To make banks less likely to fail, authorities in all principal jurisdictions have decided to strengthen regulation. Using the agreements in the Basel Committee on Banking Supervision as a foundation, authorities have raised capital requirements, instituted liquidity requirements and set standards for governance, risk management and remuneration. Together these measures will reduce the likelihood that banks will fail.

Less certain is the impact of various measures, such as structural reform, that individual jurisdictions such as the United States and the United Kingdom have implemented. As these measures are not coordinated internationally, they will lead to fragmentation of financial markets and reduce efficiency, without necessarily reducing risk or improving resolvability.

**Increasing capital requirements**

Capital that is immediately available to absorb loss – tangible common equity – serves as the primary bulwark against failure. This is just as true for banks as it is for non-financial firms. Banks that have a greater loss-absorbing capacity are less likely to fail. In the crisis the prevailing capital regimes proved insufficient to absorb the losses that banks incurred – despite the fact that banks maintained capital significantly in excess of the minimum requirements in force at the time.
Consequently, reforming capital requirements has constituted the first plank of the reform program. This has four aspects: (i) hardening the definition of capital, (ii) increasing capital requirements, (iii) tightening the rules determining the calculation of risk-weighted assets and (iv) introducing a leverage regime as a complement to the risk-weighted regime. Together, this means a vast increase in capital requirements (see Figure 2.1).

**Basel III hardens the definition of capital**

First of all, and perhaps most significantly, the basis for bank capital requirements has shifted towards a tangible common equity standard, or capital that is unequivocally and immediately available to absorb loss whilst the bank remains a going concern. This new standard, called common equity Tier 1 (CET1) capital, is a much tougher standard than the core Tier 1 capital standard that had prevailed under Basel II as it excludes certain items that had previously qualified as core Tier 1 capital (see Figure 2.1). Moreover, practically all