

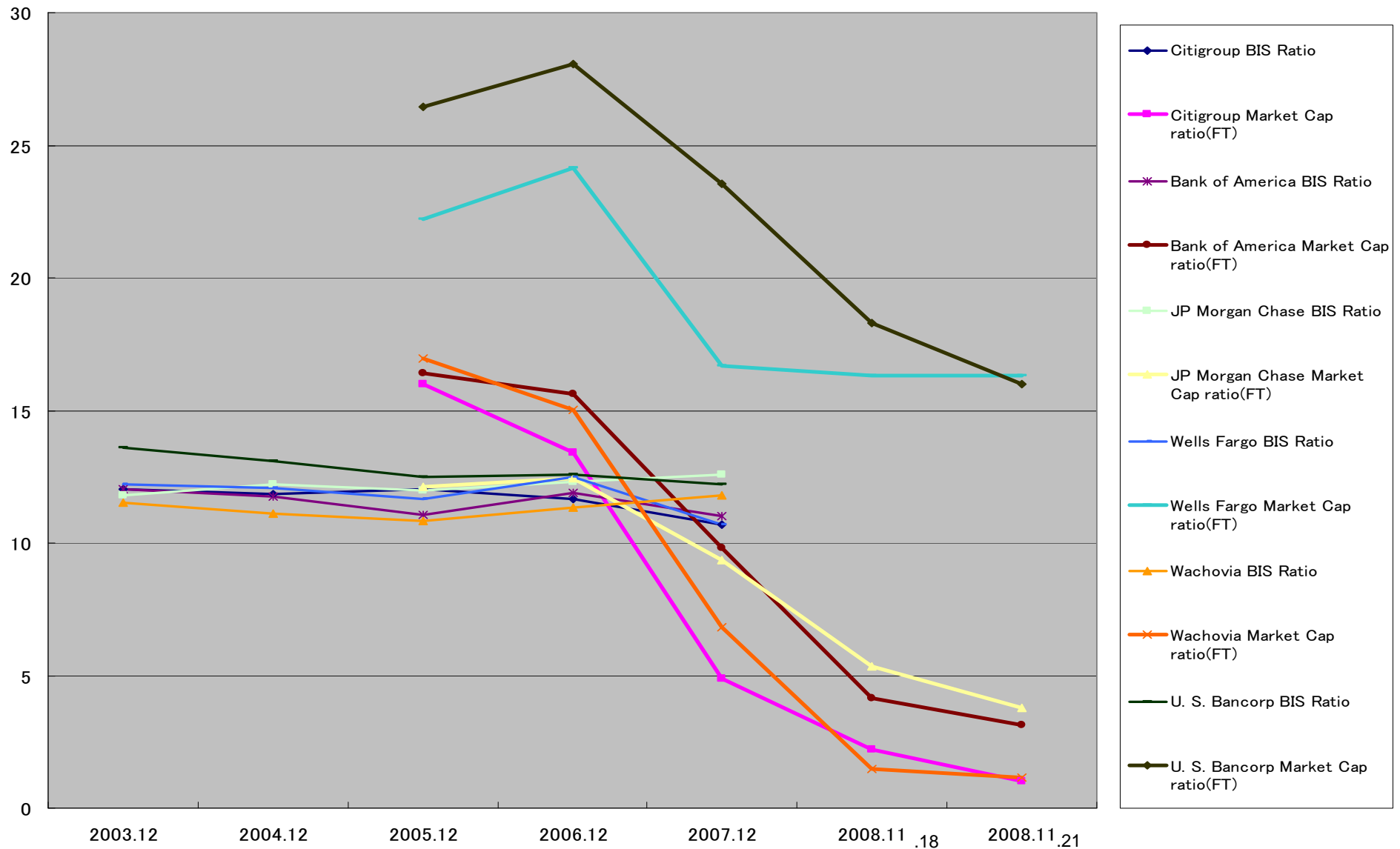
**Follow-up Report to:
Financial Technologies and
Global Regulation:
The BIS Capital Regulation as a Cause of
the Current U.S. Financial Crisis
Presented
At the MPS 2008 Tokyo**

