

Duisenberg
school of
finance

Re-design of the financial sector: Comments on White and Freixas

By

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Duisenberg school of finance

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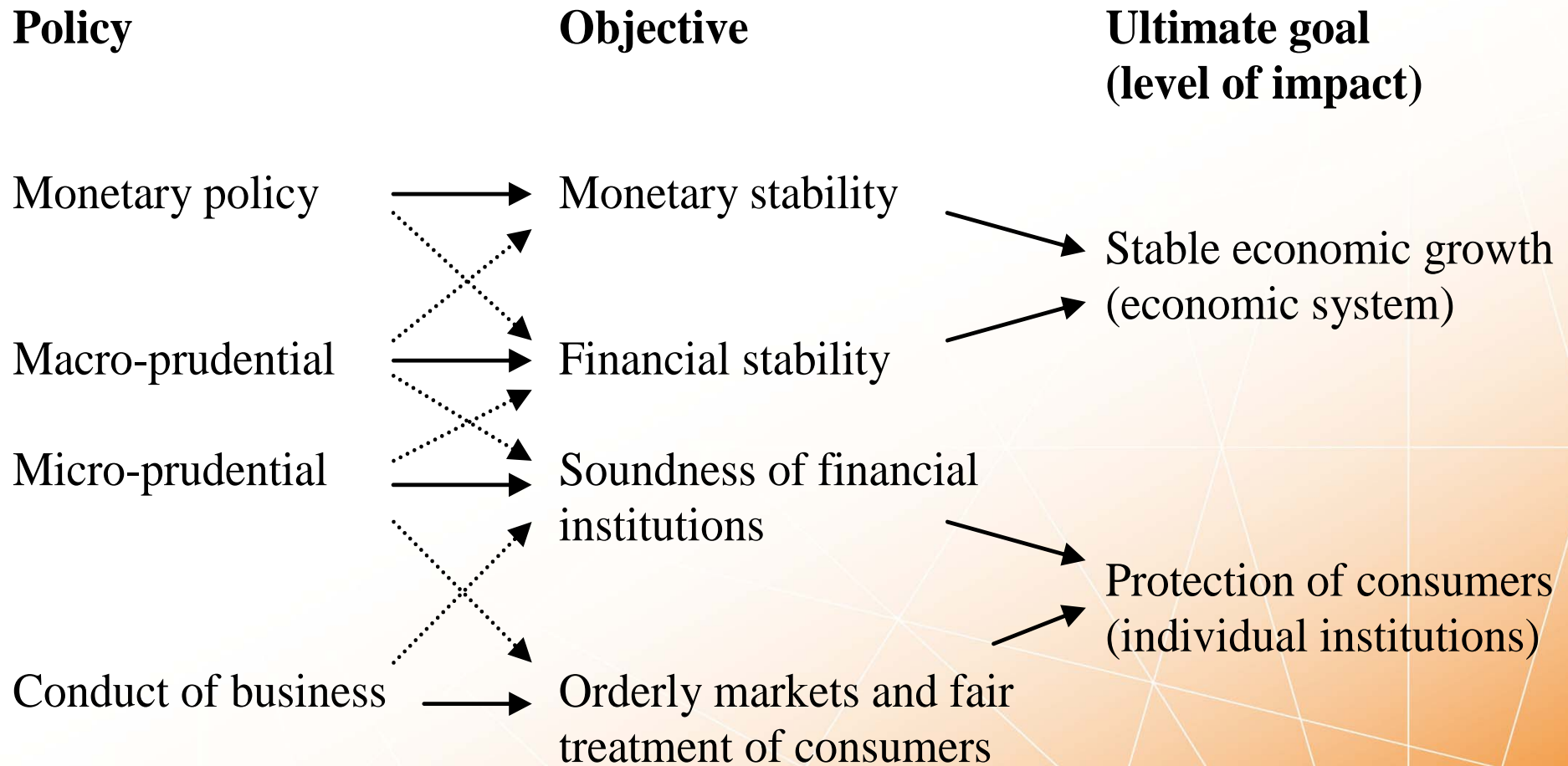
White

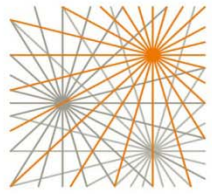
- As we know from Bill White, wide ranging perspective
- Big picture: macro-economic imbalances, monetary and credit creation
- Macro-prudential approach complements micro-prudential
- Pro-cyclicality is feature of financial system
- Financial system not fully restored

