INSIDE DEBT

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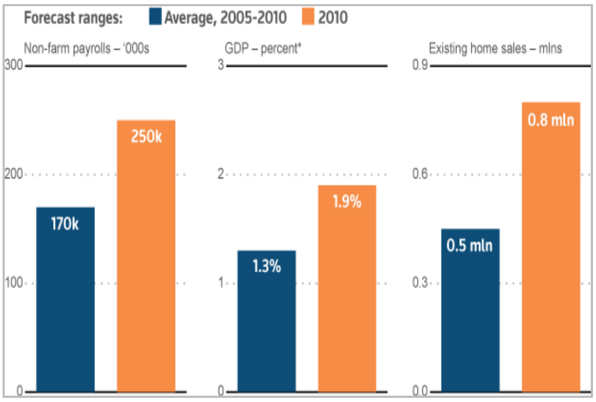
Monday, September 13, 2010

CHART OF THE DAY

"Unusual uncertainty"



As the recovery falters analyst forecasts for economic data are all over the map-a sign that Bernanke's "unusual uncertainty" characterization is apt.

TODAY'S TOP NEWS

- Basel eases capital fears, top banks still in spotlight
- U.S. govt posts $90.53 bln budget deficit in August
- Geithner says U.S. economic recovery not fast enough
- Senate Republicans firm on tax cuts for rich
- OECD reports mounting signs of slowing growth
- China economy shows inner strength in buoyant data
- IMF urges stimulus to help "dire" job market

ECON WATCH

FOR TUESDAY SEPTEMBER 14

ET		Indicators	Unit	Reuters	Prior
02:00	DE	Wholesale price ind mm	%	0.2	-0.3
04:30	GB	CPI mm	%	0.3	-0.2
04:30	GB	RPI mm	%	0.3	-0.2
04:30	GB	RPI-X mm	%	0.3	-0.3
05:00	EZ	Ind production mm	%	0.2	-0.1
05:00	DE	ZEW economic senti	ind	10.0	14.0
05:00	DE	ZEW current conditions	ind	48.0	44.3
08:30	US	Retail sales mm	%	0.3	0.4
08:30	US	Ex-autos mm	%	0.3	0.2
08:30	CA	Capacity utilization	%	75.8	74.2
08:30	CA	Labor productivity	%	-0.5	0.7
10:00	US	Business Invents	%	0.5	0.3

Thomson Reuters LPC Loan Conference

Wednesday, September 22,2010
Marriott Marquis, New York City
For more please **click here**

MARKETS TODAY

TODAY'S TOP STORY: New capital rules set by global regulators brought relief to the world's banks, giving weaker lenders time to raise funds and freeing the strong to lift dividends or hit the acquisition trail.
For more please click here

TREASURIES: U.S. Treasuries prices rose as bargain-hunters snapped a three-session losing streak that had been caused by a drop in pessimism over the economy and a poor 30-year bond auction.

- 10-yr notes rose 16/32 to yield 2.74 pct from 2.79 pct.
- 30-yr bonds was last yielding at 3.84 pct.
- 2-10's part of the yield curve flattened by 2 bps to 221 bps and 3-30's part of the yield curve steepened by 4 bps to 301 bps.

FOREX: The dollar fell against the euro as strong Chinese data boosted currencies of countries like Australia that are big sellers to the world's second largest economy.

- Euro jumped 1.31 pct to last trade at $1.2872. Earlier gains triggered automatic buy orders around $1.2750. It rose 0.65 pct to 107.66 yen.
- The Australian dollar reached a five-month peak of $0.9362. The dollar fell 1.13 pct to 1.0074 Swiss francs.
- The dollar fell 0.63 pct to 83.65 yen, still near a 15-year low around 83.34 yen on EBS. The low recorded by Reuters data is 83.32.
- The dollar index was at key technical levels. The index was last down 1 pct at 81.871.
  Click here for a Yen package.

CORPORATES: U.S. corporate bond spreads were unchanged to tighter as new global banking rules supported the financial sector and a spate of new issuance met good demand.

- The CDX.IG-14 index was unchanged at about 103 bps.
- General Electric Capital launched $4 bln of notes in a two part sale, the offering includes $2 bln of three-yr notes expected to yield 110 bps and $2 bln of 10-yr notes expected to yield 175 bps.
- Symantec Corp launched a $1.1 bln, two-part note sale, the offering includes $350 mln of five-yr notes expected to yield 125 bps and $750 mln of 10-yr notes expected to yield 150 bps more than Treasuries.

