

# **The impact of the recent global meltdown on banking regulation and supervision**

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## **1. Introduction**

Banks have been regulated since 1988 based on the Basel I capital accord. The 1988 accord followed a rules based one-size-fits-all approach to regulation of the capital adequacy of banks.

To address the deficiencies in the 1988 Basel Accord, Basel II was implemented. Basel II is a more risk based approach to the regulation of banks. Under the Basel II accord, the banks can determine their capital adequacy ratio based on their own internal risk based model or on the credit ratings of rating agencies (Mostert, 2003).

The key issue was whether the new Basel II accord will be adequate in the face of a global financial meltdown.

The recent global crisis highlighted various issues in terms of the prudent regulation and supervision of banks. Some of these issues include banks that are deemed of too-big-to-fail, moral hazard and the role of regulators in preventing these crises.

The Basel Committee on Bank Supervision has proposed new rules for the capital adequacy of banks after the crisis by launching the Basel III proposals (BIS, 2011). The Basel III proposals mainly focus on refining the definition of capital used to

determine the capital adequacy of banks and new guidelines to regulate the liquidity of banks.

The aim of the paper is to provide a critical overview of the Basel III proposals.

In the first part of the paper a short historical overview on the regulation and supervision of banks will be provided with a focus on the main issues necessitating a review of the regulation and supervision of banks. The second part will provide an overview will be provided of the of the Basel III proposals on the capital adequacy and liquidity of banks.

The third part of the paper is a critical evaluation of the Basel III. Some of the issues that will be dealt with are the impact of the new proposals on the cost and availability of credit, the impact on macroprudential regulation and supervision and the possible impact of the Basel III proposals to prevent similar banking crises from happening again (Angelini et al., 2011).

The paper will make some suggestions on the way forward in terms of the review of the regulation and supervision of banks.

## **2. Historical overview of the regulation and supervision of banks**

It is important to provide an overview of the Basel I and Basel II proposals before the Basel III proposals can be evaluated critically. The aim of this section of the paper is to provide a brief overview of the main limitations identified in the Basel I and Basel II proposals.

The 1988 Basel Accord was accepted in 1988 to promote regulatory convergence in terms of the capital adequacy of banks. According to the BIS (1988:1) the proposals had two fundamental objectives. Firstly, “it is that the new framework should serve to strengthen the soundness and stability of the international banking system; and, secondly, that the framework should be fair and have a high degree of consistency in its application to banks in different countries with a view to diminishing an existing source of competitive inequality among international banks”.

The 1988 Basel Accord (Basel I) was accepted to develop a single risk-adjusted capital standard that would be applied throughout the major banking countries of the world. This level playing field would cause best practices to be adopted by banks throughout the world thereby enhancing the efficiency, productivity, safety and soundness of the global financial system.

The Basel process produced many successes, but also several important unintended consequences.

One of the main criticisms against the Basel I accord was the fact that it originally only made provision for credit risk. The system also was too rude for the highly advanced banking systems that it needed to regulate. Another critique was against the fact that it only had four risk buckets, that provided an opportunity for capital arbitrage. Basel I was also criticised for the fact that it only implicitly implied a specific solvency level in banks despite prescribing a specific capital adequacy level.

The advantage of the Basel I accord was that it assisted to increase the capital levels at banks. Over time a need however arisen to develop a more risk focussed approach based on the internal risk models of banks.

The Basel Committee on Banking Supervision duly obliged by launching the Basel II proposals in 2004. The Basel II proposals had three pillars focusing on the capital adequacy of banks, regulatory review and disclosure of information. The aim of the proposals was to increase the market discipline on banks.

Basel II also updated and expanded on the credit risk weighting scheme introduced in Basel I, not only to capture the risk in instruments and activities that had developed since 1988, but also to allow banks to use their internal risk rating systems and approaches to measure credit and operational risk for capital purposes (Hannoun, 2010:2)

Mostert (2003) critically evaluated the Basel II proposals and raised issues like the geographical spread of credit ratings and the sovereign ceiling on ratings in developing countries. Research has also indicated that the rating agencies tended to be pro cyclical during the Asian crisis. The methodology used to determine credit rating is also based on historical information whilst the capital adequacy of banks is more forward looking. Despite these criticisms, Basel II was a proactive step to make the regulation of the capital adequacy of banks more risk based.

