Thr effect of stringent capital requirement for Systemically Important Banks

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ABSTRACT

With the growing size of the interbank financial market, it has widely been argued that the capital regulation for large wholesale banks should be set more stringent than for small retail banks. The latest version of Basel Accord places high capital adequacy requirement for large financial institutions, calling them "Systemically Important Financial Institutions/ SIFIs" or "Systemically Important Banks/ SIBs". This paper constructs the general equilibrium model with wholesale bank and retail bank to discuss whether wholesale banks should face tighter leverage restrictions than retail banks. The analysis mainly focuses on the bank runs both on wholesale banks and retail banks, and the bank run only on wholesale banks. The simulations show that, in the baseline parameter settings, the probability of the bank run only on wholesale banks can be eliminated when capital adequacy requirement is placed on the wholesale banks, although the simultaneous run on both types of banks remains possible. Similarly, bank run only on wholesale banks is eliminated when the regulation is placed both on wholesalers and retailers. The drop in the price of capital is moderate with the regulation only on wholesalers, compared to the case of regulation on both types of banks, due to the smaller inefficiency. These results support the view that wholesale banks should face strict capital regulation.

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