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Financial Outlook of Banks in Light of Basel III Framework

*How new capital and liquidity requirements reshape banking
strategy*

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Course

Date

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Introduction

Basel III regulatory framework has a lot of impact on the European and United States' banking sector. Basel III normally focuses on the capital and funding which are provided by the banking sector. These are to make the banking system safer by redressing most of the flaws that tend to become visible in times of crisis. It also improves the quality of capital and enhancement of liquidity management. Besides, it is a rule which specifies new capital targets and ratios, defines a core tier 1 requirement of 7% and sets new standards for short term funding and sketches out requirements for long term funding.

The Financial Outlook of the Bank in Light with Basel III

The impacts of these regulatory changes are very dire when there is no mitigation strategy which has to be put in place to rectify the situation. For instance, in accordance with the McKinsey & Company's report, the European sector will have a capital downfall of 1.1 trillion pounds and US 0.6 trillion pounds (McKinsey & Company, 2010). Besides, there will be a liquidity short fall totaling to 1.9 trillion pounds (The US will have a short fall of 0.3 trillion pounds while European 1.3 trillion pounds). Also, the long term funding ratios will also cause a short fall of 2.3 trillion in Europe and 2.2 trillion pounds in United states. These shortfalls come as banks find it challenging to achieve the technical compliance (McKinsey & Company, 2010). On the other hand, the mandatory LR which is applied to banks was considered one of the most important reforms. Basel III did fix the LR rate at 3% of Tier 1 capital. However, there are pressures for the regulators to exclude repos, export credits and sovereign bonds on credits. However, as the weakening of the standards continues, there is an increased probability that the market will be subjected to the financial crisis as well as output losses (McKinsey & Company, 2010). Therefore, the most appropriate LR rate should be set at 7% or 8%.

Corporate and Business Strategy Response to the Legislations

In response to the impacts of these regulatory measures, the banks are building their capital and funding stocks and take risks off their balance sheet so as to improve their operations. The managers have also indulged in the capital and liquidity management, business model adjustments and balance sheet restructuring process (Constancio, 2017). These will enable them to improve their liquidity hence operations. Besides, they should improve their internal control process to ensure that the financial decisions are approved by the board of directors before their actual implementation. These will prevent the managers from undertaking some risks or involving in certain fraudulent activities.

Conclusion

In conclusion, Basel III regulation tend to affect the money and good market in a negative way if the mitigation strategies are not put in place. Therefore, the managers of various banks should implement the capital and liquidity management, business model adjustments and balance sheet restructuring process so as to maintain their going on concern.

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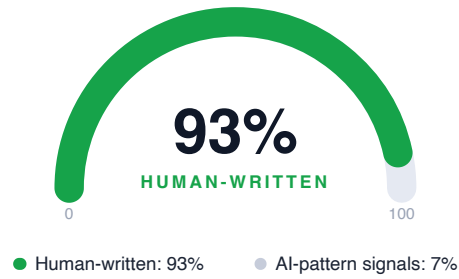
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