The biggest concern on Basel II is its capacity to avoid further global banking crises and the ability of the international banking system to recover from such a global meltdown. The world economy was hit by such a crisis in 2007 that exposed some deficiencies in the way banks were regulated and supervised. The Basel Banking Committee on Banking Supervision decided to refine the regulations for banking supervision with the release of the Basel III proposals for the regulation of banks.

A brief overview about the proposals will now be provided.

### **3 The Basel III proposals.**

The Basel III proposals comprise of the proposals to reform the global capital framework and the proposals towards an international framework for liquidity risk management, standards and monitoring.

According to the BIS (2011:1) the Basel Committee on Banking Supervision is trying with these proposals to address the lessons learnt from the recent global financial crisis. The Committee also “aims to improve risk management and governance as well as strengthen banks’ transparency and disclosures”. The Basel III proposals also want to address the issue of systemically significant cross-border banks.

### **3.1 Capital adequacy of banks**

The erosion of the level and quality of the capital base and insufficient liquidity during the recent financial crisis caused the near demise of the banking system (BIS, 2011:1). These two factors caused a situation where confidence in the solvency and liquidity of the banking system was lost.

The Basel III proposals provide for the improved micro and macroprudential<sup>1</sup> supervision of banks.

The first set of proposals deals with the strengthening of the regulatory capital framework. According to the BIS (2011:2) the reforms raises both the quality and

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<sup>1</sup> Caruana (2011:2) defines macroprudential policy as the use of primarily prudential tools to limit system-wide financial risk, and so prevent disruption to key financial services and the economy

quantity of the regulatory base, enhances the risk coverage of the capital framework and constrains the excess leverage in the banking system. The Basel III proposal also deals with systemic risks like procyclicality and the interconnectedness of banks.

### **3.2 Liquidity of banks**

The BIS (2011:8) highlighted the fact that strong capital requirements are not a sufficient condition for banking system stability but that a strong liquidity base is as important. This was highlighted during the recent financial crisis. During the crisis, banks that were still adequately capitalized still experienced difficulties due to a lack of liquidity.

Tarullo (2011) also highlighted the fact that the doubt about the institutions' financial strength contributed to severe liquidity problems during the crises. Investors and other counterparties were not prepared to provide credit of any sort due to the lack of information on the capital adequacy of the banks. Banks were unable to roll over their short term funding. This create a liquidity crisis in the banking system.

The Basel Committee for Banking Supervision has therefore decided to formally regulate the liquidity requirements of banks. The Committee released two minimum

standards to complement the *Principles for Sound Liquidity Management* that was released during 2008.

According to the BIS (2011:8) these standards have been developed to achieve two separate but complementary objectives. The first objective is “to promote short term resilience of the banks’ liquidity risk profile by ensuring that it has sufficient high quality liquid resources to survive an acute stress scenario lasting for one month” (BIS, 2011:8). This objective is achieved by the Liquidity Cover ratio.

The scenario comprises of a significant stress, but not a worst case scenario, and assumes the following (BIS, 2011:9):

- A significant downgrade of the institution’s public credit rating;
- A partial loss of deposits;
- A loss of unsecured wholesale funding;
- A significant increase in secured funding haircuts; and
- Increases in derivative collateral calls and substantial calls on contractual and non-contractual off-balance sheet exposures, including committed credit and liquidity facilities

The second objective is “to promote the longer term horizon by creating additional incentives for a bank to fund its activities with more stable sources of funding on a structural ongoing basis”.

