# Who Regulates Commercial Banks?

**<u>Bank Holding Companies and Financial Holding Companies (FHC):</u>** Federal Reserve

**TABLE 10.2 Who Regulates Commercial Banks?**

| | |
|---|---|
| **National Banks** | Office of the Comptroller of the Currency (OCC) |
| **State Banks** | |
| Members of Federal Reserve System | Federal Reserve and state agencies |
| Non-members of Federal Reserve System | FDIC and state agencies |

# Capital Requirements for Melvin's Bank

**TABLE 10.3 Capital Requirements for Melvin's Bank**

**(A) Computing Weighted Assets**

| | Assets | Weights | Weighted Assets |
|---|---|---|---|
| Reserves | 10 | 0.0 | 0 |
| Securities | | | |
| Treasury bonds | 10 | 0.0 | 0 |
| Municipal bonds | 10 | 0.5 | 5 |
| Loans | | | |
| Interbank | 10 | 0.2 | 2 |
| Home mortgages | 20 | 0.5 | 10 |
| C&I | 90 | 1.0 | 90 |
| TOTAL | 150 | | 107 |

**(B) Minimum Levels of Capital**

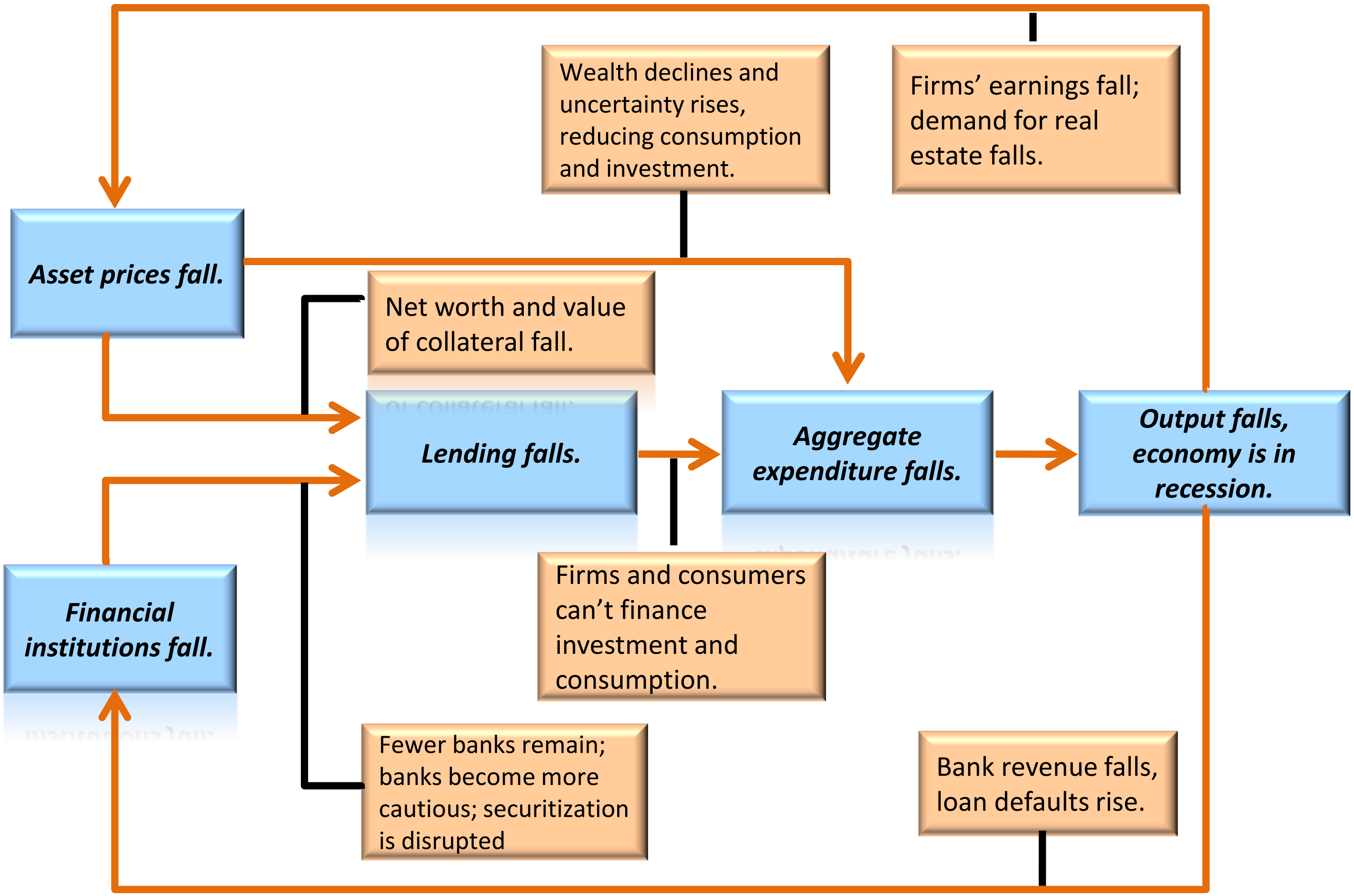
*Based on minimum equity ratio:*

$$\begin{aligned}\text{Minimum capital} &= (0.05)(\text{total assets})\\ &= (0.05)(\$150)\\ &= \$7.50\end{aligned}$$

*Based on Basel requirement:*

$$\begin{aligned}\text{Minimum capital} &= (0.08)(\text{weighted assets})\\ &= (0.08)(\$107)\\ &= \$8.56\end{aligned}$$

# Financial Crisis




A typical financial is triggered by declines in asset prices and the failures of financial institutions. A series of effects then leads to a fall in output, which reinforces the causes of the crisis.

