

Global Financial Reform aimed at “hard and gentle” capitalism

Combining western dynamism with eastern prudence

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Prologue --- the Myth of Sisyphus

- I have always told my students, to whom I teach monetary economics, on no account become a bank supervisor. The pay is not commensurate with the likelihood of losing your reputation. The best a supervisor can expect is not to be noticed;
- I could have added that the task of devising good and effective financial regulation is truly like the labors of Sisyphus.

‘Some New Directions for Financial Stability?’

Charles A.E. Goodhart

London School of Economics

Zurich, 27 June 2004 just after the Basel II capital adequacy standard was approved on the occasion of the BIS Annual Meeting

Sisyphus in Financial Regulation



The global financial crisis and Asia

2007 ~2010 Q2 in \$billion

source: Mizuho Securities, based on the Bloomberg database

	losses	capital raised	public money injected
World	1806	1531	695
Americas	1192	812	424
Europe	571	576	270
Asia	43	143	1

The global financial crisis and Asia

This time is different, why?

- ❑ In 1997, Asian financial institutions/regulators were blamed for their “crony capitalism” as the source of Asian financial crisis
- ❑ At that time, financial sectors of north Atlantic economies were in the process of dramatic shift from “relationship banking” to the “originate to distribute” (OTD) model, which served to bring about the “great moderation” of the global economy
- ❑ After the global financial crisis, however, the OTD model is blamed as the symbol of “greedy” or “casino” capitalism that led to the crisis

Global Financial Reform

How to make the financial system hard and gentle

“ If I wasn’t hard, I wouldn’t be alive. If I couldn’t ever be gentle, I wouldn’t deserve to be alive “

--- Raymond Chandler

“Confucius on the right hand, Abacus on the left hand”

--- Eiichi Shibusawa (Spiritual leader of the Japanese capitalism)

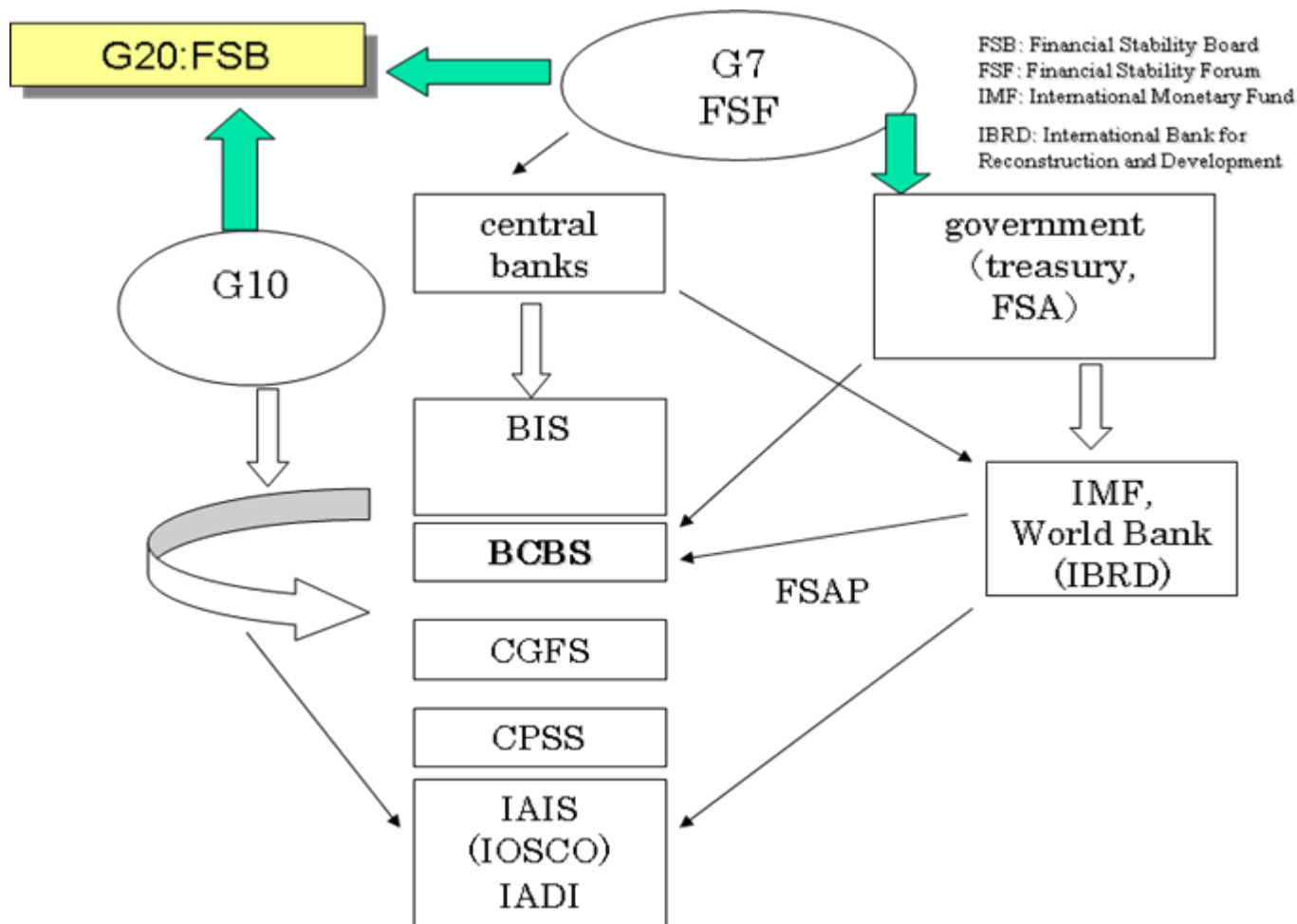
--- Abacus was the name of synthetic CDOs the Goldman Sachs created and later criticized as a symbol of toxic financial products which led to the global financial crisis

