

Session 60097573

short answer question

W3 PBL2: APRA (Group, 10min)

When banks raise capital, they cannot lend all of it out as assets. A portion (%) has to be kept as liquid capital in reserve to buffer and protect against loan losses. This is called Capital Adequacy. *(From your Pre-load Slide 15)*

The current CAR is a minimum of 8%. If the CAR goes up to 10%, holding all else equal, what is the impact on ...

1. Availability of capital to be invested in productive, interest-earning assets?
2. What is the impact on total revenue from assets?
3. What is the effective impact of higher CAR on the overall cost of capital?

(for simplicity, we ignore the type of capital to be held in reserve, but for those interested it is primarily equity capital. You learn more about capital adequacy in BFC3170)

Work in your groups to answer each of the sub-questions. Answering each sub-question in sequence will help answer the following question.

Re-drawing the example provided in the Pre-load of the balance sheet impact of capital adequacy may help your comprehension.

Answer in short bullet points, one bullet for each sub-question.

✓ [I get it now](#) ✗ [I still don't get it](#)

- 28831500. 1. If the CAR goes up to 10%, there is less availability of capital that can be invested in productive, interest-earning assets as more capital would be put in reserve. 2. This would lead to a decrease in total revenue from assets as there is less capital that can be used to invest. 3. A higher CAR would lead to a higher cost of capital as rate of return would be lower.
- 28821327. 1. less available capital to be invested, earning less interest. 2. Total revenue on assets will reduce since less assets are being invested in. 3. Overall cost of capital will be lower since less assets can be invested in
- 28813715 – a increase in the CAR by 2% means that the bank must keep an extra 2% of capital as a reserve. This results in less available capital for investment. – The lower availability of capital subsequently lowers the total revenue from assets, because holding the reserves results in the bank forgoing investment opportunities and therefore potential revenue from assets. – In result a higher CAR results in an increase in the overall cost of capital
- 28813073 If CAR increases to 10%, there will be less availability of capital for investment. Total revenue from assets will be 2% less, as this 2% cannot be re-invested. Overall a higher CAR will increase cost of capital.
- 28806514. 1. before there was a remaining 92% to invest in assets, with a higher CAR there is only 90%. As such there is a decrease in capital invested into assets. 2. there is less revenue because the assets are less productive and fewer. 3. decrease in cost of capital
- 28805925– The availability of the capital available for investment will reduce, as a greater amount, 2% extra capital must be kept on reserve, which means there is less capital available to invest and generate revenue. When CAR increases there is a negative impact on the total revenue from assets, if less capital is invested then there is less revenue generated from the assets available, the 10% CAR remains as a stagnant or stationary asset. Overall, the cost of capital will reduce as there is less capital that is invested and less earning.
- 28805739 1. Less capital can be invested as an extra 2% must be kept liquid. 2. Total revenue is likely to be lower because you have less capital that you can use to invest into the prosperity of the firm. 3. Higher CAR means that the overall cost of capital is likely to increase because the return on assets is lower meaning that capital will relatively cost more.
- 28800540 1. Availability of capital to be invested into productive, interest earning assets is reduced 2. Total revenue from assets, therefore, is reduced. 3. Higher CAR will increase the overall cost of capital.
- 28798848 1. It will negatively impact the availability of capital to be invested as there will be a lower amount of funds available for investment. 2. Total revenue from assets will decrease. As more percentage of the capital must be kept as a liquid asset and cannot be invested. So less returns on investment. 3. The overall cost of capital increases.
- 28791851 1. the availability of capital to be invested will decrease as more money must be kept as cash (more liquid assets) meaning this money cannot be invested into productive assets. 2. The total revenue gain from assets will therefore decrease as you have less productive assets 3. the overall cost of capital will therefore increase
- 28790944 1. the availability of capital will decrease as more will have to be kept within the bank in case investments fail. interest earning assets would not be maximised as capital is not fully utilised. 2. total revenue on assets is less than it used to be as we invest 2% less. 3. The overall cost of capital will decrease as there is a lower liability
- 28790537 1) there will be less capital able to be invested, so less investment in interest earning assets 2) total revenue from assets will decrease as there is less investment 3) the cost of capital will increase as banks will have less capital to invest
- student ID: 28786440 1. there will be less liquid funds available for investing options 2. the revenue will drop 3. it is more stable
- 28782216, 1. the availability of capital to be invested in productive, interest earning assets will be lowered. 2. The total revenue from assets will drop. 3. The overall cost of capital will increase
- 28778391 – The availability of capital to be invested would decrease because banks have to save more of their capital for the CAR. The amount of capital for investment decreases. The impact on the total revenue from assets is that their revenues would decrease because of less investment. The effective impact of a higher CAR on the overall cost capital is that the overall cost of capital increases, because they have less choices to make as a result of the lower capital.
- 28777735 – 1. the banks would have less availability of capital to invest in productive, interest-earning assets, as they are required to hold a greater portion of their capital in reserve. Increasing CAR results in less available capital. 2. Less revenue from assets because less capital able to invest in assets. 3. higher CAR increases cost of capital
- 28777352– They are unable to invest the 2% that is used in the CAR thus they are unable to build a larger amount of capital. 2. The amount of total revenue will then decrease as less amount of capital can be invested. 3. Thus a higher CAR will lead to an decrease in overall cost of capital
- 28772415 – The increase to 10% means that the bank is has been reduced to how much of its Capital that can be invested in assets. – Less assets being invested in assets means less revenue will be earned from the less assets. – Effectively there will be a higher cost of capital as less revenue is being earned from it.
- 28771818, By raising the CAR there is a decrease of capital that can be used to be productive for interest earning assets decreases and hence there is less borrowing capital and this impacts total revenue from assets as they then have to charge consumers/loaners a larger interest rate to cover for the savings and attempt to make more profit from their current capital. Now the overall cost of capital increases for both the lenders and others as there is less available capital. The banks revenue may also decrease as they can loan out as much as they wanted to, to provide to the loaners