The Net Stable Funding Ratio (NSFR) has a time horizon of one year and has been developed to provide a sustainable maturity structure of assets and liabilities (BIS, 2011:9). The NSFR requires a minimum amount of stable sources of funding at a bank relative to the liquidity profiles of the assets, as well as the potential contingent liquidity needs arising from off-balance sheet commitments, over a one-year horizon. According to the BIS (2011:9) the NSFR would like to limit the over-reliance on short-term wholesale funding during times of buoyant market liquidity and encourage better assessment of liquidity risk across all on- and off-balance sheet items.

The two pillars of the Basel III proposals will now be critically evaluated.

#### **4 Critical evaluation of the Basel III proposals**

The Basel III proposals have been evaluated and discussed in the literature to determine the impact of the new set of regulations on the domestic and international banks.

These different issues will now be discussed.

##### **4.1 Importance of banking sector to avoid crises**

The banking sector is a key sector that needs to be regulated to avoid the severe negative impact of banking crises on the real economy. According to Walter (2011:1), banking crises leads to losses in economic output to about 60% of pre crisis GDP.

Walter indicates that the impact of a banking crisis is so severe due to the central role of banks in the financial intermediation process. Banks are also prone to liquidity runs and loss in confidence

These banking crises also have a severely negative impact on the countries in which the banking crisis occurs. In the recent crisis sovereigns had to increase their debt-to-GDP ratio by 10- 25% to stabilise the banking systems (Walter, 2011:1).

Mostert (2003) provided a detailed analysis of the reasons why banking crises occurs and the implications for the regulation of banks. Research has indicated that stability in the banking sector leads to higher levels of economic growth. This view is supported by the Basel committee on Banking Supervision (2010:1) which stated that the role of banks as financial intermediary is the foundation for sustainable economic growth

It is clear that there are potential economic benefits in increasing the resilience of the banking sector to shocks.

## **4.2 The regulatory burden of Basel III**

Concerns have been raised on the potential cost of implementing Basel III. Another concern that must be addressed is the fear that the higher capital requirements will cause banks to reduce their credit extension and in the process hamper the economic recovery after the crisis.

Walters (2011:2) highlights the fact that the Basel Committee on Banking Supervision's long-term economic impact analysis found that capital and liquidity requirement could be increased well above the minimum levels while still achieving positive net economic benefits.

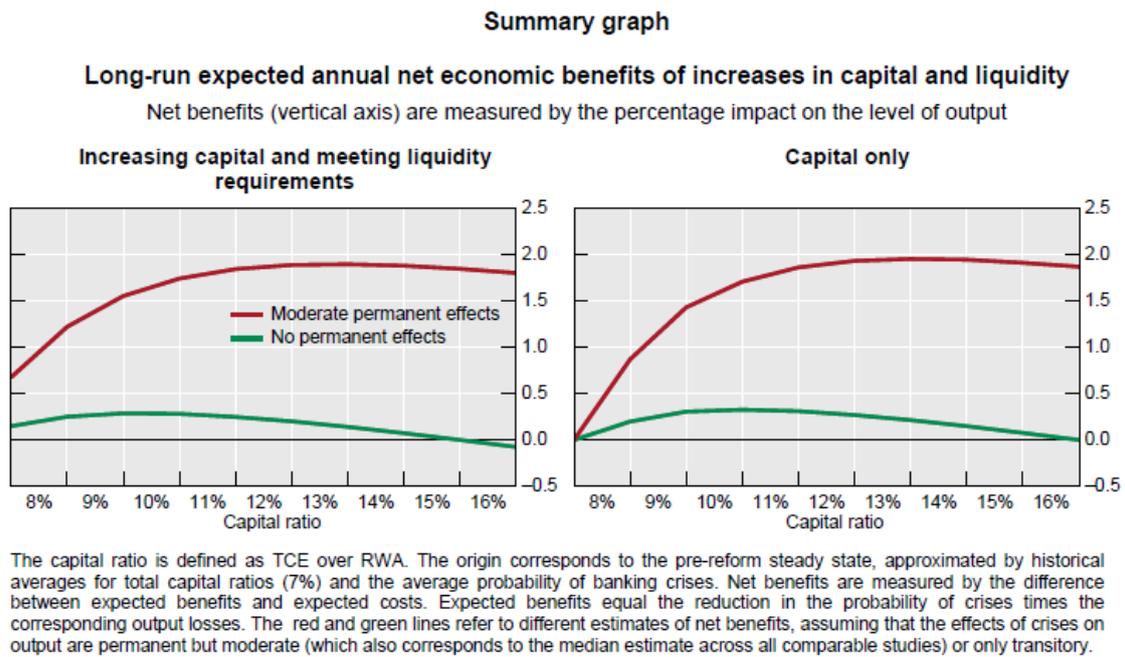
The result of the long-term impact on economic performance indicated that the new regulations will have an insignificantly small negative impact on the level of economic growth (Angelini et al 2010: vii). The research has indicated that for each percentage point increase in the capital ratio causes a median 0,09 percent decline in the level of steady state output, relative to the baseline. The liquidity regulations will reduce the output by 0,08 percent.