March 7th, 2009

The MPS 2009 New York

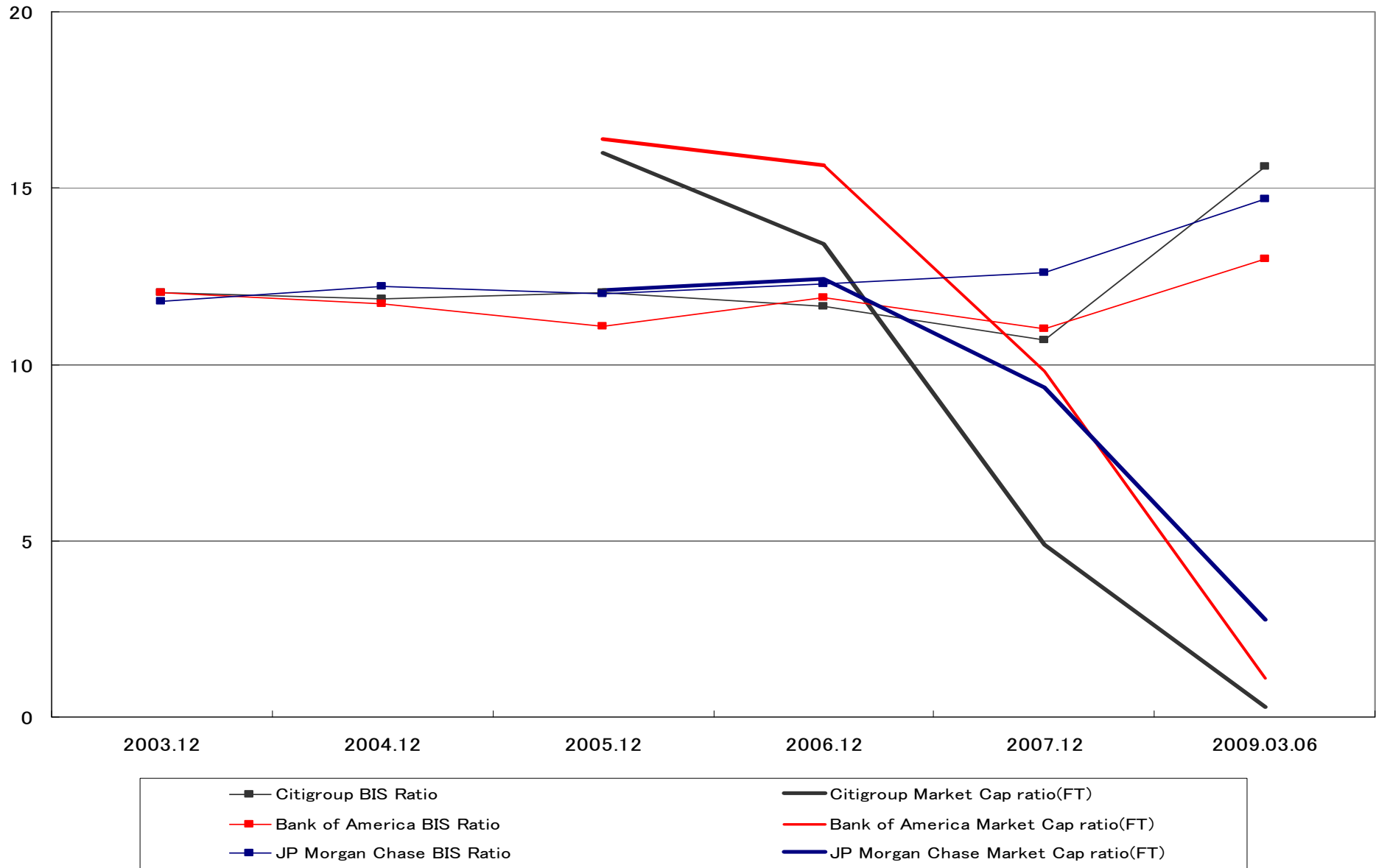
Prof. Yoshinori Shimizu
Hitotsubashi University
Tokyo, Japan