THE
PERFECT STORM
Cold Front
Cyclone
Hurricane Grace

# 11,000 banks closed in the United States 1930-33

# Farm Bankruptcies “Fire Sales” Midwest 1930s

# Fast Forward…new


Northern Rock
Deposit Run, UK

September 2007

Bank of England
Saves the Bank

Northern Rock hit by
sub-prime mortgage
credit crisis…

# Markets Slide as Wall Street Sees Signs of Trouble
# Friday, October 19, 2007   NY Times

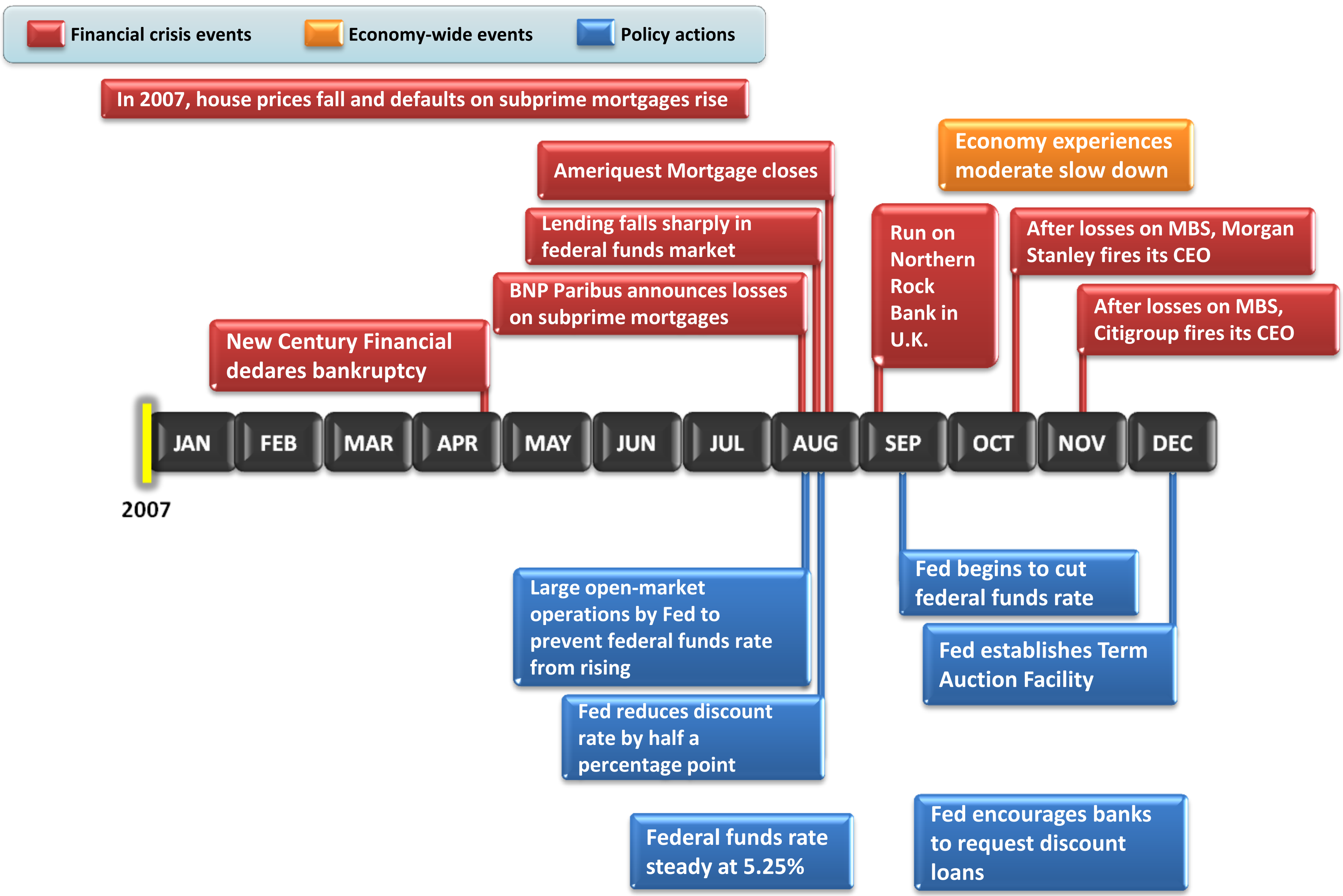
# The Human Face of Financial Crisis: Present, Past and Future