STOCKS: U.S. stocks advanced to their highest levels in five weeks, taking the S&P 500 near the top of its summer range, on upbeat Chinese factory data and new global banking rules.

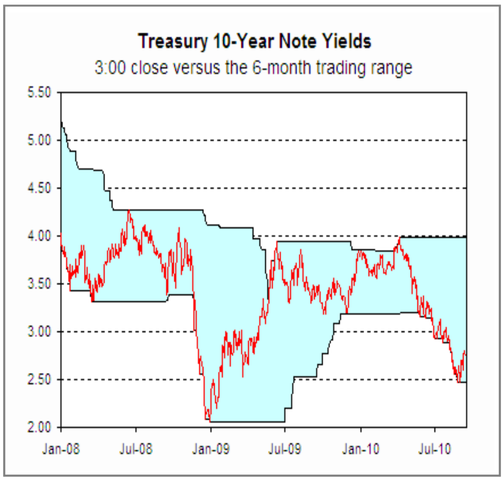
- Dow rose 0.78 pct at 10,544.35 and S&P added 1.11 pct to 1,121.92 and Nasdaq was up 1.93 pct at 2,285.71.
- Shares of JPMorgan Chase rose 3.5 pct to $41.15. ArcSight jumped 25.10 pct to $43.91, while HP rose 0.16 pct at $38.26.
- KBW bank index rose 3.05 pct. S&P technology added 2.06 pct.

C & E: Oil prices rose to a one-month high, spurred by an extended shutdown of a major Canada-U.S. crude pipeline and strong Chinese demand growth and industrial output.

- U.S. crude oil rose 0.90 pct to $77.14 per barrel.
- Gold remained fell 0.08 pct to 1,244 an ounce.
- Reuters-Jefferies index added 0.88 pct to 277.56.

- For MARKET SNAPSHOT click here
- For NEXT UP click here
- For DEEP DIVE click here

MARKET SNAPSHOT as of 3:00 pm EST



REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.280	O/N	0.280
2-Week	0.280	2-Week	0.300
1-Month	0.280	1-Month	0.300
3-Month	0.290	3-Month	0.310
AGENCY REPOS		i-REPO[SM] INDEX	
O/N	0.280	10:00 AM	0.220
2-Week	0.290	3:00 PM	0.219
1-Month	0.300		
3-Month	0.300		

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.200	0.230	-	-
1-Month	0.250	0.350	0.179	0.189
3-Month	0.300	0.420	0.183	0.193
6-Month	0.480	0.620	0.184	0.194
12-Month	0.800	1.100	0.220	0.230

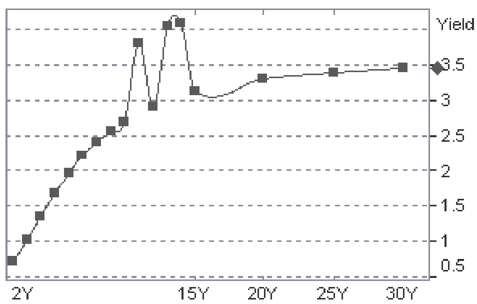
TREASURIES <5> <500>

	BID	ASK	YIELD	CHANGE
1-Mo Bill	0.100	0.07	0.101	0.001
3-Mo Bill	0.140	0.130	0.142	0.007
6-Mo Bill	0.185	0.180	0.188	0.004
1-Year	0.243	0.233	0.246	-0.002
2-Year	99.695	99.719	0.532	0.082
3-Year	99.766	99.797	0.830	0.188
5-Year	98.773	98.820	1.508	0.367
7-Year	98.203	98.250	2.154	0.461
10-Year	99.000	99.063	2.741	0.492
30-Year	100.547	100.609	3.844	0.453

IR SWAPS <19901>

	SPREAD		RATE	
2-Year	17.75	21.75	0.70	0.73
3-Year	20.00	24.00	1.02	1.05
5-Year	17.25	21.25	1.67	1.69
7-Year	5.75	9.75	2.21	2.22
10-Year	-3.50	0.50	2.70	2.70
30-Year	-39.00	-35.00	3.45	3.44