The Basel III proposals will also limit the effects of output volatility.

The BCBS (2010:8) conducted a study to determine the impact of the Basel III proposals on the reduction in the frequency of banking crises and the accompanying reduction in the economic cost related to economic crises.

Figure 1 indicates the long run benefits of implementing the proposed capital and liquidity standards

**Figure 1. Long-run expected annual net economic benefits of increases in capital and liquidity**



Source (BCBS, 2010:2)

From Figure 1 it is clear that the benefits occurs over a wide range of capital adequacy ratios

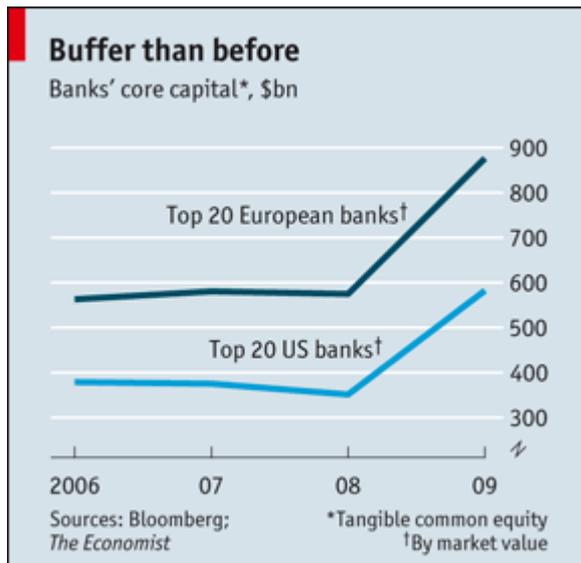
The study supports historical evidence which indicate that crises will appear in countries on average every 20-25 years, with an accompanying loss in GDP of between 20 and 100%. The impact of the crises is also felt not only in the year that the crises occurred, but also in subsequent years. Mostert (2003) provided a detailed analysis of the economic impact of banking crises that supports this study by the BCBS.

According to the Economist (2010), analysts at Barclays Capital calculated that the hit from domestic legislation alone could amount to 16% of banks' profits in 2013. Analysts at Credit Suisse reckon European banks' profits in 2012 could fall by 37% because of proposed regulation.

The Economist (2010) also highlights the fact that most banks have increased their level of capital after the crisis. This will limit the impact of the proposed Basel III in terms of raising capital.

These higher levels of capital are shown in figure 2

## **Figure 2 Level of capital at banks**



Source: Economist (2010)

From Figure 2 it is clear that the proposals will not put pressure on the banks to raise substantial levels of additional capital.

#### 4.3 The quality of capital.

The Basel III proposals explicitly make provision for more stringent definitions of the kind of capital that banks should keep. The aim of the proposal is support the banks during a crisis during which common equity be deemed to be the most loss-absorbent form of capital (Tarullo, 2011:2)

Willink (2011:1) support this notion of re-looking the quality of capital that banks should keep. According to Willink, more stringent requirements provide the necessary incentives and limits on banks risk taking.

Willink (2011:3) also notes that the strong capital base should be supported by adequate risk coverage. The biggest part of the risks of the banks should be covered by capital.