# Indonesia Riots 1998: Thousands of rioters set cars, tires, shops and homes on fire and looted

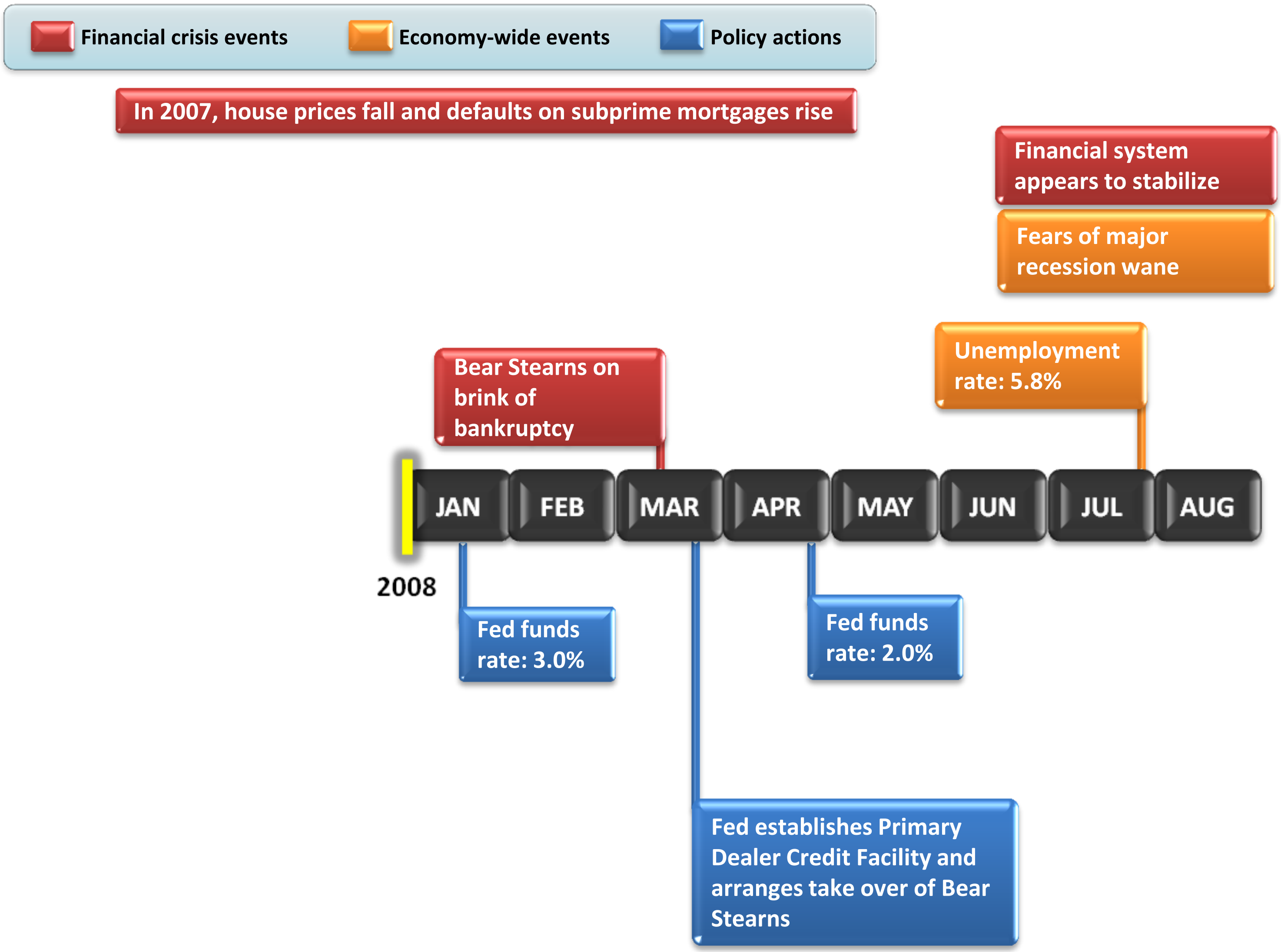
# Riding Out the Storm: Avoiding Financial Crisis