U.S. Interest rate swap—yield curve



EQUITIES

	INDEX	CHANGE
DJIA	10528.08	61.87
NASDAQ	2280.28	36.50
S&P 500	1120.27	10.38

OIL

	PRICE	CHANGE
NYMEX	77.2	0.7
BRENT	79.2	1.0

EURODOLLAR FUTURES

	CLOSE	CHANGE
Oct-10	99.665	0.010
Dec-10	99.590	0.035
Mar-11	99.520	0.065
Jun-11	99.415	0.070

FUTURES

	PRICE	CHANGE
CBOT 5 yr	120.38	0.37
CBOT 10 yr	124.61	0.19
CBOT 30 yr	131.63	0.09

CURRENCIES

	BID	ASK
Euro	1.2866	1.2868
Sterling	1.5407	1.5412
JP Yen	83.62	83.64
Swiss Franc	1.0079	1.0082
Can Dollar	1.0269	1.0274
Mexico	12.8469	12.8570

FED FUNDS

Open	0.2100
High	0.2700
Low	0.1400

NYFR[SM] - 10AM

1m	0.2502
3m	0.3162

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	0.625	24/09/2012	15.5	13	0.68
3-Year	1	23/09/2013	21	19.5	1.03
5-Year	1.75	10/09/2015	28.5	28	1.79
7-Year	3.75	27/03/2019	7.25	4.25	2.81
10-Year	6.625	-	25	-	4.09
30-Year	6.25	15/07/2032	22	18.5	4.06

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	27/07/2012	12	9	0.66
3-Year	0.875	28/10/2013	21.5	20.5	1.04
5-Year	2.375	28/07/2015	24	23	1.74
7-Year	5.125	18/10/2016	7	-	2.22
10-Year	-	-	-	-	-
30-Year	-	-	-	-	-

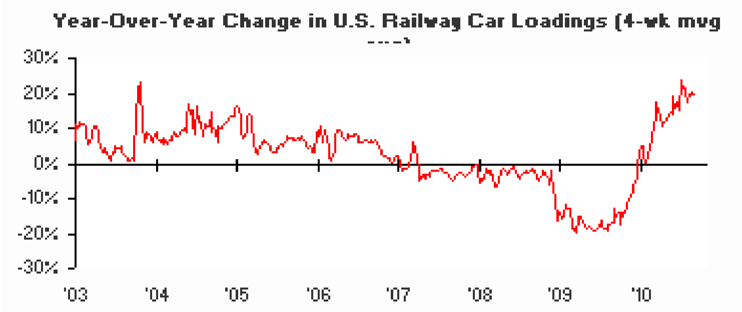
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	4.0	104.1830	104.1870	2.489
FHLMC	4.0	104.1830	104.1870	2.527

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.5	104.0500	104.0500	3.034
FHLMC	4.5	104.0020	104.0060	3.031
GNMA	4.5	105.1400	105.1500	2.988

Wrightson ICAP[SM] Chart of the Day



ICAP THOMSON REUTERS

TODAY'S TOP NEWS

Basel eases capital fears, top banks still in spotlight

New capital rules set by global regulators brought relief to the world's banks, giving weaker lenders time to raise funds and freeing the strong to lift dividends or hit the acquisition trail.
But the biggest international banks still face a capital surcharge on top of Basel III rules announced late on Sunday, to tackle concerns that banks deemed "too big to fail" may take risks that could derail the entire financial system.
The FSB will put forward its proposals to a summit of G20 leaders in November. Investors welcomed the long phase-in of new capital standards under Basel III.
The new Basel III requirements will demand banks hold top-quality capital totaling 7 percent of their risk-bearing assets, more than triple what they do now, but a long lead-in time eased fears of a rush to raise capital.
Europe is the most likely region for banks to need to raise funds, notable in Germany and Spain.
The new capital ratio represents a substantial increase from the current requirement of 2 percent, but is significantly lower than what banks had feared earlier this year and comes with a phase-in period extending in part to January 2019.
ECB President Jean-Claude Trichet said regulators had struck a good balance between strengthening capital while allowing lenders to lend, but said it remained "a work in progress". He said the more stringent capital requirements for banks would not hamper global economic recovery.

