Summary of the General Discussion concluding Part I of the Conference

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Opening the general discussion Estrella reflected on the question of stringent fixed rules versus more flexible rules as the optimum capital adequacy regulation. Sheepeard-Walwyn questioned from today’s perspective the presumed goal of the Basle Accord to raise the average capital to assets ratio of banks. He doubted the validity of a high international competition as a driving force for a suspected undercapitalization of banks and the appropriateness of the fixed rules of the Basle Accord as a means to set the «right» incentives for the risk-taking behaviour of banks. Burghof supplemented the criticism by pointing to the rising inflexibility of regulation in the process of global harmonization not only in the markets under consideration but also in their regulation. Estrella acknowledged that the Basle Accord failed as an attempt to provide an international level playing field for banks. The diversity of market participants made this generally impossible.

Hellwig repeated his comments made at the conference three years ago: in 1988 the Basle Accord started with the answers; today scientists and practitioners start with the questions. Further, he stated that the discussion of the optimal level of capital and the optimal regulatory scheme had so far neglected the role of the cost of equity capital and the cost of the considered scheme of regulation. Analyzed in the light of the political economy, the proposition of banks to introduce a regulatory scheme with more «flexibility» seems to be an indirect attempt at deregulation as it introduces a regulatory scheme that makes any efficient regulatory control impossible. In this connection and generally the consequences of any regulatory scheme on the competitive structure of the industry has to be kept in mind. Estrella defended the proposed regulatory schemes. He pointed out that the standard capital regulation, i.e. the Basle Accord, was meant only to guarantee a minimum level of capital. This regulation should create as few distortions, i.e. changes of the intensity of competition in the market, as possible. On top of this standard regulation, any further regulation, in the sense of the precommitment approach, should try to utilize the self-interest of the banks and leave the search for the optimum level of capital to them.

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NOUY understood the previous presentations as follows: equity capital is not supposed to cover expected losses, but unexpected ones arising from different kind of risks. Apart from the capital regulation aspect, the regulation of provisions then plays a central role in the determination of the safety of any banking system. This raises the question of the optimal regulation of provisions and the respective national or international regulatory body. This aspect should not be overlooked. SHEPARD-WALWYN took up this point and acknowledged the central role of the measurement of expected losses in credit risks. Contrary to NOUY he thinks that in this area a self-regulation, i.e. an agreed standard of measurement conditions, will emerge that would require regulatory interventions only if a bank does not submit itself to this self-regulation.

Any regulation to be imposed on a bank regarding its equity is, according to SHEPARD-WALWYN, only a second-best solution and is justified only if there is a clear case of market failure. A capital adequacy regulation generating a binding level of capital for banks creates unwanted consequences by forcing the banks to take higher risks to meet the expectations of their shareholders. TERBERGER objected by pointing to the possibility that the higher equity ratio of a bank might be interpreted by the shareholder as higher safety for his investment and therefore might justify a lower expected return. Acknowledging this, SHEPARD-WALWYN came back to his point and concluded the discussion by presuming that the stockmarket today is imperfect in the sense that the investors do not have a large enough time horizon and enough information to correctly interpret the consequences of the capital adequacy regulations imposed on banks.