# Economists to the rescue?

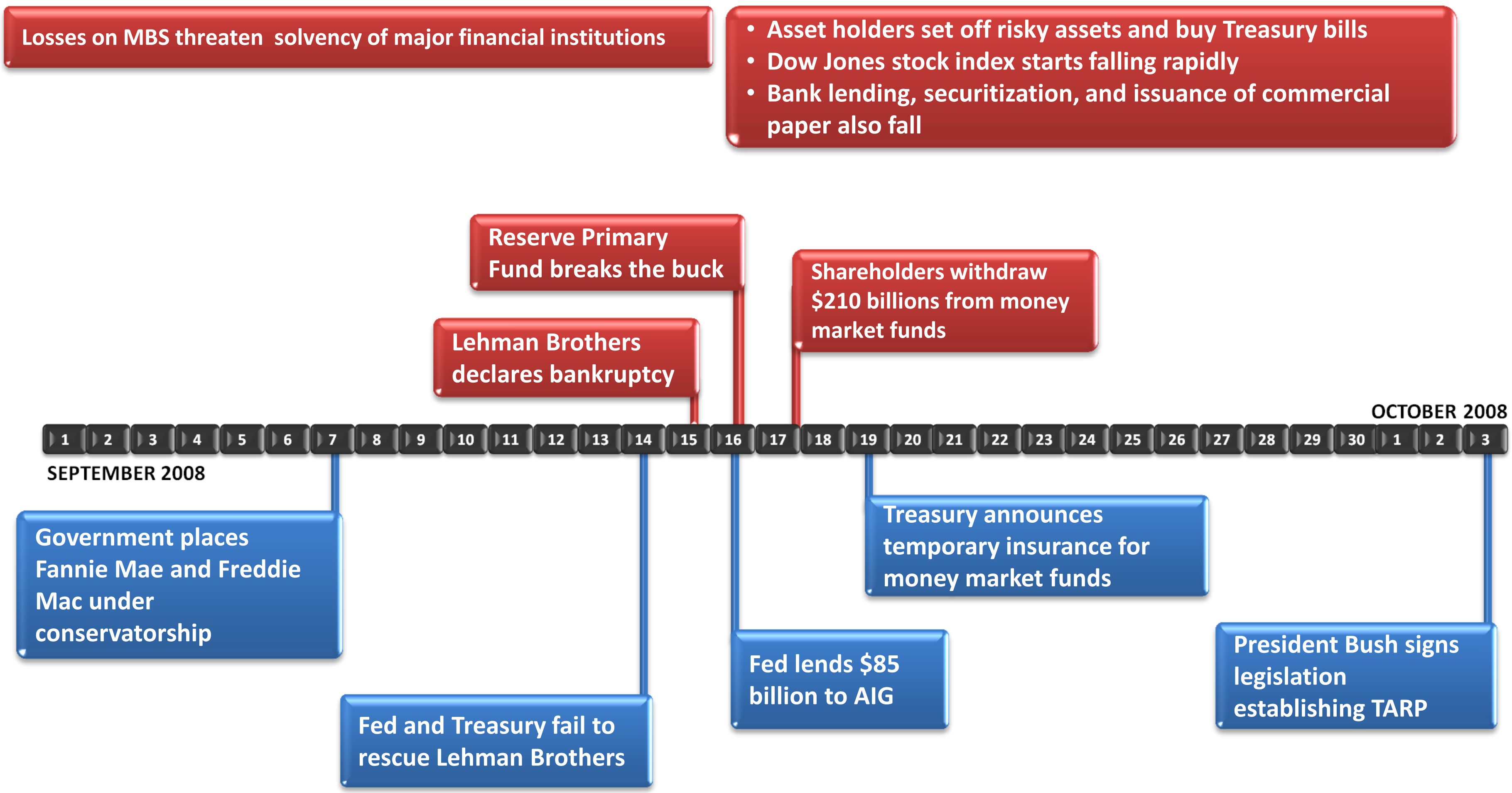
# The U.S. Financial Crisis and Its Aftermath 2007-2010



