Like Malcolm Turnbull, the head of the Australian Prudential Regulation Authority (APRA), Wayne byres, is a glass half full type of guy. In a speech to the Institute of Actuaries this week, Mr Byres was fairly bubbling over with enthusiasm (for a regulator that is)

In short, the [banking] sector is well-capitalised, and risk-based capital ratios are as high as they have ever been.

But as an economist, years of working in the dismal science means that such optimism cannot be sustained for long, and the speech was peppered with the traditional economist's 'on the other hand'. Mr Byre's admitted that "regulators are not omniscient [and…] cannot foresee, with any degree of precision, how [changes] will play out". And, in a statement that is music at least to this author's ears, if not the bankers in Martin Place and Collins Street, he said "so regulation needs to be adjusted and updated periodically in response to market developments".

In his speech, Mr Byre's did an excellent 'tour d'horizon' of the upcoming changes in banking regulation and how they might affect Australian banks over the next few years. His conclusions may be summed up as 'we live in exciting times'.

First, while bankers are currently in a capital raising frenzy to meet new 2016 requirements set by the global Basel III rules, all is not going as well as was hoped, as CBA is finding . Not so obvious is that this capital raising is nowhere near over yet and as Mr Byres said

International developments may well also necessitate higher capital levels, but given the situation we are in today, this challenge should be manageable provided [banks] continue to sensibly accumulate capital.

Mr Byres noted that, as regards capital ratios, the banks were 'comfortably in the top half of the spectrum', i.e. somewhere in the middle not the top quartile demanded by the Murray Inquiry for Australia to have an 'unquestionably strong' banking system.

Before turning to the importance of having an ‘unquestionably strong’ banking system, it is worth noting that Mr Byres saw plenty of clouds on the horizon for local banks.

The Global Financial Crisis (GFC) was not only a credit crisis, but also a liquidity one. Banks such as Northern Rock and Lehman found that their major source of funding, the short term international money markets, dried up just when they needed it most.

Recognising this, regulators have come up with new rules on Liquidity and Funding, especially for Too Big To Fail banks, which includes the Four Pillars locally in Australia.

Regulators love acronyms and in Basel III there are more than enough to satisfy even the most geeky of banking analysts. Two acronyms in particular are important but mind-numbingly dreary in this context: Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The LCR sets out to ensure that banks can pay their bills in the next few months while NSFR seeks to ensure that they can fund themselves over the next year or so.

Basically, the regulator has already finagled the Basel intentions for the LCR by allowing banks to pay a fee for a new acronym CLF (Committed Liquidity Facility) rather than meet the strict letter of the Basel III rules.

On the NSFR, which is due to be implemented in 2018, Mr Byres noted that the Australian banks were not in good shape,

The only observation that I want to make is that given their funding structures, the largest Australian banks do not easily meet the new standard and, as things stand today, international comparisons are not favourable to them.

Fixing the NSFR will not be easy since, as Mr Byres noted, there has been an apparent ceasefire in the “war for deposits”. With the US Federal Reserve still giving money away for free, just why would banks compete for local deposits – to them that would be nuts?

So what to do? One approach might be to adhere to the new Basel rules, painfully as that might be, or alternatively, in a uniquely Australian way, come up with another fix that, like the CLF, leaves the taxpayer on the hook if banks cannot fund themselves in an emergency.

But what should be done? David Murray and his fellow members of the Financial Service Inquiry FSI were on the right track

The core function of the Australian financial system is to facilitate the funding of sustainable economic growth and enhance productivity in the Australian economy. [… And to do that it is necessary to] Strengthen policy settings that lower the probability of failure, including setting Australian bank capital ratios such that they are unquestionably strong by being in the top quartile of internationally active banks

For a strong and resilient economy, the FSI stated that there also needs to be an ‘unquestionably strong’ financial system “within a strong and effective legal and policy framework provided by government”. Such a system would encourage the international investment needed to support the fundamental changes to the Australian economy needed post the mining boom.

Malcolm Turnbull became Prime Minister by arguing that the economy had been mishandled and needed attention. As an ex-investment banker, Turnbull should understand the risks that are ever-present in the global financial system, not least the extreme volatility in the financial markets that caused the Fed to keep sitting on its rate-setting hands.

If Mr Turnbull is serious about the future of the Australian economy he, and the new Treasurer (insert guess here), must be equally serious about making the financial system as strong and resilient as possible.

Anything else is just selling out the future, to prevent a bit of present pain - hardly exciting?

Read more http://theconversation.com/exciting-times-for-the-financial-system-47770