It is also important that banks still adhere to good risk management practises as highlighted in the Basel II proposals.

Hannoun (2010:3) highlighted three issues with regards to the capital equation namely the numerator in the new solvency ratios namely capital, the denominator – the risk-weighted assets and then the capital ratio itself.

In terms of the requirement for capital, Hannoun agrees that the new proposals will raise the quality of capital. Before the crisis, the amount of tangible common equity of many banks were as low as 1 – 3% when measured against risk-weighted assets, net of regulatory deductions. Hannoun also raises a concern about the complicated rules that were used to determine capital.

Figure 3 shows the concerns with the different kinds of assets during the recent financial crises

### **Figure 3 Risk-Weighting challenges**



Source Hannoun (2010:6)

The fact that banks credit losses during the crisis came directly from retained earnings and therefore common equity, highlights the importance of a high capital base.

#### 4.4 The leverage ratio

The Basel Committee on Banking Supervision also proposed a leverage ratio as part of the Basel III proposals. The leverage ratio will be a measure of a bank's Tier 1 capital as a percentage of its assets plus off balance sheet exposures and derivatives. The leverage ratio will form part of the macroprudential impact of Basel III (Hannoun, 2010:10). The concern is that leverage usually builds up before a crisis and is then unwound when the crisis occurs. This has a procyclical effect by increasing both the upswing and the downswing phase

The Basel Committee on Banking Supervision's research indicated that the leverage ratio was a highly significant discriminator between banks that ultimately failed or required government assistance and those that did not (Walter, 2011:4)

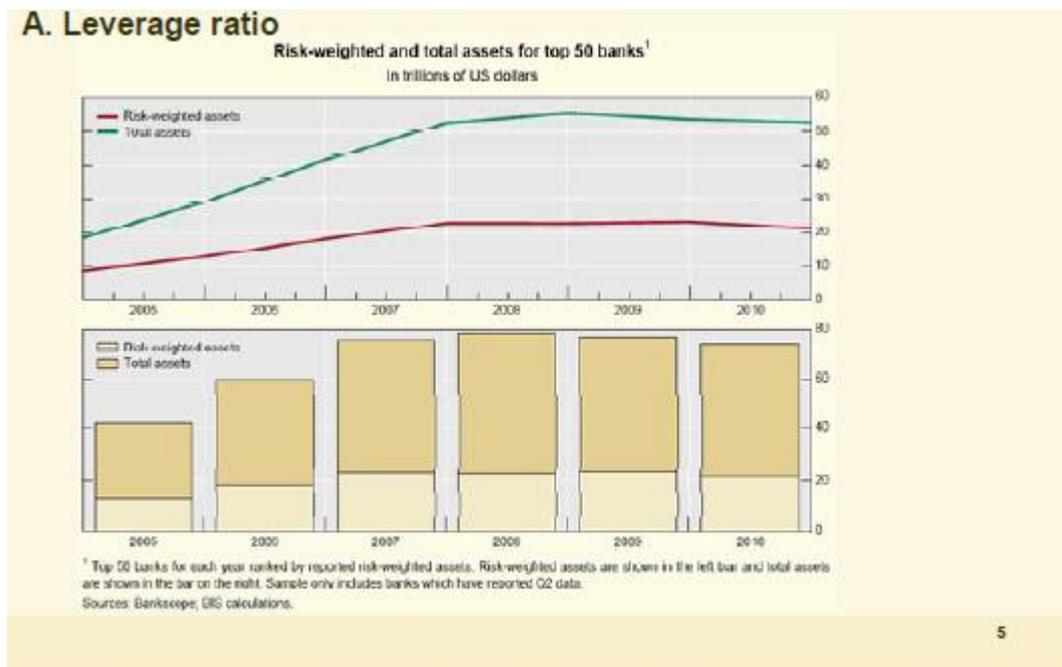
Hannoun (2010:5) supported this view that the leverage ratio will address the systemic risks in the system. According to Hannoun, seemingly low-risk exposures in one firm can create substantial threats to broader financial stability.

