**Comparative Study – Measures of Financial Performance of Banks Between the European Union, United States, and Canada**

**INTRODUCTION**

The focus of this paper will center upon a comparative study between the measures of financial performance of banks in three separate jurisdictions – the European Union (EU), United States (U.S.), and Canada. At a high level, banks play a vital role in the financial system as well as the overall economy by allocating funds from savers to borrowers in an efficient manner, providing the liquidity required for families and businesses to invest in the future. Due to the importance of banks in the context of both local and global economies, measures of financial performance of banks are subject to heavy scrutiny from key stakeholders.

This paper will begin by providing the context for measuring financial performance along with the key drivers of financial performance in the banking sector. Following this, a brief history, rationale and what constitutes the framework of Basel committee will be discussed. This paper will then explore a brief history of how the financial crises started and the true impact of Basel III on the banking sector in the three jurisdictions. Furthermore, this paper will present the requirements that the three jurisdictions have to satisfy under the Bank for International Settlements- how the countries make the requirement laws, why compliance matters.

**MEASUREMENTS OF FINANCIAL PERFORMANCE – CONTEXT AND DRIVERS**

The financial performance of a bank refers to its ability to generate sustained profits over the long-run, as profits represent the bank’s first line of defense against unexpected losses while allowing the bank to bolster its capital position and improve future profitability through the investment of retained earnings, in turn creating shareholder value[[1]](#footnote-1). There are four main drivers of financial performance, which in turn affect the implementation of measurements of financial performance[[2]](#footnote-2):

1. Earnings: The composition and volatility of a bank’s earnings[[3]](#footnote-3).
2. Efficiency: The bank’s ability to generate revenue from its assets and turn a profit from sources of income[[4]](#footnote-4).
3. Risk-taking: Necessary adjustments to earnings for relevant risks undertaken by the bank[[5]](#footnote-5).
4. Leverage: Improves results when things are going well but subjects a bank to being more prone to unexpected losses[[6]](#footnote-6).

In this paper, measurements of financial performance as it relates to the banking sector for all three jurisdictions will consider the aforementioned context and drivers along with the comparability, stability over time, and forward-looking capability of these measurements.

**HISTORY, RATIONALE AND WHAT CONSTITUTES THE FRAMEWORK OF the BASEL COMMITTEE.**

**The Basel Committee**

The Basel committee came into existence in1974 after the failure of Bankhaus Herstatt in West Germany. The committee was established by the Central Bank Governors of 10 countries (G-10) with the main goal to “enhance financial stability by improving the quality of banking supervision worldwide, and to serve as a forum for regular cooperation between its member countries on banking supervisory matters”. In achieving its goals for supervision of international banks, the committee in 1988 released the Basel Capital Accord also known as Basel I. The primary focus of Basel I was to set out a minimum capital ratio for banks and to assist in addressing Credit Risk issues in International Active Banks. In spite of the advantages of Basel I, its implementation soon brought about some weaknesses. These weaknesses included the failure to address other forms of risks such as systematic risks, operational risks, reputation risks, and strategic risk in banking. Also, the one size fits all approach in defining risks weight led the banks to treat debtors of varying credit quality and rating equally.[[7]](#footnote-7) This then led the banks to issue more risky and high yielding loans within the same risk category[[8]](#footnote-8). Due to the shortcomings of Basel I, the Basel committee on banking supervision made amendments by taking into consideration some of the concerns raised by some of the central banks around the world and key stakeholders of the banking industry. After a lot of deliberations, in 2004 a new set of regulations was introduced known as Basel II. Basel II comprised of three main pillars. This included advancing and expanding the minimum capital requirements set out in Basel I. The second pillar was based on internal assessment control and supervisory review on capital adequacy requirement. This second pillar obligated the banks to set up internal methods to ensure that they are in compliance with the capital levels. The rationale is that internally developed systems will make the framework more risk sensitive and evaluate risk in a more precise manner.[[9]](#footnote-9) The third pillar centered on market discipline. Banks were required to disclose to the public its market related investment to ensure that the market understands the banks soundness, risk portfolio and also its capital adequacy.[[10]](#footnote-10)

1. European Central Bank. (2010, September). BEYOND ROE - HOW TO MEASURE BANK PERFORMANCE. Retrieved from https://www.ecb.europa.eu/pub/pdf/other/beyondroehowtomeasurebankperformance201009en.pdf [↑](#footnote-ref-1)
2. *Ibid* [↑](#footnote-ref-2)
3. European Central Bank, *supra* [↑](#footnote-ref-3)
4. European Central Bank, *supra* [↑](#footnote-ref-4)
5. European Central Bank, *supra* [↑](#footnote-ref-5)
6. European Central Bank, *supra* [↑](#footnote-ref-6)
7. <http://studenttheses.cbs.dk/bitstream/handle/10417/2882/geir_oedegaard.pdf> pg 32 [↑](#footnote-ref-7)
8. ibid pg 32 [↑](#footnote-ref-8)
9. <http://studenttheses.cbs.dk/bitstream/handle/10417/2882/geir_oedegaard.pdf> page 38 [↑](#footnote-ref-9)
10. http://www.abj.org.jo/portals/0/BaselCommittee.pdf [↑](#footnote-ref-10)