- 28765451 1. there will be less funds available to invest in productive, interest-earning assets as more funds must be kept in reserves. 2. as a result of more funds being kept in reserves less is able to be invested and thus reducing total revenue. 3. the cost of capital is increased as less funds are able to be invested into productive assets
- 28763653 1. The available funds that may be invested in productive/interesting earning assets decreases as the bank will have withhold from spending a greater amount of money in order to stay within the appropriate CAR. 2. Total revenue from assets would decrease due to less available capital for investment 3. Overall capital decreases.
- 28760859 – 1. Less capital will be able to be invested in interest earning assets. 2. Total revenue from assets will be expected to decrease, as less capital is available to be invested 3. Overall cost of capital will increase as a result of higher CAR
- (28760247) 1. less 2. less 3. more
- 28760123 1) Less capital can be invested 2) Total revenue will decrease if interest is kept same 3) Overall cost of capital increases
- 28759982 – 1) Capital Adequacy Ratio is the define percentage of capital which Banks or other ADI's must hold in reserve to ensure protection against defaulting loans. However, due to the Banks holding in a greater amount of Capital, less capital will be loaned out to various investors. These funds cannot be invested in any productive asset, therefore it will lower the available capital that could be invested in productive asset which generate a return. 2) The Impact on the revenue from assets by reducing the total revenue from assets. 3) Increases the cost of capital
- 28754859 a. it is reduced b. will be reduced if the invest the same way, however if they choose different options or increase interest rates for loans they are giving out it will remain the same or possibly go up c. it will increase the cost of capital as less will be able to be invested by the banks so they must be more efficient with the capital they can invest so they will increase interest rates and therefore the cost of capital
- 28754328 1. This will be reduced, as banks have to retain more capital by regulation from the CAR. 2. The total revenue from assets will also decrease, as less funds were initially available for investing. However this can be combated through increasing interest rates on loans. 3. It increases the overall cost of capital, as banks cannot lend as much funds, thus they need to increase interest rates bestowed on customers to compensate.
- 28748336, – Available capital to be invested decreases as more has to be kept as reserve, therefore total revenue from the invested assets will decrease as there will be less assets invested into, Cost of capital will drop as there is less capital to invest and return from.
- 28742303 --- a) the availability of capital to be invested in productive, interest-earning assets decrease there is more available 2) thus, total revenue from assets will decrease as the banks make more investments 3) The effective impact of higher CAR on the overall cost of capital would be that the cost of capital increases.
- Id: 28629922 availability of capital to be invested will go down. Now we will be able to invest less as compared to earlier rate. B- total revenue from assets will decrease C- overall cost of capital
- 27930408 1) Less capital to be invested in assets. 2) Less cause there's less investments from assets. 3) More demand for capital
- 27871568 1. decreases 2. might decrease 3. increases cost of capital depending on the capital structure
- 27853748 1. less capital as additional 2% is in the reserves as liquid capital, thus less revenue as less is coming in from interest earning asset 2. There will be a reduction in revenue from assets as the potential 2% of assets cannot be invested into interest earning activities therefore decreasing revenue. 3. higher cost of capital
- 27842452 1. If the Capital Adequacy Reserve increases from 8% to 10%, it will result in less availability of capital to be invested in productive, interest earning assets, as the banks will be forced to hold onto more of their available investment options. 2. As a result of less available capital, it follows that potential investment opportunities will also be lower, thus reducing the amount of total revenue from assets. 3. Since potential revenue from capital investment has fallen, it means that investments will need to have a higher return in order to cover the cost of debt. As a result, it is only logical that there will have been a higher cost of capital
- 27832169 a) There would be a decrease in availability of capital as banks will have less funds to invest. They must now keep in greater portion of funds in liquidity. b) Due to there being less assets invested in, due to a decrease in the initial investment, the revenue from assets decreases. c) The overall cost of capital would increase as it is in shorter supply.
- 27823601 1. if they are not able to invest, lower capital available. 2. Total revenue from assets would decrease. 3. Cost of capital becomes more expensive.
