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Bankers' new clothes

Lunchtalk, Bruegel, 15 May 2013

According to Anat Admati and Martin Hellwing, authors of the book "The bankers` new clothes", the financial regulation about banks have not reached a satisfying level, able to ensure investors from high level risk.

In her presentation, Professor Admati shows that many problems at the origin of the crisis have not being resolved. In the actual form, banks are still too fragile, then too dangerous, and they expose public to unnecessary risk. Their activity generates significant distortions in the economy and even now they do not support the economy as well as they can do. An inefficient and ineffective regulation did not prevent this market failure. Further, the risk of contagion remains behind the corner. The interconnections of the system are still very strong and the information stream is not linear and transparent. Overall, there is a governance problem and a bad management and balance between investments and lendings.

This being the general picture, Admati and Hellwig have in mind clear proposals. First, stop using the too-big-to-fail formula. If failure cannot be the solution, they suggest to work on other hypothesis, such as resolutions implemented, for instance, on a European scale. Second, do not accept fragility as an inner, unavoidable part of the banking system. In the opinion of the authors, increase the level of equity (up to a minimum of 20-30%) would be the most straightforward way to increase the soundness of the whole system.

Hellwing underlines that at the origin of the crisis there has been first a scarcity of equity issues, that only one year later developed into a liquidity problem. That`s why it is crucial to increase them. On the other hand, the regulation up to now has failed. According to Hellwig, Basil III, or Basil II.01 as he refers to it, does not cover customers from major risks (even the one that can derive from concentration) and it does not provide an adequate system of risk weighting.

Nadia Calviño has a fair more optimistic view of the progress achieved so far. In her opinion, there are three main critical points in Basil III. First, it is not easily understandable, and consequently hard to apply by bankers and supervisors. Second, the approach to risk is too "banco-centric" and it is concentrated on the bank protection from external risks rather than from internal ones. Finally, it is excessively focused on assets while important problems remain on the liability side of banks` balance sheet. Contrarily to the two authors, she does not believe that capital can be a unique, miraculous solution. Further, the equity level should be differentiated according to the diverse activities of banks. Even though the path is long, some objectives have been reached. From the introduction of new regulation, the capital requirement increased and so did the quality of the capital. In this process, the role of good supervisor will be fundamental. Calviño states a positive conclusion: even if not much has happened until now, we will see significant differences in two years.

After the crisis, some bankers really changed the wear, according to Thomas Leysen. KBC is repaying to the Belgian government a loan of 7 billions euros that will generate an interest, so a profit, for the population of around six billions. Further, previous managers have been fired and the cost of the crisis has been sustained by shareholders. The bank decided to start a new path, reducing its size, selling parts of the assets and leaving some countries. After having closed the investment sector, it concentrated on the retail one, providing mortgages to private or small-medium sized enterprises.

If gambling is a core part of the investment banking, regulation is necessary so that this activity is safe for clients, who lastly bear a consistent part of the risk.

Event notes by Valeria Cipollone