Geithner says U.S. economic recovery not fast enough

U.S. Treasury Secretary Timothy Geithner said the U.S. economy was recovering but not fast enough and Washington needed to do more to boost growth and create jobs.
In a speech to the Congressional Hispanic Caucus Institute, Geithner urged support for a small business lending package the U.S. Senate is set to debate this week. Geithner urged Congress to act quickly on extending expiring tax cuts for the middle class and on a proposal by President Obama to provide new federal financing for rebuilding U.S. roads, bridges and other infrastructure.
Geithner is scheduled to testify about China's exchange rate practices to the Senate Banking Committee on Thursday.
The bill would create a new $30 billion fund the government would invest in independent community banks to encourage lending to small firms.

OECD reports mounting signs of slowing growth

A slowdown in economic growth in the world's developed countries looks increasingly likely, the OECD said, highlighting signs the recovery may now have peaked in the United States, Japan and Brazil.
The OECD said its July composite leading indicator for the 32-nation OECD area fell for the second month in a row, shedding 0.1 point to 103.1, and that there were tentative signs German and Russian expansions may soon peak.
The CLI reading for Japan declined for the first time since April 2009, falling 0.1 point to 102.8. The overall reading for the G7 stood at 103.1, down 0.2 point compared with the previous month. Meanwhile, The OECD estimates that the Canadian economy won't be able to expand more 1.6 percent a year between now and 2017, more than a full percentage point less than over the past decade.
The OECD's outlook for growth of 3.5 percent this year and just over 3 percent next year roughly coincides with the BoC's latest projections in July.

U.S. govt posts $90.53 bln budget deficit in August

The United States posted a $90.53 billion budget deficit in August, Treasury Department data showed.
The August deficit was slightly below the $95 billion expected by economists polled by Reuters and smaller than the $103.56 billion budget gap a year earlier.
The department said the budget gap so far for fiscal 2010, which ends at the end of this month, was $1.260 trillion, smaller than the $1.371 trillion posted for the first 11 months of fiscal 2009. The government has now posted a budget deficit for a record 23 straight months, the Treasury Department said.
August outlays were $254.52 billion, higher than the $249.08 billion in August 2009.
Receipts totaled $164 billion in August, higher than the prior year's $145.53 billion in August receipts.
The non-partisan Congressional Budget Office last month forecast the U.S. budget deficit will hit $1.342 trillion this year, down slightly from its March projection of $1.368 trillion.
Americans' concern about the economy, including the high deficit, are expected to hurt U.S. President Barack Obama's Democrats in November's midterm elections.

Senate Republicans firm on tax cuts for rich

Senate Republicans have enough votes to block President Barack Obama's plan to extend tax cuts for the middle class while allowing those for the rich to expire, a spokesman for the Senate Republican leader said.
Republicans scrambled to regroup on the tax issue ahead of Nov. 2 congressional elections after House of Representatives Republican Leader John Boehner appeared to open the door for a possible compromise.
Obama raised the stakes last week when he accused Republicans of "holding hostage" middle class tax cuts to save lower tax rates for the top two income groups.
Tax cuts enacted under former President George W. Bush for all individuals will expire at the end of the year if Congress fails to act. Some Democrats have distanced themselves from the administration's call to let tax cuts expire for the wealthy, arguing the economic recovery is too weak to impose tax increases.

China economy shows inner strength in buoyant data

Chinese factories ramped up production in August and money growth easily topped expectations, showing that the economy remained buoyant despite government efforts to clamp down on bank lending and property speculation.
Investment was also resilient, while inflation sped to its fastest pace in 22 months, though the bulk of price rises stemmed from higher food costs, which analysts have said should be transitory after a spell of bad weather across China this summer.
Industrial production rebounded to rise 13.9 percent year on year. The broad M2 measure of money growth sped up to 19.2 percent in August, blowing past expectations of a 17.5 percent increase. The rise came alongside slightly stronger-than-expected bank lending, with the stock of outstanding loans in the economy up 18.6 percent, the first acceleration in four months. Investment was another data point that revealed unexpected strength, with capital spending in urban areas up 24.8 percent in the first eight months of the year compared with the same period in 2009. Economists had forecast a 24.5 percent rise. Separately, China is currently in the process of revising its foreign investment catalogue to expand the number of sectors for which foreign investment is encouraged or permitted, a senior official said.

