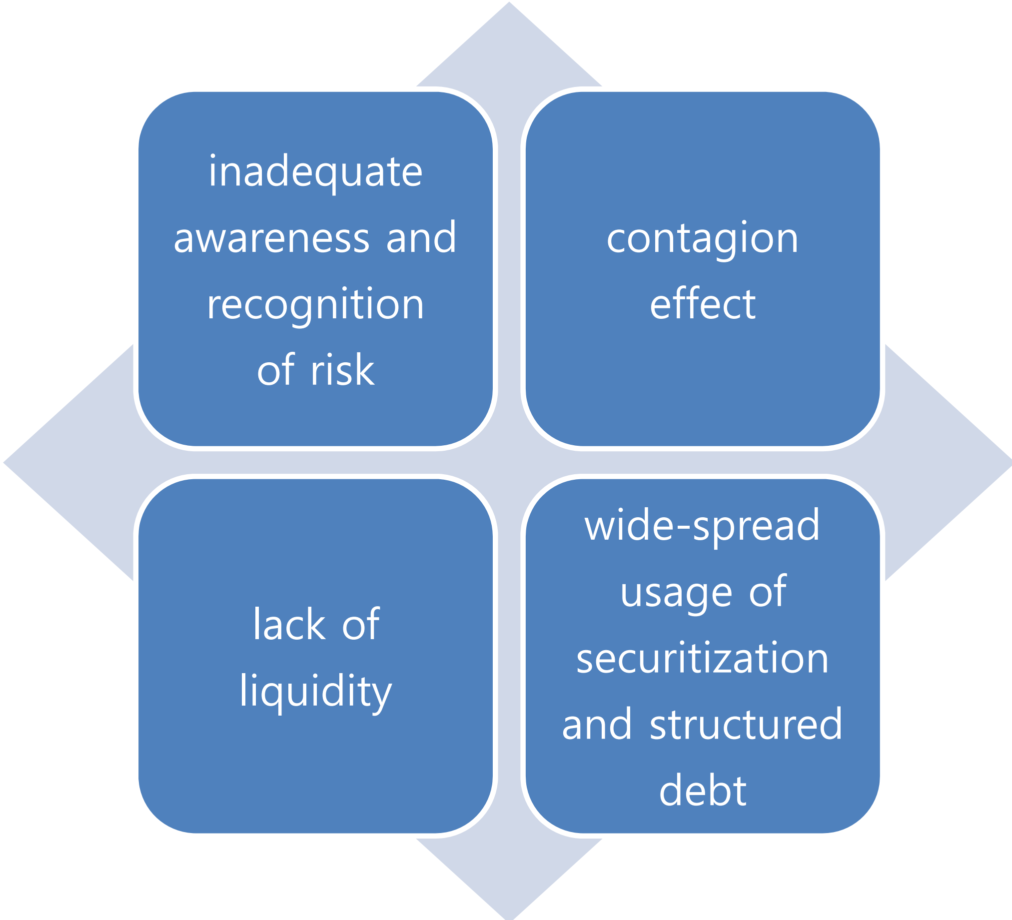
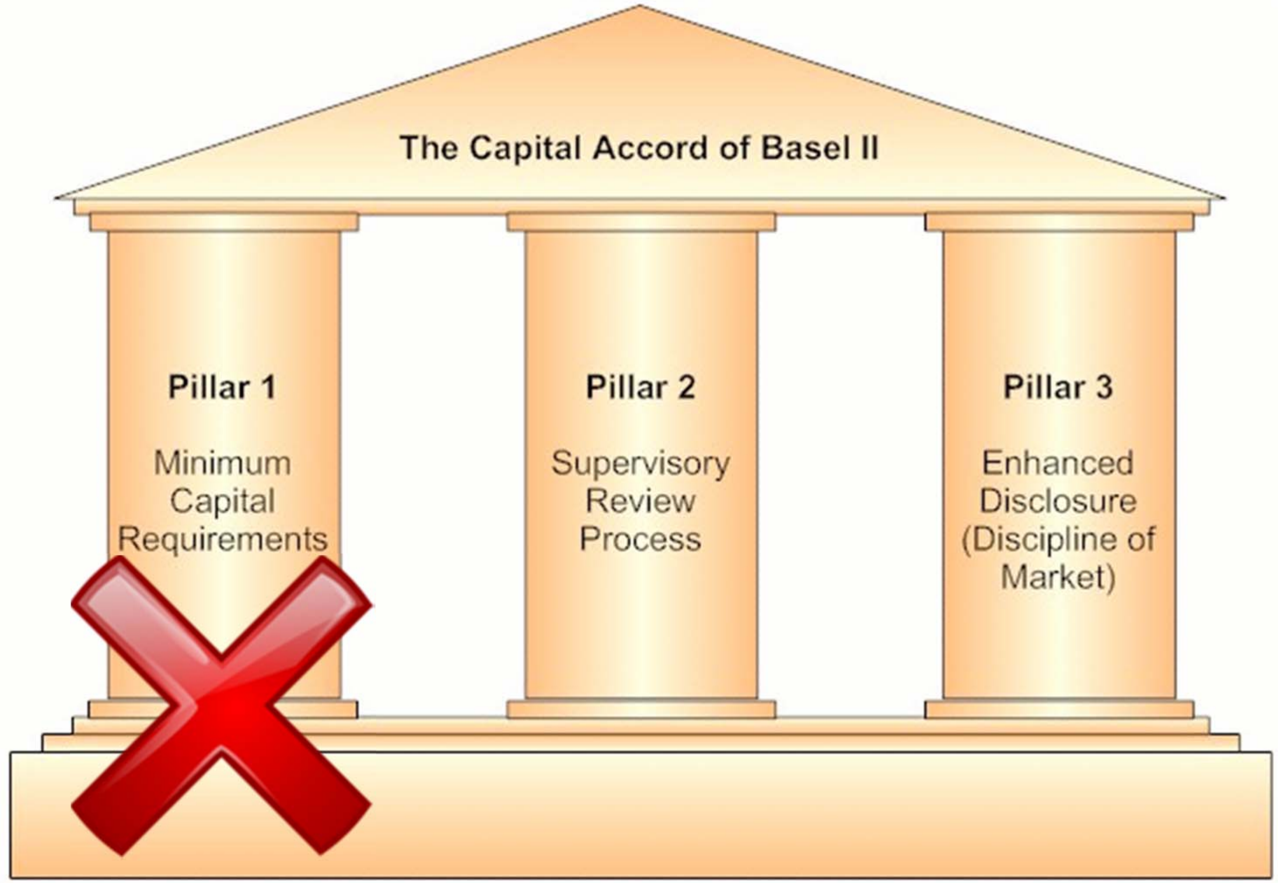
Global Financial Crises