G20 and FSB initiatives aimed at strengthening the global financial system

- ❑ strengthening the quality and quantity of capital
- ❑ reducing procyclicality in the financial system
- ❑ adjusting the compensation system of financial institutions
- ❑ tougher regulation on systemically important financial institutions (SIFIs)
- ❑ IOSCO's contribution (OTC derivatives, CRA regulation)

Global co-operation aimed at “hard and gentle” financial system

From G7/FSF to G20/FSB



Basel III seeks to strengthen the quality and quantity of capital

source: Basel Committee on Banking Supervision

Strengthened capital framework: from Basel II to Basel III

In percentage of risk-weighted assets	Capital requirements							Additional macroprudential overlay	
	Common equity			Tier 1 capital		Total capital		Counter-cyclical buffer	Additional loss-absorbing capacity for SIFIs*
	Minimum	Conservation buffer	Required	Minimum	Required	Minimum	Required		
Basel II	2			4		8			
<i>Memo:</i>	<i>Equivalent to around 1% for an average international bank under the new definition</i>			<i>Equivalent to around 2% for an average international bank under the new definition</i>					
Basel III New definition and calibration	4.5	2.5	7.0	6	8.5	8	10.5	0-2.5	Capital surcharge for SIFIs?

* Modalities to be defined.

Dodd-Frank Act --- Back to basics of finance

■ Volcker Rule

- Prohibiting depository institutions' involvement in proprietary trading, hedge fund and private equity business
- not allowing a merger which would create a too big too fail financial institution

■ New regulatory framework

- Establishing Financial Stability Oversight Council (FSOC) as a systemic regulator
- Strengthening the regulatory power of the FRB including non bank FIs

■ Financial derivatives

- In principle, OTC derivatives should be cleared and settled using central counter parties (CCPs)
- Banks should conduct some derivatives transactions in a separate entity (Lincoln Clause)

■ Orderly liquidation of large, interconnected FIs

- Strengthening the role of FDIC
- Establishing Orderly Liquidation Fund

■ Others

- Rating agencies and Originators of securitised products under stronger regulation
- "Say on Pay" clause --- non-binding vote of shareholders on the remuneration of executives

Fundamental Question --- Is stability enough?

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“The key is to avoid killing the last several decades’ spirit of entrepreneurial capitalist system. At present there is a real danger that the policy prescriptions offered by a political community now infatuated with class warfare and protectionist rhetoric will end up killing the patient”

David M. Smick “The world is curved” 2009

Managing International Financial Instability

National Tamers versus Global Tigers



Fabrizio Saccomanni

Epilogue --- beyond the Myth of Sisyphus

□ I leave Sisyphus at the foot of the mountain! One always finds one's burden again. But Sisyphus teaches the higher fidelity that negates the gods and raises rocks.

.....The struggle itself towards the heights is enough to fill a man's heart. One must imagine Sisyphus happy.

--- Albert Camus "the Myth of Sisyphus"

□ In addition, I hope that each time Sisyphus gets back to the foot of the mountain, gradually but steadily, the height of the foot becomes higher.

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