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The Impact of Basel III on Malaysian Stock Performance

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ABSTRACT

The introduction of new capital requirement by the Basel committee has positive and negative impacts on banking stock prices. Previous studies on Basel Accord's minimum capital requirement on various countries have shown mixed results in the stock returns during the announcement date. This paper examines the impact of Basel III announcements on Malaysian banking stocks' returns. Findings showed that investors viewed the implementation of new regulation as bad information and would reduce the banks' stock prices.

Keywords: Basel III, Bank, Malaysia, Stock Returns

INTRODUCTION

Global financial crises have led to huge losses to the economy. Most economic recessions were mainly due to the crash of financial system. Most financial crises are associated with banking panics (early 1900's), stock market crashes (1929), financial and asset bubbles (2008), and currency crises (1997), or a combination of these reasons. Not only does the financial sector suffer a huge loss, it will also have a global consequence. The Basel Accord was designed with the primary goal of making capital requirements reflect bank risk exposures. More credit risks would require an appropriate amount of additional capital to keep the banks' default probability low. The introduction of capital adequacy rules strengthens bank capital and improves banks' resilience against negative shocks. This paper aims to explore whether Malaysian banks are influenced by the announcements of Basel Accord.

Banks are vital for a nation's economy. Success of the banking sector contributes

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towards a country's economic growth, financial stability and development. Nevertheless, the collapse of banks during financial crisis could worsen an economic recession. With the advent of globalisation, cross-border banking activities are increasing every day. The need to standardise the global bank regulations to provide guidance on banking rules and create a fair and competitive platform are crucial. The Basel Committee on Banking Supervision (BCBS) was established by the central bank governors of the Group of Ten (G10) countries in 1975. BCBS consists of representatives from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States. The committee members set down a consensus on the common minimum capital standard for banking industries. Minimum capital requirements are put in place to ensure banking institutions have sufficient capacity to undertake the intermediation function necessary for the development of the economy. A bank that has a better control on their capital is able to allocate more resources to expand their business to compete in a global level.

Basel I & II

There were several bank failures from 1965 to 1981. Banks throughout the world were lending extensively, while countries' external indebtedness was growing at an unsustainable rate. As a result, the potential for bankruptcy of major banks grew. In order to avert this, the Basel Committee on Banking Supervision drafted a document to set up an international minimum amount of capital that banks should hold. This minimum is a percentage of the total capital of a bank, which is also called the 'minimum risk-based capital adequacy'. In 1988, the Basel I Capital Accord (agreement) was created. The accord contains a capital requirement of 8% based on the risk weighted assets and a minimal 4% high quality capital, which is also known as Tier-1. The accord was only focused and implemented on the credit risk. It took many years before the first accord was established. This was due to several factors such as, international political disagreements, different accounting standards and lack of necessity within the financial market for such an accord.

The introduction of risk-based Basel capital requirements for financial institutions is to protect the firms, their investor and customers and the economy as a whole. It intended to offer banks a space to avoid straightly regulation. If the risk exposure of the banks is reduced, they will able to reduce their cost of holding the capital sources of funds. Thereby, the main objective of Basel capital requirements is to control bank risk taking. The motivation behind the implementation of Basel I was described

as increasing the regulatory control over bank risk exposure and improve the safety of the banking system by encouraging the safe bank to grow faster and risky bank to grow slower (Keeton, 1989).

Quantitatively, Basel I did not reflect the true risk profile of a bank. Basel II is the second rendering of Basel accord. It was introduced in 2004 due to the inadequacies of Basel I. Basel I focused more on credit and market risks. In Basel II, BCBS have expanded the risk to include a specific operational risk component in banks' capital ratio. The objectives of Basel II were to improve banks' risk management system, ensure a better support of regulatory capital to underlying risk and enhancement of disclosure requirements, as well as ensure that the banks' risk is quantified based on the approach provided. The Basel II framework focused on the three pillars concept: 1) minimum capital requirement, 2) supervisory review, and 3) market discipline. The first pillar required banks to maintain a minimum level of capital to cover the credit risk, market risk and operational risk. The second pillar was related to the control of banks' capital relative to their risk, the supervisor review and corrective process. The last pillar aimed to improve the discipline in the marketplace by increasing the banks' risk disclosure.