- 27814718 1. there is less capital available for the banks to invest 2. there is less total revenue from assets as they can't invest as much 3. a higher CAR increases the cost of capital
- 27805050 1. The availability of capital will be less due to more capital will be held in reserve in order to protect against loan losses. 2. The total revenue from assets will decrease as less capital is available to be invested, hence decreasing returns. 3. it will increase the cost of capital due to less availability
- 27800946 1. There will be less capital available to be invested. 2. Due to the decrease in availability of capital to invest, therefore total revenue from assets is also decreased. 3. Higher CAR has no impact on overall cost of capital for the bank, due to capital costs being passed on to borrowers.
- 27799913 1) the availability of capital to be invested will decrease as the banks can only invest 90% (instead of 92% of its capital) due to higher Capital Adequacy Ratio (CAR). 2) The total revenue from assets will decrease as the capital available for investment has decreased. 3) The overall cost of capital will increase with higher CAR Therefore in order to cover the 2% discrepancy the banks will raise its interest rate on its customers eg. Increase Interest rate of debts Kd increases, consumers and business borrow less Even lower consumption and investment, contracting supply of money
- 27798976 1. it will be less. 2. less because less is going to assets. 3. it would increase because they're less likely to invest bc they have less to spend
- 27787486. 1. There will be less capital available to invest in productive assets. 2. Following on having less capital to invest, the total revenue will decline given the rate of return remains approximately equal. 3. Effectively, increasing CAR increases the cost of capital, as it inhibits banks in investing and earning interest, who as such earn less revenue, and will pass some of these increases costs on to consumers.
- 27765504: 1) There will be less available capital (by 200 basis points). 2) The total revenue will decrease as there will be less investment funds to earn interest on. 3) A higher CAR will increase the cost of capital as it reduces the effective returns from their capital.
- 27601250 1. availability of capital will decrease, interest-earnig assets will also decrease because more liquid capital must be kept. 2. because there are less available capital, the total revenue from assets will decrease. 3. there will be less cost of capital
- 27026604 – 1. There would be less capital available to be invested in productive and interest-earning assets as there would be more capital reserved to protect against loan losses. 2. There would be less revenue as there would be less money to invest as more capital is reserved to protect against loan losses. 3. Increasing the CAR you lower the available capital, therefore there would be a lower cost of capital
- 26941422 | 1. Available capital for investments will be reduced and interesting-earning assets will most like be liquidated to raise CAR to 10%. 2. Revenue will be reduced as the assets will longer be productive. 3. Cost of capital will be increase
- 26846866: 1) the amount of capital to invest will decrease, 2) this will decrease the total revenue from assets 3) the higher CAR will increase cost of capital
- 25960423 1. the bank can't invest the extra 2% of capital, they can't create more capital and make revenue with that money. 2. they will therefore earn less revenue as they can't use all of their assets 3. I don't know
- 25580221 1. less capital is available to be invested in productive, interest-earning assets such as customers' loans. more capital must be set aside, so the bank will earn no potential interest in that 2% of capital. 2. total revenue will decrease since there is less available capital for investment. 3. a higher CAR means that cost of capital will increase since banks need to earn a higher return (revenue) from the remaining 90% of assets per unit of asset (instead of 92% available assets before).
- 24214175: 1) The availability of interest earning investments is reduced. 2) therefore reducing potential revenue, or investments forgone. 3) a higher CAR increases the overall cost of capital due to the investments forgone by the 2% increase in required reserves.
- 24201839 1. There is a decrease in capital that is available to be invested in interest-earning assets. 2. The total revenue from assets will be reduced. 3. A higher CAR leads to an overall increase in the cost of capital
- 23441194 – 1. Less availability of capital to be invested in assets 2. Most likely a decrease in total revenue from assets as you would have less assets 3. lower cost of capital
- 2793 0645 | 1. Lower availability of capital to be invested in assets | 2. Decrease total revenue from assets | 3. Higher cost of capital

- 2515 2092 1) there will be less capital to be invested, as they need to keep 10% of their total capital in the reserve, thus, less capital to invest in other areas (2% less). 2) revenue will decrease due to the fact that they will not be able provide as many loans and carry out as many investments, as the previous CAR of 8%. 3)

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