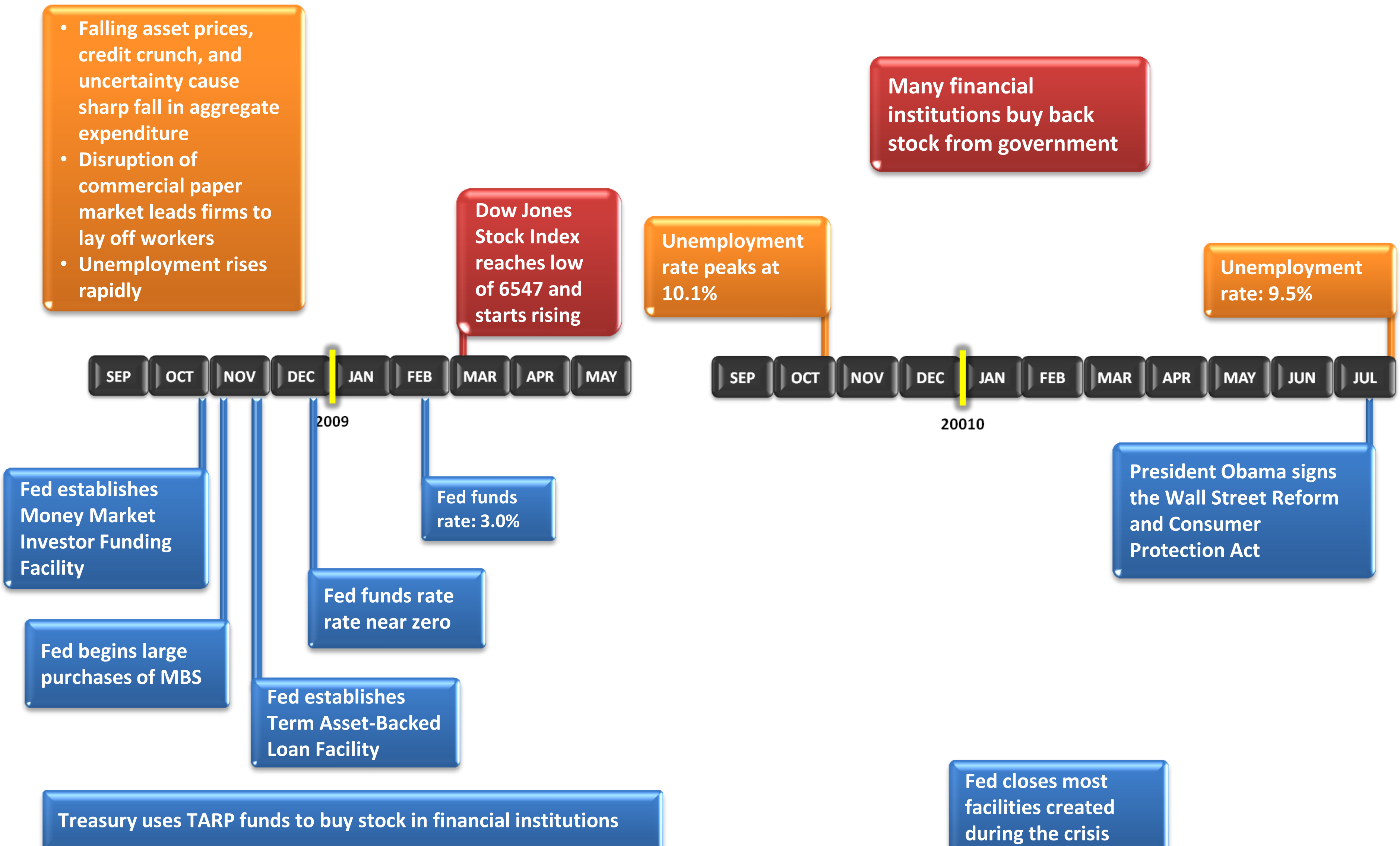
# The U.S. Financial Crisis and Its Aftermath 2007-2010



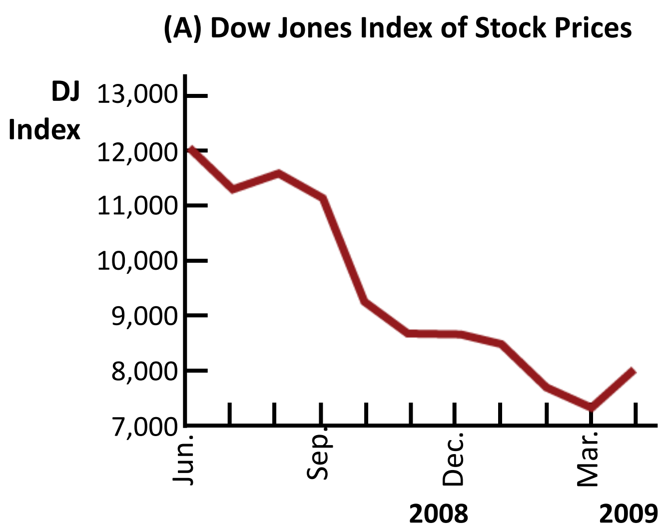
# The U.S. Financial Crisis and Its Aftermath 2007-2010