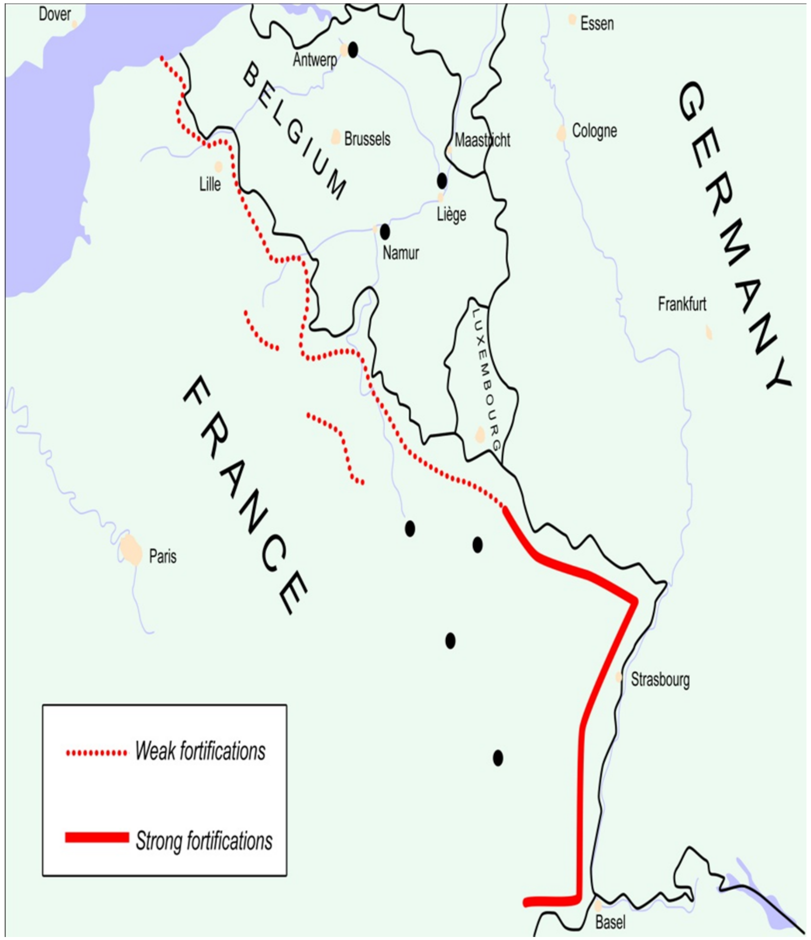
source: CIB Market Report BCG (2007Q3)

