Discussion of the Paper by G. Sheldon

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Accepting the goal of capital adequacy rules underlying the paper of SHELDON, BALTENSPERGER welcomes the new method of determining the capital adequacy ratio proposed by SHELDON. BALTENSPERGER finds the criticism directed at the old RAR-approach correct.

Although the proposal seems to justify a change in the regulatory approach that is in effect at the moment, BALTENSPERGER still sees three major problems connected with the new proposal:

First, agreeing with the comment by ZUBERBÜHLER he acknowledges the implementation problem.

Second, the new proposal leaves more room for cheating, i.e. for «window dressing», by the banks when calculating their capital adequacy ratios. A reason connected to this is the reliance on «in-house-models». This «moral hazard» problem makes the task of supervision much more complex.

Finally, the new proposal shares with all other capital adequacy rules a certain degree of arbitrariness by leaving open the question of how to determine the optimal probability of insolvency.

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