Global Financial Reform aimed at “hard and gentle” capitalism
Combining western dynamism with eastern prudence

Shinichi Yoshikuni
Senior Advisor, Mizuho Securities Co.
Chairman of the International Advisory committee
Japan Securities Dealers Association
Asia Securities Forum, Osaka Japan
September 30, 2011

Mizuho Securities Co., Ltd.

Please refer to the last slide of this presentation for important disclosure and analyst certification information
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

<table>
<thead>
<tr>
<th>Region</th>
<th>Losses (billion)</th>
<th>Capital Raised (billion)</th>
<th>Public Money Injected (billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>1806</td>
<td>1531</td>
<td>695</td>
</tr>
<tr>
<td>Americas</td>
<td>1192</td>
<td>812</td>
<td>424</td>
</tr>
<tr>
<td>Europe</td>
<td>571</td>
<td>576</td>
<td>270</td>
</tr>
<tr>
<td>Asia</td>
<td>43</td>
<td>143</td>
<td>1</td>
</tr>
</tbody>
</table>
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

G20:FSB → G7:FSF

G10

central banks

BIS

BCBS

CGFS

CPSS

IAIS (IOSCO)

IADI

government (treasury, FSA)

IMF, World Bank (IBRD)

FSAP

FSB: Financial Stability Board
FSF: Financial Stability Forum
IMF: International Monetary Fund
IBRD: International Bank for Reconstruction and Development
 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

<table>
<thead>
<tr>
<th></th>
<th>Common equity</th>
<th>Tier 1 capital</th>
<th>Total capital</th>
<th>Counter-cyclical buffer</th>
<th>Additional loss-absorbing capacity for SIFIs*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>In percentage of</strong></td>
<td>Minimum</td>
<td>Minimum</td>
<td>Minimum</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>risk-weighted assets</strong></td>
<td>Conserved</td>
<td>Required</td>
<td>Required</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Basel II</strong></td>
<td>2</td>
<td>4</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Miaa:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Basel III</strong></td>
<td><strong>4.5</strong></td>
<td><strong>6</strong></td>
<td><strong>8</strong></td>
<td><strong>0–2.5</strong></td>
<td><strong>Capital surcharge for SIFIs?</strong></td>
</tr>
<tr>
<td><strong>New definition and calibration</strong></td>
<td><strong>2.5</strong></td>
<td><strong>8.5</strong></td>
<td><strong>10.5</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*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?

“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
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.
All the information contained in this presentation is based on the author’s individual views and does not necessarily reflect the views of the institution to which the author belongs whose accuracy and perfection cannot be guaranteed. Also, any views and forecast are based upon the information available at the time of its making and subject to changes according to the evolution thereafter.