Basel III

Basel III is one of the most important reforms to have emerged from the 2008 financial crisis. It was introduced in September 2010 to promote: 1) bank capital adequacy, 2) stress testing, and 3) market liquidity. Basel III aims to: a) improve the banking sector's ability to absorb shocks arising from the financial and economic stress, b) strengthen the risk management, and c) promote the banks' transparency and disclosures. It is scheduled to be gradually introduced from 2013 until 2019. In addition to the capital requirement of former Basel II, Basel III introduces the short-term Liquidity Coverage Ratio (LCR) to maintain banks' short term cash stability.

Basel III requires banks to hold 4.5% of common equity up from 2% of Basel II. It also requires banks to maintain 6% of Tier I capital (compared to 4% in Basel II), as well as a newly introduced buffer of 2.5 per cent. The purpose of the conservation buffer is to ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. While banks are allowed to draw on the buffer during such periods of stress, the closer their regulatory capital ratios approach the minimum requirement, the greater the constraints on earnings distributions. The Basel Committee has outlined phase-in arrangements outlined as Table 1 below.

TABLE 1
Basel III Phase-in arrangement

Phases	***2013***	***2014***	***2015***	***2016***	***2017***	***2018***	***2019***
Capital							
Leverage ratio	Parallel run 2013 - 2017					Migration to Pillar 1	
Minimum common equity capital ratio	3.50%	4.00%	4.50%				
Capital conservation buffer				0.625%	1.25%	1.875%	2.50%
Minimum common equity plus capital conservation buffer	3.50%	4%	4.50%	5.125%	5.75%	6.375%	7%
Phase-I of deduction from CET1*		20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital	4.50%	5.50%	6%				
Minimum total Capital	8%						
Minimum Total Capital plus conservation buffer	8%			8.625%	9.25%	9.875%	10.50%
Capital instruments that no longer qualify as non core tier 1 capital or tier 2 capital	Phased out over 10 year horizon beginning 2013						
Liquidity							
Liquidity coverage ratio - minimum requirement			60%	70%	80%	90%	100%

The proposed changes in Basel III include a new definition in capital requirement to improve the quality, consistency, and transparency of capital. The three types of capital components in Basel III are: a) common equity tier-1, b) additional tier-1 capital, and c) tier-2 capital. To have a closer demarcation of capital, common equity tier-1 instruments should be predominantly in the form of common shares and retained earnings. The additional tier-1 capital should include instruments that are issued by banks that meet the criteria for inclusion in additional tier-1 capital (which are not included in common equity tier-1). The tier-2 capital aims to provide loss absorption on a going-concern basis such as general provisions, revaluation reserves and undisclosed reserves. The liquidity coverage ratio (LCR) is an important part of the Basel III. It defines how many liquid assets have to be held by financial institutions so that they possess sufficient high-quality liquid assets to cover net liquidity outflows during a 30-day period of stress.

For the last two decades, Malaysian banking systems have experienced a deep transformation under the pressure of

financial liberalisation, international capital flows, technological developments and financial innovations. The Asian financial crisis in 1997 played a meaningful role in the process. The Malaysian financial system has emerged stronger and more competitive since the Asian financial crisis. The Malaysian banking sector consists of Bank Negara Malaysia (the central bank of Malaysia), conventional banks, Islamic banks and investment banks. In Malaysia, conventional and Islamic banking systems coexist and operate together. In this study, commercial banks are the focus of the research as the Islamic and investment banks operate on a different set of rules of engagement and capital volume. The main functions of commercial banks are to provide credit facilities, trade finance services, treasury services, cross-border payment services, hire purchase and leasing activities. There are a total of 8 local commercial banks in Malaysia: Maybank, CIMB Bank, Public Bank, Hong Leong Bank, Am Bank, RHB bank, Affin Bank and Alliance Bank (in the increasing order of market capitalisation). This study examined the returns on stocks of Malaysia Banking Sector around the announcement period of Basel III. With the stringent requirement of Basel III, it is expected that the banks' profitability would be affected as some funds would not be able to be used due to strict Basel III requirements. Even though the impact of Basel III is not immediate (i.e., banks will be given some time to implement Basel III requirement), it would be interesting to see its impact on banking stocks.