The BIS Ratio and the Market-valued Capital Ratio: U.S. Five Largest Banks

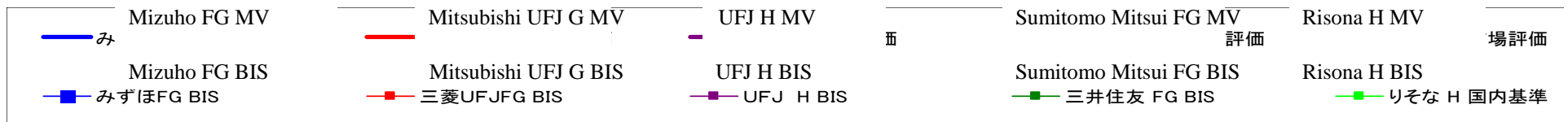
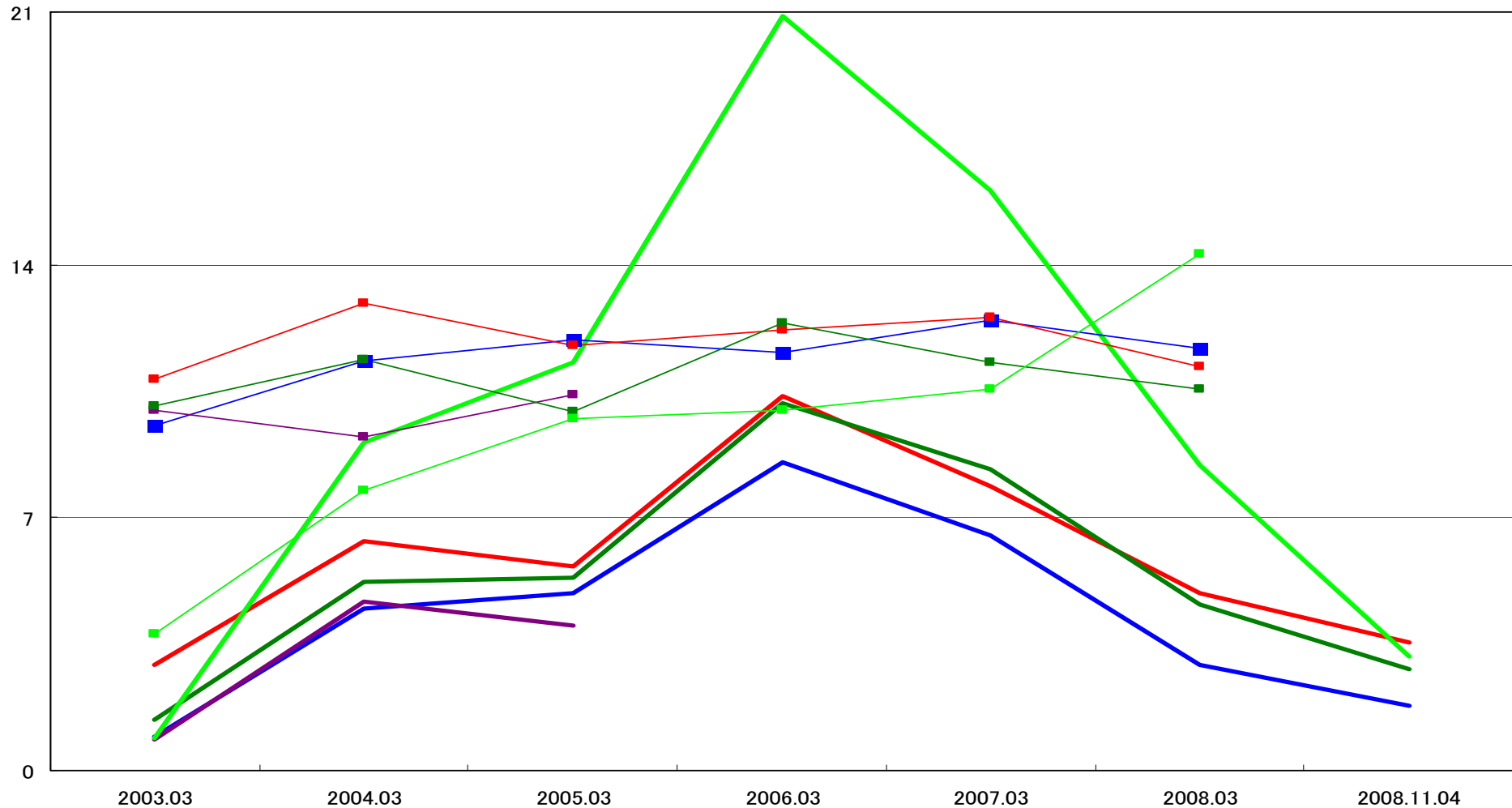


The BIS Ratio and the Market-valued Capital Ratio for the three largest U.S. Banks

(March 6th, 2009)



The BIS Ratio and the Market-valued Capital Ratio: Japanese City Banks (After March 2003)



Lessons from the Japanese Financial Crisis

1. A central bank has to watch not only price indices such as consumer price index, but also asset prices carefully as well.
Every great depression is initiated and lead by a burst of real estate bubbles. Real estate is the single largest asset for everybody.
2. A delay of couple of years to tighten monetary policy causes the worst part of speculative bubbles. The Bank of Japan failed to raise the discount rate in 1987 due to a pressure from the U.S. not to do so after the black Monday crush of stock prices in October.
Their policy to raise the discount rate delayed until after the successful introduction of the exercise tax in April 1989, due to the lack of independence from the Ministry of Finance.
This experience led to an enactment of the new central bank law to strengthen BOJ's independence.

3. A bank fails when its market-valued capital ratio falls below 2.0 due to its inability to borrow money in the market.

4. Public money injection to failed banks is not enough. A bank can be rehabilitated only after the injected money is effectively used to write off bad loans. In the case of the U.S., it is hard at this stage, since the amount of bad assets cannot be determined until real estate prices start to recover after hitting the bottom. It took a decade in Japan for this to happen.

5. The regulatory authority need to watch the use of the injected tax money and enforce a strict rehabilitation plan of a bank that accepted the tax money.

6. The U.S. should focus on measures to reschedule and lessen the burden of mortgage payments. This was easier to do in a country with bank-dominated financial market rather than capital markets.

7. A burst of housing price bubbles in the U.S. was expected to come sometime.
→ Excessive pessimism prevails when the true amount of losses is unknown.

8. Repeated fiscal stimulus packages in 1990s that amounted to one trillion dollar did not work. It simply raised the government debts to the worst in the world (170% of GDP), making Japan the country of a fiscal crisis.

9. How to stop moral hazard?

- To avoid “too big to fail”, limit the size of financial institutions to a size that allows a bank to fail when things go bad.
- Keep the competitive environment in the financial markets by having many smaller financial institutions.
- Helps to solve “Pro-Cyclical.”

The Challenge of the Current Financial System



Stop Pro-Cyclicality!

- BIS Capital Regulation (Basel II)
- Mark-to-market accounting
- Rating system
- Derivatives
- Risk evaluation based on the normal distribution
- Mega-size financial institutions in information society
→ No risk diversification + Counter party risk

**Stop and/or revise the above aspects
in a new financial regulatory system**