TODAY'S TOP NEWS

IMF urges stimulus to help "dire" job market

The world's rich countries need to extend fiscal stimulus and job growth initiatives to fix a "dire" labor market that could threaten entire societies, the International Monetary Fund said.
At a conference co-hosted by the IMF and the ILO, visiting Spanish Prime Minister Jose Luis Rodriquez Zapatero said high unemployment may trigger a "crisis of confidence" in Europe.
The IMF said more and more workers worldwide were unable to find jobs for longer periods, weakening social cohesion and raising risks of unrest and even undermining democracy. Zapatero said longer periods of high unemployment could set off a confidence crisis in the European Union, which has been rocked by high debt and financing fears from Greece to Portugal.
"The worst crisis would be a crisis of pessimism, of a lack of confidence, of resignation. Europe must not fall into that," he said. The IMF said that extended fiscal stimulus was worth the additional debt if it helped cut long-term unemployment, which poses an even costlier burden on society as workers get discouraged, lose lifetime earnings or leave the labor market.

U.S. debt fund shuns Dubai World debt deal - paper

U.S.-based distressed debt fund Aurelius Capital Management is the only creditor to have not signed on to Dubai World's $24.9 billion restructuring deal, the Financial Times said citing people close to the talks.
The company could still approve the deal, people close to the matter told the paper. But by missing the Sept. 9 deadline to vote on the deal, Aurelius Capital will not receive the incentive fees paid to creditors that signed up in time.
State-owned conglomerate Dubai World reached an agreement with over 99 percent of its creditors by value to restructure its almost $25 billion in liabilities, the Dubai government said.
Dubai World said in a separate statement it was well positioned to close the restructuring in coming weeks. While Dubai World's agreement with most of its creditors is seen as a positive step for Dubai, the announcement came just days after a unit of Dubai Holding, said it will delay repayment on a $555 million loan, the second time it has failed to meet a repayment deadline.

EU exec more upbeat on 2010 euro zone growth

The euro zone economy is likely to grow almost twice as fast this year as previously thought and is now on solid ground, the European Commission said.
The EU executive said it now expected the euro zone to grow by 1.7 percent this year, rather than the 0.9 percent it forecast in May and up from a 4.1 percent contraction in 2009.
The Commission forecast is in line with projections by the ECB which said on Sept 2 it expected euro zone growth to be between 1.4 and 1.7 percent this year.
The Commission said risks to its forecasts were broadly balanced. Among the negative risks, it saw high debt levels and lingering tensions in sovereign debt markets.
The EU as a whole is also likely to see much stronger economic expansion of 1.8 percent in the whole of 2010, rather than the 1.0 percent estimated in May and up from a 4.2 percent contraction in 2009, the Commission said.
Despite the stronger growth, euro zone inflation was likely to be slower than previously expected, it said. It forecast euro zone 2010 inflation at 1.4 percent year-on-year, down from 1.5 percent seen in May, although up from 0.3 percent in 2009.

Global bonds drop on recovery hopes, Basel deal

Lead 10-year Japanese government bond futures fell, extending their losses after an auction of five-year notes met with tepid demand following a recent spike in market volatility.
JGBs took in their stride news that the Incubator BoJ, an unlisted lender specializing in small business loans, was set to file for bankruptcy protection.
Separately, German government bonds fell, as Chinese and U.S. economic data eased fears about the global economic recovery and an agreement on bank capital requirements supported banking stocks. Bunds pared earlier losses however, after Italy sold 5.5 billion euros of bonds into good demand.
Meanwhile, British gilt futures fell, weighed down by an equity rally after new bank capital rules were agreed at the weekend, but prices were volatile in the absence of any other news to provide direction.

NEXT UP

U.S. Fed to buy about $27 bln of Treasuries and TIPS

The Federal Reserve will buy about $27 billion of Treasuries and Treasury inflation-protected securities in nine operations from Sept. 15 through Oct. 6, the New York Fed said on its website.
The Federal Reserve said at its Aug. 10 meeting that it would buy Treasuries using funds from maturing agency bonds and mortgage-backed securities in an effort to keep steady its holdings of domestic securities.
The Fed has already purchased about $17.64 billion of securities in nine operations between Aug. 17 and Sept. 13.