LITERATURE REVIEW

The minimum capital requirement was introduced by the Basel committee to ensure that banks would have sufficient resources to operate securely. However, it could be detrimental to the competitiveness of the banking industry. If banks are required to maintain an equity position in excess of what it would hold voluntarily, they might put constraints on their operations. It has been argued that the new regulations generally lead banks to set aside higher amounts of capital. Nevertheless, at least in the U.S., part of the increase seemed to be attributable to capital arbitrage (Juliusz, 2009). The implementation of Basel III strengthens the resilience of the global banking system. However, even with this new framework aimed to increase liquidity to improve the quality of capital to cover risks, the integrated risk approach cannot exclude the future emergence of other classes of vulnerabilities in the financial and banking systems (Vasile & Costin, 2012).

Several studies have examined the effects of announcements on banks' share prices. The evidence from event studies on the stock market reaction to announcements of the introduction of Basel requirements is generally mixed and does not indicate an overwhelming reaction one way or the other regarding the expected effect on profitability. Using an event study methodology, Eyssell and Arshadi (1990) find significant negative abnormal returns for three events preceding the imposition of risk-based capital requirements. The announcement of regulatory changes is

viewed by the capital market participants as generally unfavourable. Furthermore, those banks most likely to be affected are those whose capital ratios were deficient at the time of the announcements, suffered the greatest value losses (Eyssell & Arshadi, 1990). In their study, they analysed the effects of a series of announcements being made on the equity share prices of large banks in Canada, Japan, the UK, and the US. They found a significant decline in equity returns for U.S., Canadian and U.K. banks in response to news announcements, with U.S. bank stocks exhibiting the largest negative reaction. For Japanese banks, the equity return results are mixed. This may be due to uncertainty among investors regarding the handling of their sizeable hidden reserves under the new risk-adjusted capital rules. In another study on the period corresponding to the Basel conferences, evidence indicates that the market had already impounded information regarding risk-based capital requirements in bank stock prices (Cooper *et al.,* 1991).

Typically, banks tend to use the least cost to meet the regulatory capital requirement (Jackson *et al*., 1999). During Credit crisis and economic recession, the cost of issuing an additional capital may become prohibitive. Hence, banker may meet their capital requirement by restricting lending. When the bank's net interest margin is reduced by the implementation of tight regulation, the bank will likely hold less capital. This restricts the loan supply to the economy. This circumstance is called "bank capital financial accelerator", which transmits monetary policy to the banking sector's level of credit creation (Chami & Cosimano, 2001). When regulatory capital requirement increases, banks are less likely to restructure the troubled loans, which will increase the cost of lending. This will eventually lead to a drop in the demand of bank loan (Thakor & Wilson, 1995). In a more recent study by Biase (2012), who examined the impact of Basel III on bank lending rates in Italian banks, it is concluded that the long-term impact of heightened capital requirements on bank loan rates is likely to be modest.

Chiuri *et al*. (2002) used international data from 15 emerging countries (Argentina, Brazil, Chile, Hungary, India, Korea, Malaysia, Mexico, Morocco, Paraguay, Poland, Slovenia, Thailand, Turkey and Venezuela) to test whether the implementation of Basel accord causes credit to contract. In their study, they found that for countries which have enforced the Basel accord capital requirements, retrenchment in the supply of bank loans has negative impacts on the aggregate level of its real economic activity. Al-Hares *et al.* (2013) conducted a more recent study on Gulf Cooperation Council (GCC) region to compare the financial performance of conventional and Islamic banks. The results revealed that Basel III capital standard requirements are on average have produced less efficient Islamic bank but more profitable, more liquid, more solvent and enjoyed higher internal growth rates than conventional banks.

Avery and Berger (1991) studied the impact of Basel I on the leverage

requirement in the US during the 1980s. They found that the introduction of risk based capital requirement had increased the capital standards for large banks more than small banks. Basel Accord minimum capital requirements are only one of the options used by the regulators to control bank risk taking. During the pre-Basel capital requirement, the bank's profitability, risk preferences and initial capital position are the criteria to decide whether a bank should increase or decrease its incentive to hedge the risk exposure (Morgan & Smith, 1987). A study conducted by Jaseviciene and Jurksaityte (2014) in commercial bank of Lithuania suggested five statistically significant variables that have impacts on banks' capital adequacy changes: the influence of management, the bank's size, return on assets, assets weighted by risk assets ratio and all assets ratio and asset growth. Bank management decision factor by far has the largest impact (negative) on the capital adequacy in view of the conditions existing in the market. The influence of the size of the bank on the capital adequacy ratio once again proves how important in the Lithuanian banking sector is systemic risk management.