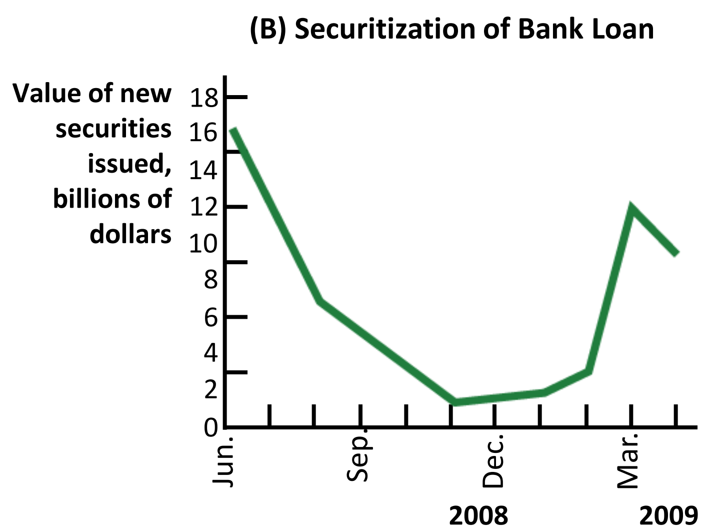


# The U.S. Financial Crisis and Its Aftermath 2007-2010



# The Flight to Safety, Fall 2008

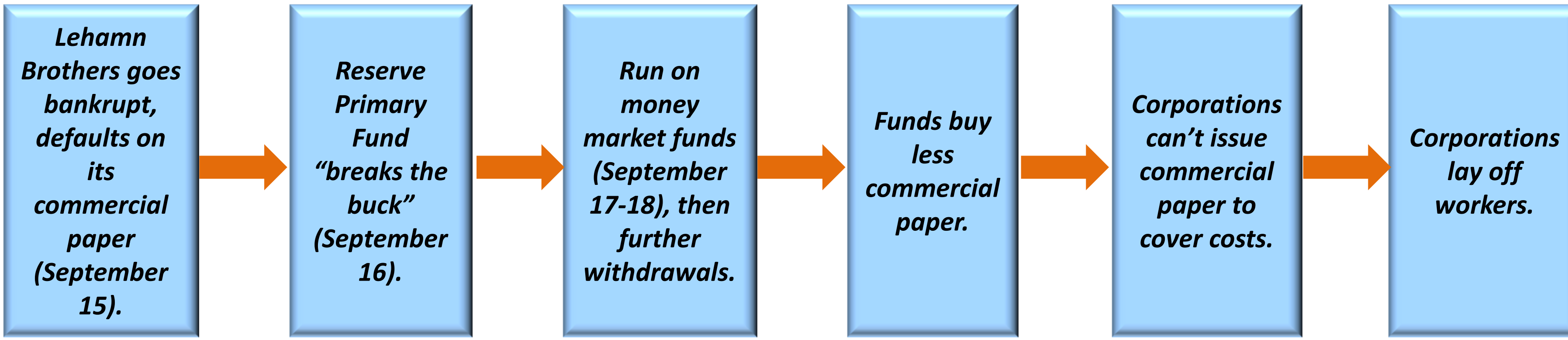



In the panic following the failure of Lehman Brothers, financial institutions dumped any assets that appeared risky, causing a sharp fall in stock prices (A), a collapse in securitization of bank loans (B), and higher interest rates on corporate bonds with moderate default risk (C). A surge in the demand for Treasury bills, a safe asset, pushed the interest rate on T-bills near zero (D).