Another macroprudential concern is that what appears to be very low risk assets on firm level can lead to the build up of broader risks in the system. The leverage ratio will limit excessive concentrations in these asset classes.

The importance of the leverage ratio can also be deduced if the increase in total assets versus the increase in risk-weighted assets are compared in the time before the crisis.

Figure 4 shows the relative level of assets versus risk weighted assets.

**Figure 4 Risk-weighted and total assets for top 50 banks**



From figure 4 it is clear that the balance sheets of banks were leveraged. According to Hannoun (2010:10) the risk-based framework failed to capture this dynamic.

#### **4.6 Trading book and securitizations.**

Two of the areas needing enhanced risk coverage are the trading book and securitisations. The major losses during the 2007-2009 financial crises came from the trading book, especially complex securitisation exposures such as collateralised debt obligations (Hannoun, 2010:5).

Figure 5 shows the relatively low levels of capital that is held against the trading book at major internationally active banks.

**Figure 5 The Denominator: Risk Weighting challenges**



Source: Hannoun (2010:7)

To address these trading book concerns the revised framework now requires the following:

- Introduction of a 12-month stressed VaR capital charge;
- Incremental risk capital charge applied to the measurement of specific risk in credit sensitive positions when using VaR;
- Similar treatment for trading and banking book securitisations;
- Higher risk weights for resecuritisations (20% instead of 7% for AAA-rated tranches);
- Higher credit conversion factors for short-term liquidity facilities to off-balance sheet conduits and the shadow banking system; and
- More rigorous own credit analyses of externally rated securitisation exposures with less reliance on external ratings.

Hannoun (2010:6) states that these developments will eliminate the possible regulatory arbitrage between the banking and trading books.

#### **4.7 Capital conservation**

Under normal circumstances it is expected that banks will build their capital buffers during times of economic growth and to have the capital available during contractions. During the recent crises banks however continued with their practise like paying dividends, bonuses to shareholders and workers and other capital contributors.

To address this concern banks will now be expected to hold a 2,5% buffer of risk-weighted assets. The buffer must be held in tangible common equity capital. Hannoun (2010:10) highlighted the fact that supervisors can force banks to keep a higher percentage of their earnings and will impose restrictions on distributable items such as dividends, share buybacks and discretionary bonuses.

#### **4.8 Systemic risk capture in banks risk models**

The suitability of the internal risk model that banks can utilize to determine the capital adequacy has also been subjected to scrutiny during the recent crisis.

The Joint Forum (2010:1) conducted a study to determine whether the risk aggregation in Internal Risk models will perform adequately in varying circumstances, like the recent economic crisis.

According to the Joint Forum the concern is that the internal risk models were now being used for purposes they were not originally designed for (The Joint Forum, 2010:1). The models were designed originally to assess the relative risks and relative merits of different capital projects for capital allocation purposes and are being used to support capital adequacy and solvency assessments. The challenges are that these assessments require precision in measuring absolute and not relative levels of risk and reliable ways of assessing 'tail events'. This might lead to an under estimation of the capital needed. The model also lacks the granularity to measure the correlation, scope and depth of the risk.

The internal models of the banks are therefore not adequate to determine the levels of capital needed on its own.

Based on the study the Joint Forum made the recommendation to supervisors “to recognise and communicate with firms the risks posed by continued use of Risk Aggregation Models. In doing so, they should highlight the benefits of appropriately calibrated and well-functioning Risk Aggregation Models for improved decision making and risk management within the firm”.

The recommendation from the Joint Forum is supported by Hannoun. According to Hannoun the supervisors should avoid over reliance on the banks' internal models. Their supervision should be more intrusive to ensure that systemic risk and tail events are adequately captured in banks' risk modelling and stress testing (Hannoun, 2010:15).

## **5 Evaluation of the liquidity proposals**

The proposals for increasing the liquidity will now be evaluated.