Issues

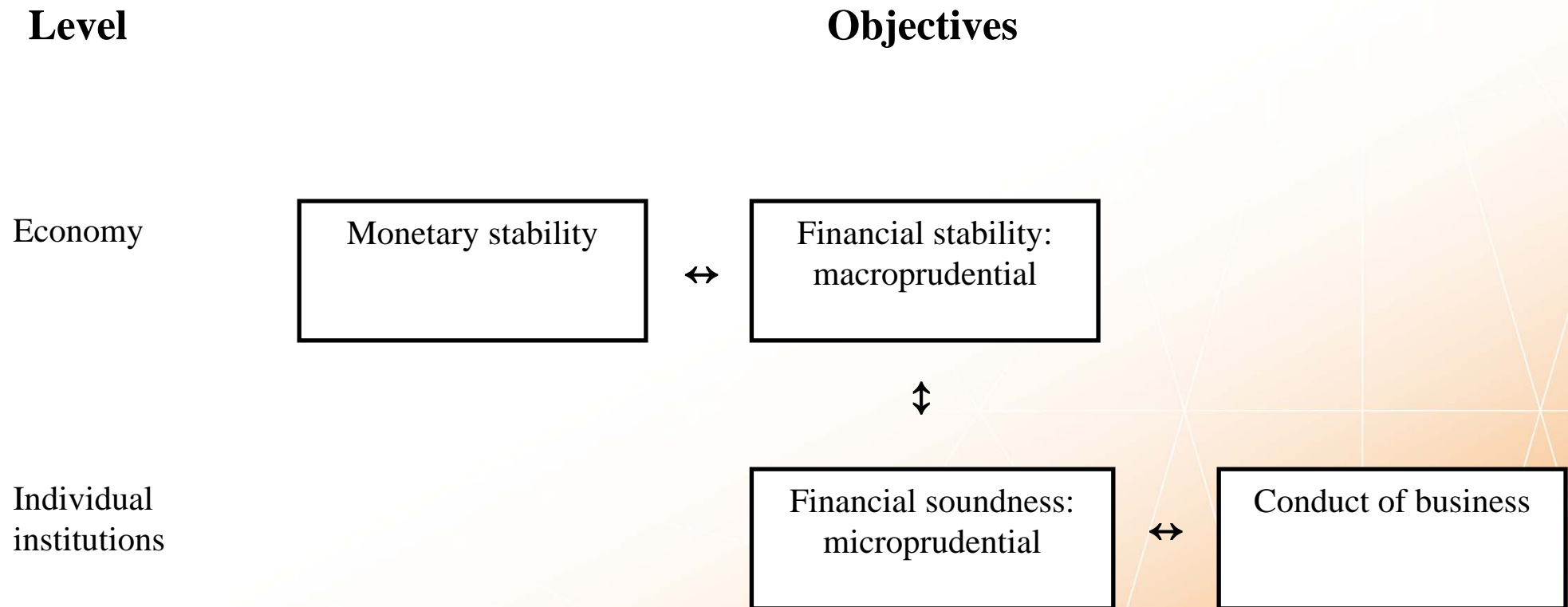
- International co-operation is problem
 - National champions, domestic lending
 - Yes, we need to address cross-border SIFIs
 - Yes, we need to address “too big to fail/save”
- Systemic risk
 - Fundamental rethink: Hellwig, Minsky
 - Yes, leverage important (ignore bank lobby)
 - Framework and instruments for macro-prudential
- Shadow banking system
 - Issue not raised in paper
 - Constraint on what we can do with official banks

Policy framework





Hierarchy of objectives



Do we look at the trees (institutions)?



Or at the forest (system)?



Macro-prudential framework

- Two new regional bodies
 - European Systemic Risk Board
 - Financial Stability Oversight Council

- But “Emperor without clothes”
 - No proper framework for macro-prudential analysis
 - No macro-prudential tools (that are legally binding)
 - Discretionary or semi-automatic?

Freixas

- As we know from Xavier Freixas, theoretical foundation
- Again big picture: macro-economic imbalances, monetary and credit creation
- Opacity of assets -> adverse selection
- Procyclical capital regulation
- Don't rely on market discipline (only)
- Bankruptcy rules, also in international context
- Corporate governance (bonus & dividend)

Proposals

- Capital: not only micro, also aggregate capital industry
- Multiple regulators: coordination problem for bankruptcy and deposit insurance
- Macro-prudential:
 - SIFIs risk
 - Contingent capital or straight equity (Hellwig)?

European dimension

- Freixas recommends European deposit insurance as a starter
- Key issue is European mandate -> common purpose (see burden sharing for Greece / Ireland)
- DG ECFIN should pick this up