This means the failure of Basel II



failed to protect the international financial system from the Global Financial Crises

similar to Maginot Line



- **a line of concrete fortifications**, tank obstacles, artillery casemates, machine gun posts, and other defenses, which **France constructed along its borders with Germany** and Italy,
- However, it was strategically **ineffective,** as the Germans flanked the Maginot Line, and proceeded relatively unobstructed

(source: Wikipedia)

Basel III newly introduced!

banking capital

prepared for the future crisis

Calibration of the Capital Framework Capital requirements and buffers (all numbers in percent)			
	Common Equity (after deductions)	Tier 1 Capital	Total Capital
Minimum	4.5 (now 2%)	6.0	8.0
Conservation buffer	2.5		
Minimum plus conservation buffer	7.0	8.5	10.5
Countercyclical buffer range*	0 – 2.5		

Source: http://www.bis.org/press/p100912.htm

Liquidity

- After an observation period beginning in 2011, the liquidity coverage ratio (LCR) will be introduced on 1 January 2015
- The revised net stable funding ratio (NSFR) will move to a minimum standard by 1 January 2018.

Leverage

- test a minimum Tier 1 (non-risk-based) leverage ratio of 3% during the parallel run period
- based on the results of the parallel run period, any final adjustments would be carried out in the first half of 2017
- migrate to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration

Annex 2: Phase-in arrangements (shading indicates transition periods)