U.S. Aug retail sales seen rising +0.3 pct

Retail sales probably rose for a second straight month in August, lifted by a combination of back-to-school buying and tax holidays in some states, which should further allay financial market fears of a double-dip recession.
Worries the economy could tip back into recession have diminished in recent weeks as private payrolls and manufacturing growth in August exceeded market expectations.
Retail sales last month were also seen boosted by strong receipts at gasoline stations, reflecting higher gas prices. But a drop in auto sales likely limited overall retail sales growth.
Excluding autos, retail sales likely also rose for a second straight month. Core retail sales, which correspond most closely with the consumer spending component of the government's GDP report, are expected to have rebounded strongly in August. Core sales exclude autos, gasoline and building materials.
The expected rise in core retail sales could set up real consumer spending for an annual growth pace of between 2.0 percent and 2.2 percent in the third quarter, according to analysts. This would compare with the second quarter's 2.0 percent growth rate.
U.S. Treasuries have fallen sharply in recent sessions as data suggested the economy is not on the cusp of falling back into recession, as some traders had bet. They could rise strongly if the retail sales report signals weak consumer spending On the other hand, if sales come in stronger than forecast, it could force traders to further scale back their bullish bond bets.
Stronger-than-expected retail sales are likely to lift U.S. stocks, as any sign of a pickup in consumer spending would bolster the outlook for corporate profits.

DEEP DIVE Commentary and Analysis

FED FOCUS
Policy road less traveled leaves markets lost

By Pedro Nicolaci da Costa
The Federal Reserve's renewed push toward monetary easing was meant to offer some clarity on its likely policy path.
But by pulling the U.S. central bank even deeper into uncharted territory, the Fed's announcement on Tuesday has inadvertently heightened uncertainty in financial markets.
How effective will the unorthodox policies prove? What will the Fed do next? Will it bolster its Treasury bond purchases and, if so, how aggressively? What does the Fed know that we don't?
All of these questions were swirling around on Wednesday as Fed watchers tried to make sense of what is arguably the central bank's most important policy announcement since it first signaled the intention to buy assets in late 2008.
"People are more uncertain about how the committee views the outlook and how worried they are," said Laurence Meyer, a former Fed board governor now at Macroeconomic Advisors. "And they're really uncertain about what's going to happen at the next meeting."
The Federal Open Market Committee, the Fed's policy-setting body, said it will begin using the proceeds from maturing mortgage bonds it acquired during the crisis to keep its holdings of domestic securities around $2 trillion.
It was a small but significant shift that fueled a sense of doubt in markets as trade data suggested U.S. second-quarter growth was softer than first believed and weak Chinese factory data added to worries of a global slowdown.
The Standard & Poor's 500 index slid 2.7 percent, while the dollar, often seen as a safe-haven from turbulence, was on track for its sharpest one-day gain since October 2008, when the financial crisis reached fever pitch.
The muddled outlook was reflected keenly in a Reuters poll of primary dealers conducted just after the Fed decision. The results found the big banks deeply divided on the issue of whether the central bank would return to outright Treasury bonds purchases. Of the 13 dealers that chimed in, five offered an unequivocal "yes," two said "possibly," another responded with "unlikely" and five said "no."
Even the immediate impact of the Fed's reinvestment decision was hard to gauge. Unlike Treasuries, which have a set maturity date, refinancings and home loan prepayments could affect the amount of mortgage backed securities rolling off the Fed's balance sheet.

QE II: SEQUELS NEVER AS GOOD
And then there is the matter of effectiveness. The new approach, which some in the market have labeled quantitative easing II or simply QE-lite, is fraught with dangers. Japan's troubled experience with a two-decade long deflationary cycle despite similar efforts with unorthodox policies offers a cautionary tale.
For starters, there is significant doubt about whether incremental steps like the one taken this week will do anything to affect lending conditions.
A New York Fed study published in March indicated the Fed's commitment to buy over $1.7 trillion in securities during the crisis earned it only about a 0.3 to 1 percentage point decline in benchmark market interest rates. That means any substantial easing effort would take big, sweeping figures to make a noticeable dent -- perhaps another $1 trillion, according to estimates by Goldman Sachs economists.
It is also possible that further easing offers diminishing returns to scale, analysts say, requiring ever increasing amounts of funds to get a similar easing effect.
Many also point out that the fundamental problems plaguing the United States are high unemployment and weak consumer demand, neither of which can addressed directly with more credit.
The ultimate fear, expressed prominently by St. Louis Fed President James Bullard earlier this month, is Japanese-style deflation where no amount of monetary stimulus is enough to propel growth.
"It's not a lack of liquidity that's holding the economy back," said Michelle Girard, senior U.S. economist at RBS Securities in Stamford, Conn.
The case of Japan is instructive on this count. The Bank of Japan repeatedly tried to funnel cash into its banks in the hope of sparking a lending boom, with little success.
Back in 2003, Fed Chairman Ben Bernanke, then a Fed board governor, had an interesting suggestion for the BOJ: "explicit, though temporary, cooperation between the monetary and the fiscal authorities."
Unfortunately, that is highly unlikely in the United States, where a bloated budget deficit has already become a major talking point for politicians looking to November's congressional elections.
In its absence, the Fed is pretty much on its own. But the doubts about whether a fresh push into asset buying can stem the U.S. economy's slide are rampant -- even within the central bank itself.
"Like the BOJ, the Fed is unconvinced how effective quantitative easing can be," said David Cohen, director of Asian economics forecasting at Action Economics in Singapore. "But they are under increased pressure as the economy faces the threat of deflation,"