Except for Belgium and Scandinavia, the volatility of banks' equity for most European countries is following on the introduction of Basel I in European countries (Ford & Weston, 2003). Before the implementation of Basel I, the risk adjusted return for these countries was very high. This suggests that these banks were originally undercapitalised relative to the risk exposure in the pre-Basel Period. Before the introduction of the Basel Accord, a pre-Basel capital requirement was implemented by central bank to limit the bank risk taking. The cost of recapitalisation is one of the themes in the banking system's feedback to risk based capital requirement (Stolz, 2002). A study by Krainer (2002) links the risk based capital requirements of Basel accord to the agency conflict between the bank creditor and depositors.

Minimum capital requirement is only one of the components of bank regulations. A study has been done on international banks to differentiate the impacts of capital requirements and individual country specific factors (Allen & Rai, 1996). Two opposing effects were found. One indicates a positive relationship between banks' risk and capital levels while the other indicates a negative association. For banks with stronger safety nets, their risk increases as they reduce their capital levels. However, in countries with inadequate safety nets, banks normally increase their capital levels (thereby reducing risk) in order to maximise bank's charter value. The increase in the cost of raising the capital could inhibit an already constrained bank from complying with the new capital requirement. Consequently, banks increase their capital ratio by lowering the size of the loan portfolio and moving towards lower risk securities such as government bond and treasury bills to lower the capital requirement (Laderman, 1994). On the contrary, Hancock and Wilcox (1994) found that capital deficient banks move their portfolio toward high risk assets. Calem and

Rob (1996) discovered that the relationship between bank risk and capital requirements is a U-shaped function of the initial capital position of the bank. Reducing the risk will help the undercapitalised banks to avoid insolvency while well-capitalised banks tend to increase the value of their equity by taking on higher risk equity.

METHODOLOGY

This study investigated the effects of capital standards by examining the profitability or market reaction on the banking industry, following the imposition of new capital standard requirements, Basel III. The event study method was used to investigate the effects of the Basel accord on banks' share prices. An event study is concerned with the impact of an event on corporations. If an event has an impact on the value of a firm, it will be reflected in the firm's security prices, manifesting it in abnormal security returns. In order to appraise the impact on the banking sector, the effects or abnormal return resulting from the Basel III announcement were measured via an event study.

The sample includes the common equity of all Malaysian banks which common shares are traded on Kuala Lumpur Stock Exchange Main Board. The daily stock prices of the banks, during the announcement period and a 120-day estimation period prior to the date (of the first public announcement), were selected. The banks which have at least one price missing is eliminated from the consideration. The final sample included 7 major local banks in Malaysia, as listed in Table 2 by order of asset size and market capital.

TABLE 2
Sample of Malaysia Banks

Local Banks	Asset Size (RM Bil)	Market Cap (RM Bil)
Malayan Banking Berhad	330.9	62.1
CIMB Bank Berhad	264.9	58.5
Public Bank Berhad	222.6	45.3
AmBank Berhad	127.2	18.3
RHB Bank Berhad	94.8	16.2
Affin Bank Berhad	46.2	4.8
Alliance Bank	31.2	4.5

The daily abnormal returns were calculated in the periods surrounding three regulatory announcements related to the imposition of higher global minimum capital requirements. The first event was on 12 September 2010, during which the announcements of a substantial strengthening of existing capital requirements and introduction of global liquidity standard of Basel III were made. The second event was on 14 December 2012, when the report on the progress of Basel III implementation was presented. A large number of countries intended to introduce the new capital requirements in 2013. A brief description of these announcements is listed below.

TABLE 3
Announcement dates of the important events on Capital requirement

Important event in the change of Capital requirement

Event no.	Event Date	Description
1)	12-Sep-10	Group of Governors and Heads of Supervision announces higher global minimum capital standards.
2)	14-Dec-12	Implementation of the Basel III Framework

A market model approach was used to obtain abnormal returns in the weeks surrounding these announcements. Abnormal return is a return over a period of time that is different from the expected rate of return under the consideration that the event had not taken place. Mathematically the abnormal return is expressed as:

$$AR_{it} = R_{it} - E\,(R_{it}|X_t) \quad 1)$$

where,

i = i^{th} bank
t = date
AR_{it} = abnormal return
R_{it} = actual return
$E\,(R_{it}|X_t)$ = normal return
X_t = the conditioning information for the normal model (in the market, model X_t is the market return).