*Source: finance.yahoo.com, Securities Industry and Financial Market Association, and Federal Reserve Bank of St. Louis.*

# The Money-Market Crisis, Fall 2008



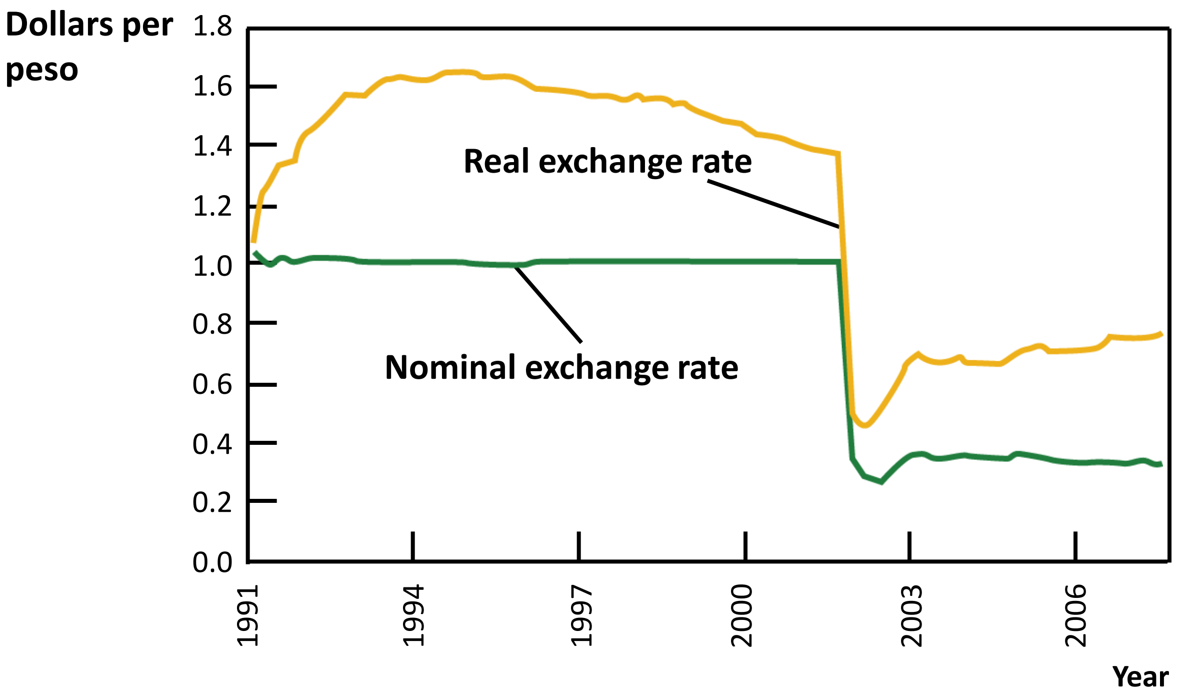

A money market fund “broke the buck” in September 2008 and triggered a series of effects that worsened the financial crisis and increased unemployment.

# Financial Reform Proposals

**TABLE 18.1 Financial Reform Proposals**

| Problem | Proposed Reforms |
| --- | --- |
| Nonbank financial institutions are insufficiently regulated. | Impose regulations similar to those for commercial banks: restrictions on assets, capital requirements, supervision. |
| | Give a government agency resolution authority over failing institutions. |
| Some institutions are considered too big to fail. | Limit size of institutions. |
| | Tie capital requirements to size. |
| | Limit scope of institutions. |
| Financial institutions have incentives to take too much risk. | Require security issuers to have skin in the game. |
| | Reform rating agencies. |
| | Restrict executive pay. |
| Multiple regulators lead to gaps in regulation. | Consolidate agencies that regulate financial institutions. |
| | Create new agency to oversee existing agencies and address systemic risk. |
| | Tighten regulation of financial holding companies. |

# Argentina's Exchange Rate 1991-2007




Starting in 1991, Argentina's currency board fixed the nominal exchange rate at one peso per dollar. Argentina's inflation exceeded U.S. inflation over 1991-1993, so its real exchange rate rose. The nominal and real exchange rates collapsed with the end of the currency board in 2002.

*Source: International Monetary Fund*