ANALYSIS-No let up in G20 reforms after Basel agreed

By Huw Jones
A deal on bank capital rules won't see world leaders take their foot of the reform pedal but will instead clear the decks for them to focus more squarely on an even harder issue -- tackling too-big-to-fail banks.
The Basel III measures agreed on Sunday are the lynchpin of efforts by the Group of 20 leading countries to learn from the world's financial crisis but other reform pledges still need completing and new initiatives are in the pipeline.
The G20 will now devote more time at its November summit in Seoul to stepping up scrutiny of derivatives markets and shine a light on off-balance sheet "shadow banking" sectors.
Improving supervision and curbing the influence of credit rating agencies will also figure prominently, sources familiar with G20 workings said.
But "too-big-to-fail" is becoming the top priority.
Even before the ink on Basel III had a chance to dry, top regulators were warning on Monday that big banks face extra capital requirements to make doubly sure that taxpayers won't have to ride to the rescue again. Basel III -- which demands banks hold top-quality capital of more than triple what they do now, but with a long transition time built in -- will not be enough to deal with internationally active banks, Financial Stability Board Chairman Mario Draghi said.
"We want systemically important financial institutions to have loss-absorbing capacity beyond these standards," he said.
Regulators want to end "moral hazard" -- the temptation for banks to take risks -- as governments won't allow them to collapse because of the damage it would wreak on the economy.
The FSB will make recommendations to the November G20 summit with a capital surcharge on big banks set to be one.
That may be easier said than done.
With Basel III, there was G20 consensus that bank capital rules

DEEP DIVE Commentary and Analysis

needed tightening but there is so far no agreement on slapping surcharges on some banks.

FSB MENU

Tackling "too big to fail" will likely take the form of a menu of solutions for G20 leaders to pick through, ranging from surcharges and forcing banks to compile "living wills" to ensure speedy wind-ups if in trouble, to agreements between countries on dealing with an ailing cross-border bank.

"The area that is probably the most difficult is the whole area of living wills and winding up arrangements," said Patrick Fell, a director at PricewaterhouseCoopers in London.

"But if your objective is to look at the system you have to focus on the too-big-to-fail issue," Fell said. If regulators do end up agreeing to slap capital surcharges on big banks, they may have to accept hybrid forms like contingent capital, said Harald Benink, professor of finance at Tilburg University in the Netherlands.

"Basel III is a step in the right direction but it's not finished. The critical thing lacking is no systemic risk charge for important banks," Benink said.

The regulators who completed Sunday's Basel III package appear to be listening.

"The Basel Committee and the FSB are developing a well-integrated approach to systematically important financial institutions which could include combinations of capital surcharges, contingent capital and bail-in debt," the two bodies said in their statement on Sunday.

SHADOW BANKING NEXT

The G20 will also turn its attention to other regulatory reforms such as making sure that all member countries are implementing pledges to make derivatives markets more transparent and safer through central clearing of contracts by the end of 2012.

The United States has already adopted a law to this end and the European Union will publish its own draft law on Wednesday.

"We also have to deal with the whole shadow banking system, which has not been addressed in a coherent manner," the G20 source said.

Regulators in the G20 want to reduce the role of credit rating agencies in determining how much capital reserves banks must set aside.

"Capital alone is not going to save us. We need more effective supervision and there is much in the way to be done by many national authorities," the source said.

There is also a need to finalize existing G20 pledges such as forging a single set of global accounting rules in 2011.

France takes over as G20 president from November and President Nicolas Sarkozy said last month that regulating commodity derivatives would be one of his top priorities.

Financial industry officials in London are already worried that France wants to regulate commodity prices, a step Britain and others would likely resist.

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