This model assumes that the relationship between the market and security returns is linear. It assumes that the return of the market portfolio R_{mt} is related to a stock return. The calculation for the actual return for stock i during time t for the market model is:

$$R_{it} = \alpha_t + \beta_t R_{mt} \quad 2)$$

where,

R_{it} = return for share i
R_{mt} = return for the market portfolio m for time period t
α_t = average return of the firm compared to the market average
βt = sensitivity of the firm's return to the market return

The event window is divided into time periods. Each time period is divided into three categories: a) the period 120 days prior to the event window, b) a "moving window" which includes periods both before and after the event window, and c) the period after the event. Event studies are usually more effective when event windows are fairly short.

Residuals are aggregated over time, as well as across securities to cater for any delays in receiving the new information. These sums of the total residuals are known as Cumulative Average Residuals (CAR_t). These cumulative average residuals determine cumulative effects over time from the start of the testing period to any given event period date t:

FINDINGS

Table 4 shows the regression analysis results for the estimated coefficients for the market model (**β)**.

TABLE 4
Beta and Alpha Analyses for the Sample Banks

Regression Analysis for Sample Banks		
Local Banks	**α**	**β**
Malayan Banking Berhad	-3.3361	0.0076
CIMB Bank Berhad	-3.7081	0.0117
Public Bank Berhad	0.1512	0.0078
AmBank Berhad	-1.8804	0.0048
RHB Bank Berhad	0.4710	0.0032
Affin Bank Berhad	-0.0930	0.0016
Alliance Bank	-0.3864	0.0023

The abnormal returns for announcements 1 and 2 are presented in Tables 5 and 6. The average abnormal returns on the banking stock price on days -7, -6, -5, -4, -3, -2, -1 related to the first announcement are -0.4078 percent, -0.4427 percent, -0.3370 percent, -0.3472 percent, -0.3721 percent, -0.3414 percent, and -0.3616 percent, respectively, all of which are significantly different from zero. For days 1, 2, 3, 4, 5, 6, 7 for the first announcement, the abnormal returns are -0.4108 percent, -0.4040 percent, -0.3708 percent, -0.3844 percent, -0.4351 percent, -0.4325 percent and -0.3386 percent, respectively. Notice that most of the banks have positive abnormal returns, except for CIMB Bank and Alliance Bank.

TABLE 5
Abnormal Return for Event 1

Time Line	Maybank	CIMB Bank	Public Bank	AmBank	RHB Bank	Affin Bank	Alliance Bank	Mean
7	0.2159	-5.3854	0.2982	0.3018	1.5266	0.7441	-0.0713	-0.3386
6	0.0798	-5.5898	0.1889	0.2516	1.4335	0.7181	-0.1099	-0.4325
5	0.1004	-5.5742	0.1893	0.2356	1.4195	0.6962	-0.1127	-0.4351
4	0.1081	-5.5408	0.2981	0.2659	1.4796	0.7660	-0.0681	-0.3844
3	0.0487	-5.5890	0.3192	0.3590	1.5283	0.7503	-0.0118	-0.3708
2	0.0034	-5.6588	0.2729	0.3303	1.5092	0.7409	-0.0257	-0.4040
1	-0.0079	-5.6762	0.1313	0.4131	1.5145	0.7386	0.0108	-0.4108
0	-0.0056	-5.6023	-0.0331	0.4972	1.5701	0.7359	-0.0587	-0.4138
-1	0.0495	-5.4686	0.0957	0.5395	1.5912	0.7059	-0.0442	-0.3616
-2	0.0770	-5.4262	0.1239	0.5571	1.6028	0.7116	-0.0358	-0.3414
-3	0.0760	-5.4277	0.1129	0.4564	1.5224	0.7114	-0.0561	-0.3721
-4	0.1229	-5.3825	0.0497	0.5545	1.5511	0.7107	-0.0370	-0.3472
-5	0.1154	-5.3940	0.0420	0.5797	1.6279	0.7092	-0.0393	-0.3370
-6	-0.0354	-5.5670	0.0201	0.4837	1.3307	0.7007	-0.0319	-0.4427
-7	-0.0565	-5.5508	0.0908	0.5276	1.3797	0.7350	0.0193	-0.4078

For announcement 2, notice that the average abnormal stock return on -7, -6, -5, -4, -3, -2, -1 and 1, 2, 3, 4, 5, 6, 7 related to the second announcement are -.0444 percent, -0.0365 percent, -0.0437 percent, -0.1278 percent, -0.1415 percent, -0.1755 percent, -0.1707 percent, and -0.1504 percent, -0.2007 percent, -0.2180 percent, -0.2441 percent, -0.1503 percent, -0.2174 percent, -0.2010 percent, respectively. Maybank and CIMB bank demonstrated negative returns.