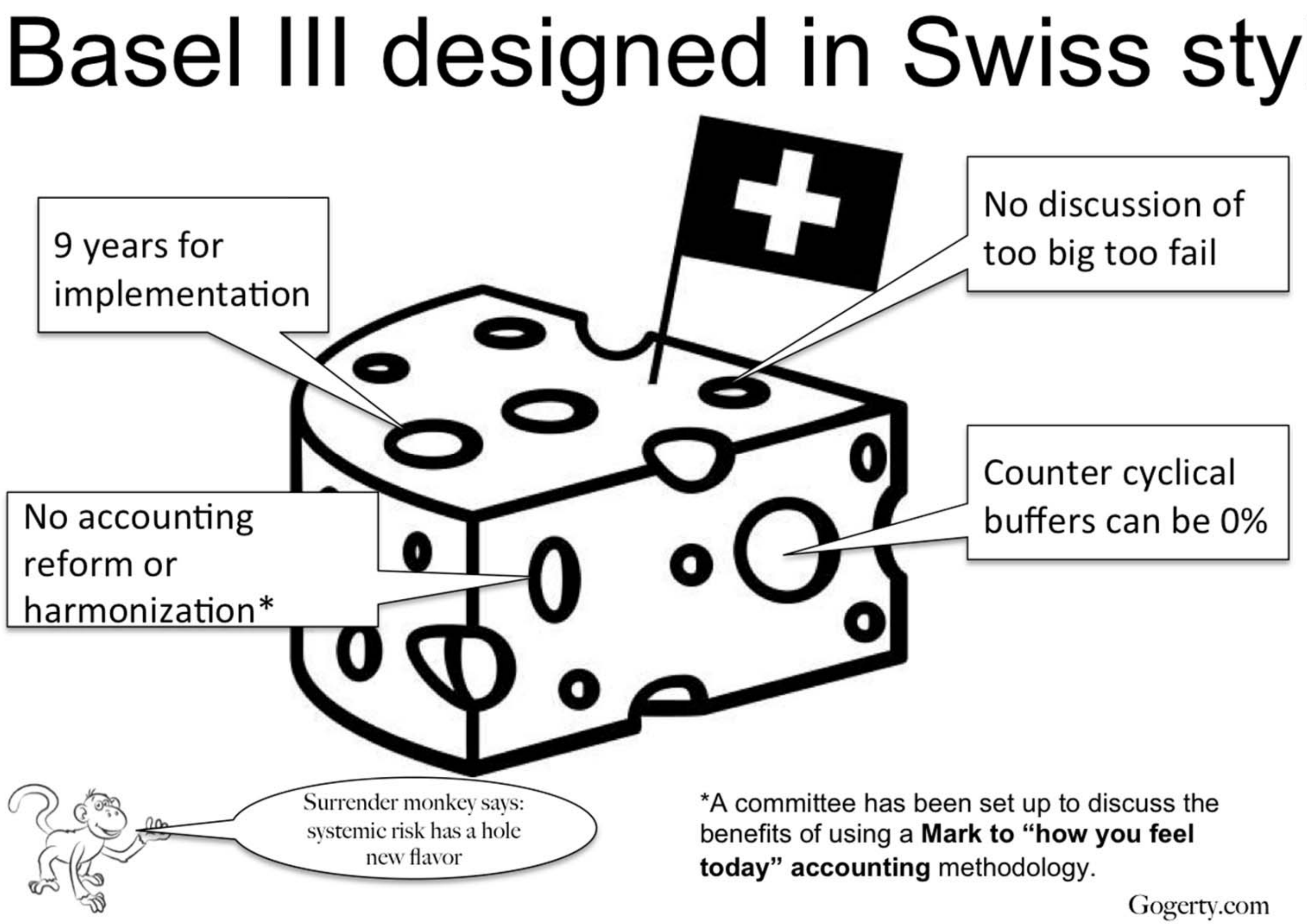
(all dates are as of 1 January)

	2011	2012	2013	2014	2015	2016	2017	2018	As of 1 January 2019
Leverage Ratio	Supervisory monitoring		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015					Migration to Pillar 1	
Minimum Common Equity Capital Ratio			3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer						0.625%	1.25%	1.875%	2.50%
Minimum common equity plus capital conservation buffer			3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from CET1 (including amounts exceeding the limit for DTAs, MSRs and financials)				20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital			4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital			8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus conservation buffer			8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital			Phased out over 10 year horizon beginning 2013						
Liquidity coverage ratio	Observation period begins				Introduce minimum standard				
Net stable funding ratio		Observation period begins						Introduce minimum standard	

