

Report on Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Jaroslav Mihok
Advisor:	PhDr. Adam Geršl, Ph.D.
Title of the thesis:	Banking supervision and regulation: Possible changes as a consequence of the global financial crisis

OVERALL ASSESSMENT *(provided in English, Czech, or Slovak):*

The thesis deals with the regulatory issues and banking supervision on the financial risks. It is an interesting summary of the legislative and regulatory acts, reports and research made in the area of financial risks and especially focuses on the origins of the financial crisis.

The scope and theme of the work is relevant and actual and author shows to have some knowledge of the recent literature. However, I strongly miss more formal description of the regulatory principles or some other original work.

I strongly miss some Basel II overview, explanation of expected and unexpected losses and their difference. I also do not agree with some of the statements, although I know, the author has taken them from existing literature and various reports and analyses. Author does not mention at all the estimation of unexpected losses through the Merton model, which leads to the Vasicek's distribution, he also does not mention the most critical part of the capital requirement (resp. the risk weighted assets) computation-the correlation of defaults. It can be shown, correlation above very low levels around 5% are lethal for almost anybody. I am also not sure about the pro-cyclicality and counter-cyclicality of Basel II measures and what is the desired state. Author describes some ways of allowing banks to lower the capital requirement in the economic downturn and their obligation to keep it high in economic upturn.

The first problem which the bank faces in case of trouble is probably the problem with liquidity. When this happens, the bank can use the most liquid capital held as Tier I, but the core of the problem is somewhere else - in the high losses. Even if I get rid of the liquidity problems, I will suffer loss. When the losses are too high, the bank would get to red numbers no matter of the capital requirement. Capital requirement I consider only as a buffer against the temporary problems with liquidity. The real burden of the portfolio management lies on the scoring processes, not on the right definition of capital adequacy. In my opinion, the more will be the computation of capital requirement complicated the worse. Capital adequacy seems to me to be a kind of fetish, not very probably preventing any bank from bankruptcy, especially when the correlation of defaults starts to grow.

The problem with the sub-prime mortgages was not primarily in bad estimation of the probability of default. The main issue was rather with underestimation of LGD caused by the general overestimation of the price of collaterals or other risk mitigants. This can be prevented by stress testing the price of all the collaterals.

Author mentions all the relevant causes of the financial crisis including the CDSs, asymmetry of information, moral hazard, monetary policy of cheap money and governmental support of mortgage for everybody. I assume, if the credit risks were treated correctly and diligently, the problem would never escalate to such a huge extent. By my opinion Basel II is generally sufficient for non-investment banking, but it is very dangerous to let the banking supervision and regulation be subject of political or individual interests.

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There are some mistakes and spelling errors, however it is not of an exceptionally high frequency. Anyway, if the author wish to continue in his work, I recommend to read the text again and get rid of these mistakes and errors.

I consider the work fully competent and interesting, showing the author's ability to write a profesional economic text. On the other hand I miss some important parts of the current regulatory framework and original work that would be something else than combining various literature sources and describing the problems in own words. I would welcome some original and specific proposals of regulatory improvement.

SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY	POINTS
<i>Literature (max. 20 points)</i>	20
<i>Methods (max. 30 points)</i>	15
<i>Contribution (max. 30 points)</i>	28
<i>Manuscript Form (max. 20 points)</i>	18
TOTAL POINTS (max. 100 points)	81
GRADE (1 – 2 – 3 – 4)	1

NAME OF THE REFEREE: Pavel Doležel

DATE OF EVALUATION: 6.9.2011

Referee Signature

EXPLANATION OF CATEGORIES AND SCALE:

LITERATURE REVIEW: *The thesis demonstrates author's full understanding and command of recent literature. The author quotes relevant literature in a proper way.*

Strong	Average	Weak
20	10	0

METHODS: *The tools used are relevant to the research question being investigated, and adequate to the author's level of studies. The thesis topic is comprehensively analyzed.*

Strong	Average	Weak
30	15	0

CONTRIBUTION: *The author presents original ideas on the topic demonstrating critical thinking and ability to draw conclusions based on the knowledge of relevant theory and empirics. There is a distinct value added of the thesis.*

Strong	Average	Weak
30	15	0

MANUSCRIPT FORM: *The thesis is well structured. The student uses appropriate language and style, including academic format for graphs and tables. The text effectively refers to graphs and tables and disposes with a complete bibliography.*

Strong	Average	Weak
20	10	0

Overall grading:

TOTAL POINTS	GRADE		
81 – 100	1	= excellent	= výborně
61 – 80	2	= good	= velmi dobře
41 – 60	3	= satisfactory	= dobře
0 – 40	4	= fail	= nedoporučuji k obhajobě