TABLE 6
Abnormal Return for Event 2

Time Line	Maybank	CIMB Bank	Public Bank	AmBank	RHB Bank	Affin Bank	Alliance Bank	Mean
7	-0.2392	-8.1451	3.0620	0.4441	1.8768	0.8605	0.7342	-0.2010
6	-0.2527	-8.1297	2.9190	0.4346	1.8837	0.8639	0.7592	-0.2174
5	-0.1629	-7.9567	3.0208	0.4854	1.8873	0.8904	0.7837	-0.1503
4	-0.3118	-8.1237	2.8896	0.4089	1.8499	0.8320	0.7464	-0.2441
3	-0.2143	-8.0858	2.9281	0.3827	1.8457	0.8498	0.7679	-0.2180
2	-0.1774	-8.0435	2.9562	0.3926	1.8455	0.8394	0.7823	-0.2007
1	-0.1152	-7.9369	3.0005	0.4249	1.9200	0.8564	0.7975	-0.1504
0	-0.0909	-7.9865	2.9541	0.4185	1.9092	0.8711	0.7596	-0.1664
-1	-0.0967	-7.9655	2.9281	0.4048	1.9068	0.8699	0.7578	-0.1707
-2	-0.0941	-7.9305	2.8514	0.4392	1.9163	0.8746	0.7147	-0.1755
-3	-0.0222	-7.8351	2.8948	0.4386	1.9124	0.8874	0.7337	-0.1415
-4	0.0491	-7.7753	2.8279	0.4839	1.8824	0.8921	0.7455	-0.1278
-5	0.1879	-7.6076	2.8995	0.5932	1.9281	0.9246	0.7688	-0.0437
-6	0.1795	-7.5996	2.8714	0.6106	1.9730	0.9070	0.8024	-0.0365
-7	0.1880	-7.6312	2.8903	0.5423	1.9108	1.0108	0.7780	-0.0444

A non-parametric Wilcoxon Rank Sum Test was performed to test for any significant differences of the abnormal returns before and after the event. The null hypothesis is that there is no difference in the abnormal return before and after the event. The result of the test is shown in Table 7. The result indicates that there is enough evidence to reject the null hypothesis due to high p-value. For the second announcement, the Wilcoxon test also showed significant evidence to reject the null hypothesis and prove that there is a significant difference between the stock return before and after the announcement. However, some of the negative abnormal return on bank stock indicates that the market assumes that the announcement will lead to a reduction in profit gain.

TABLE 7
Z, P Value & CAR for Announcements 1 & 2

	Announcement 1	Announcement 2
Z	-0.3194	-2.2361
P Value	0.6249	0.9873
CAR	-5.7999	-2.2883

CONCLUSION

The overall objective of this paper is to determine any abnormal stock return during the announcement of BASEL III on Malaysia Banking firms. The individual bank's results for the event studies are inconsistent. Some banks like Am Bank, RHB bank and Affin Bank showed a positive return for both announcements. However, the returns for Maybank, CIMB Bank, Public Bank and Alliance bank are mixed. Looking at the average return for both the announcements, a negative return was obtained for both. The magnitude of negative return for most of the banks is higher than positive return. The results also suggested that market view the imposition of high capital requirement with disapproval. The market expects that with the introduction of the new Basel accord, the banking stock prices will drop. In general, the impact of Basel III is strongly dependent on its future implementation. For example, bond markets are likely to have a positive impact. This is because increase in the capital requirement by regulation will ultimately make bonds a safer investment. Even if the performance of economy is slow, the stability of financial system will be able to sustain the confidence level of investor towards bond market. It is undeniable that the implementation of Basel III will increase transparency, growth and financial strength of the banks. Eventually, it will lead to banks' profitability and stability over the years.

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