### **5.1 Regulatory impact**

In South Africa it was calculated that ABSA will need to raise R300 million rand to meet the new liquidity requirement of Basel III. Concerns have also been raised about the availability of enough liquid assets in the South African money market to adhere to the new requirements.

The same concerns have been raised in more advanced economies. The Economist (2010) highlighted the concerns around the proposal to force banks significantly to cut their structural reliance on short-term funding. Credit Suisse reckons the regulators' proposed "net stable funding ratio" would require European banks to raise €1.3 trillion (\$1.6 trillion) of long-term funding. Even over the course of several years, finding enough deposits or issuing enough bonds to meet that requirement is a hair-raising prospect—not least because of regulators' parallel efforts to remove the implicit guarantee that bank creditors still enjoy

## **5.2 Calibration**

The main issue raised is not the conceptual basis of the framework but rather the calibration of the framework.

Willink (2011:3) states that the Basel Committee on Banking Supervision will ensure that the framework is calibrated properly by means of regular data collection from banks. Due to the fact that banks have received major financial support from government during the crisis, the Committee cannot only rely on data from the banks. It is also important to make a qualitative assessment.

## **5.3 Role of the central bank in liquidity crises**

Cao and Illing (2011:175) discuss the whole debate around the role of the central bank in liquidity crises. The danger is that the central bank is prepared to assist solvent banks that face a short run liquidity crisis which can lead to moral hazard.

Cao and Illing (2011:176) quotes Goodfriend and King (1988) who agreed that moral hazard can be a problem, but argues that a lender-of-last resort policy should target liquidity provisioning to the market and not to individual banks.

Buiter and Sibert (2007) are of the opinion that it is unfair to expect of banks to keep additional liquidity, because the central bank is in a position to create the liquidity at any stage

The arguments tend to imply that the proposals for liquidity were not necessary. The recent experience in the global crisis tends to indicate the opposite.

#### **5.4 Implementation of the liquidity framework**

Tarullo (2011:5) highlights the concern that the implementation of the liquidity requirement can have unintended consequences. The Federal Reserve and other banks, therefore propose a multi-year observation period before the LCR takes effect. During this period the Basel Committee can collect and analyse data to determine whether the LCR requirement should be refined. It will also be possible to determine the possible impact of the new regulations on the financial markets and the broader economy

#### **5.5 Types of liquid assets**

According to Walters (2011:4) the proposals will lead to a greater diversification of the pool of liquid assets held by banks. The liquid assets of banks currently predominantly comprise of exposures to sovereigns, central banks and zero percent risk weighted public sector entities. The Basel Committee on Banking Supervision's recent quantitative impact study showed that these liquid assets comprised more than 85% of the liquid assets held by the banks. Basel III will increase this pool to include high quality corporate bonds and covered bonds

## 6. The too-big-to- fail problem

The bank crises in the 1980's placed the regulators before a choice on how to solve the issue when big banks run into trouble. The problem reached a high with the near collapse of Continental Illinois. The debate also resurfaced during the recent recession.

The recent crises also raised the importance of systemic risk (Tarullo, 2011:1). A too narrow focus on the safety and soundness of individual firms can result in a failure to detect and thwart emerging threats to financial stability that cut across many firms (Foley, 2011:3). It is important to take a more macroprudential approach towards supervision ensuring overall financial stability.

Tarullo highlights two significant tendencies that necessitates the regulation of the Systemically Important Financial Institutions (SIFI) namely:

- The high levels of risk correlation between a large number of rolepalyers in markets that adapts quickly and where substantial amounts of leverage or maturity transformation is involved.
- The emergence of financial institutions of sufficient combined size, interconnectedness and leverage that their failures could threaten the entire financial system

The failure of Lehman Brothers during the recent financial crisis again raised the issue on how regulators should react when globally systemically important banks runs the risk to fail. This lead to the adoption of the Dodd- Franks Act in America (Tarullo, 2011:1). According to Tarullo, the Dodd- Frank requires from the Board of the Federal Reserve to establish special prudent standards for systemically important financial institutions. The one requirement is to establish more stringent capital standards for these banks.