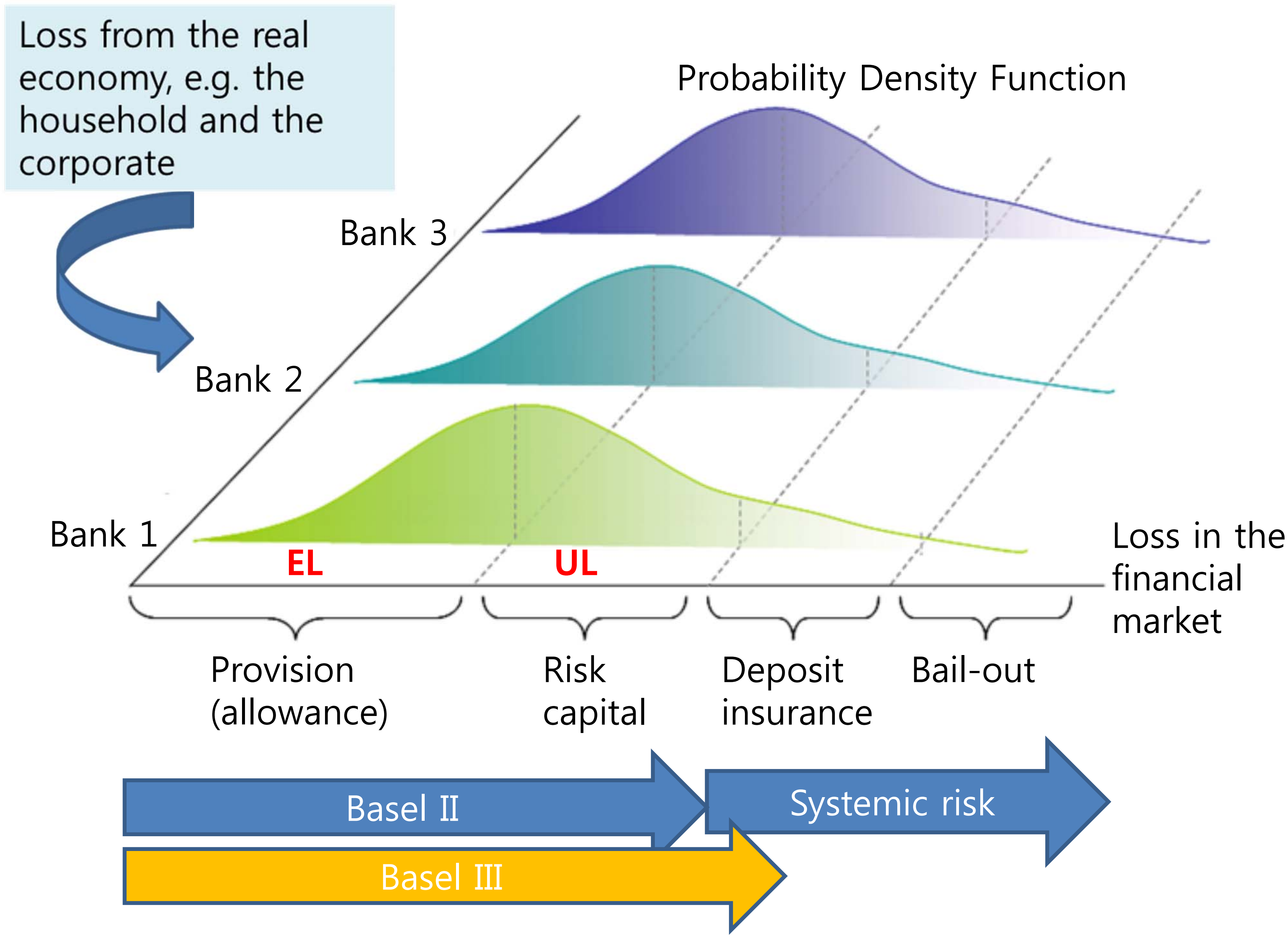
(DTA: Deferred Tax Asset, MSR: Mortgaging Service Right)

Basel III is to be finalized at 2010 G-20 Seoul Summit

Some critiques yet!



Loss absorbing structure



Who get the benefit?
Who pay the cost?

- Congressional Testimony, October 2009, Andrew W. Lo
  - Establishing the means to measure and monitor systemic risk… is **the single-highest priority** for financial regulatory reform
- **We Must Answer**
  - Systemic risk is always bad thing? No risk premium?
    (cf) high risk, high return in the finance
  - For example, the financial integration might increase the systemic risk, but could be beneficial to somebody, including the consumer.
  - Then, why only the financial institution should pay the cost from the systemic risk? Who-else?
  - Need to explore the (system-wide) risk-adjusted benefit from the systemic risk, and to design the cost-sharing structure

EoD

Thanks!