The Basel Committee on Banking Supervision tried to address this problem by prescribing an additional loss absorbency requirement. The additional loss absorbency requirement will comprise of a progressive Common Equity Tier 1 (CET 1) capital requirement ranging from 1 to 2,5%, depending on a bank's systemic importance. To provide a disincentive for banks facing the highest charge to increase materially their global systemic importance in the future, an additional 1% loss absorbency would be applied in those circumstances

An assessment methodology has also been prescribed. The assessment methodology is based on the indicator-based approach and comprises five broad categories namely size, interconnectedness, lack of substitutability, global (cross-jurisdictional) activity and complexity.

The success of these new requirements will be determined by the impact on the reduction of the incidence and severity of future crises (Tarullo, 2011:1)

Tarullo (2011:5) mentioned five desirable characteristics for enhanced capital requirements. Firstly, the capital requirements should be calculated according to a metric that takes the size and impact of the failure of the institutions on the entire financial system into account. It is even more important to take the interconnectedness of the institutions into account. Various authors like Tobias and Brunnermeier (2009:1) tried to calculate measures to determine this interconnectedness. Tobias and Brunnermeier calculated the covar to calculate the co-movement of losses for a particular firm with those of the system as a whole.

Second, the measure should be transparent and replicable. Tarullo (2011:5) highlights the trade-off between simplicity and nuance. A balance must be found in the number of factors that will be used to calculate the measure.

Thirdly, the capital standards should be progressive in nature. Bigger firms should face more stringent capital requirements. It is however important to avoid cliff effects by ensuring that the capital requirements for the firms qualifying and not qualifying does not differ too much (Tarullo, 2011:6).

The increased capital requirements should also provide constructive incentive effects for firms to discourage systemically consequential growth or mergers.

Fourth, the requirement should be met with high quality capital. This links to the first recommendation of the Basel III proposal. The implications and advantages of a more stringent capital requirement has been highlighted in the recent financial crises.

Fifthly, the capital requirement for SIFI should be internationally congruent to avoid that local firms in one jurisdiction are in a competitive disadvantage to jurisdictions with more stringent requirements. Tarullo (2011 (b):6 also emphasises the efficacy of a Dodd- Frank type system in the international banking system. Market discipline more generally will both be increased if other significant jurisdictions have parallel authority and similar expectations on how SIFI's will be resolved.

## **7. Implementation of the Basel III proposals**

According to Tarullo (2011:7), the financial stability benefits of the Basel III reforms will be realized if they are implemented rigorously and consistently across jurisdictions. This is only the first step of implementation. A second critical step is ensuring that these standards are, in practice, rigorously enforced by national supervisors and observed by all the members of the Basel Committee on Banking Supervision.

Another challenge is the fact that banks are increasingly relying more on their own internal risk models to determine their capital adequacy. This makes it more difficult to implement the Basel III proposals in different countries. Tarullo (2011:8) highlights

the fact that American banks have much higher risk-weight than that of comparable international banks.

Willink (2011) concluded that failing to implement Basel III in a globally consistent manner could lead to a competitive race to the bottom and increase the risks to the global financial system.

It is also important that the proposals be implemented fully and in a consistent manner. According to Willink (2011:3) regulators should continue to focus on the key principles of banking supervision to support the impact of the proposed Basel III proposals.

Another important element of effective supervision is the cooperation and coordination between supervisors. It is important to regulate the cross-border activities of banks. Different supervisors should meet regularly to coordinate activities to limit the potential for regulatory arbitrage.

## **8. Conclusion**

The recent global financial crisis highlighted the importance for supervisors and regulators to ensure that banks are suitably capitalised with the correct amount and type of capital.

The liquidity crunch that occurred during the crisis showed that solvent banks can fail due to a sudden drop in the availability of capital.

It is important the Basel III proposals be implemented fully and managed properly in all Basel Committee countries to avoid regulatory arbitrage and a race to the bottom.

The new liquidity requirement will be difficult to implement due to the current use of short term finance to liquidity requirement at banks.

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