

SIFI being considered, is this regulatory overreach that will undermine recovery?

Dominique Gruber
BNP-Paribas

The debate between financial stability and economic growth has not yet been decided. Supervisors still favour financial stability at the cost of economic growth. Their proven aim is to shut down balance sheets of banks at any cost: and the more ineffective they were to forecast the financial excesses, the more vocal they are to require stricter rules today.

Can SIFIs endanger the growth if they fail? The answer is clearly positive. Upon request of the G20, the FSB and the Basel Committee are reflecting on the question of the so called Global SIFIS (systemically important financial institutions). The rationale of the debate, according to supervisors, is the largest a bank, the most considerable will be the consequences of its failure. This assumption could appear quite reasonable. Nevertheless we also saw a medium size pure retail bank (namely Northern Rock) provoking a run which could have become systemic, without State intervention; it means that the size is definitely not a relevant criterion.

It is true that most academic research advocates higher capital to face solvency issues, but the working groups of the Basel Committee were unable to demonstrate the link between the amount of capital and the resilience of the bank in case of problem: Lehman Brothers was one of the most capitalized bank in the world. Most of the time, a bankruptcy is more a question of liquidity than a question of solvency. Consequently the proposed additional surcharge for SIFIs is not relevant. At once the confidence is broken, a bank becomes unable to sell its assets or at such a low price that even a 30 % capital ratio will not solve the problem.

What is really at stake is not the institutions per se but how some financial activities become systemic. Only competent and independent supervisors combining the **micro and the macro supervision** could deal with that issue. I say independent because there is a big bet that some supervisors warned their respective government against financial excesses (it is more than likely in the case of the German supervisor and the strange activities referring to their mandate of some Landesbanken) and they were required to remain silent. It is necessary to have the same requirement for the new **macro supervision** authorities, which have been set up on both sides of the Atlantic. Besides it will be indispensable that those authorities coordinate to avoid a remake of the subprime crisis.

Well-managed banks (meaning with credible corporate and risk management) together with good supervision, a credible framework for crisis management with living wills is the only credible way to prevent financial crisis or at least to minimize their effects for the tax payers. Consequences are that supervisors must be well equipped (quantity and quality of their employees / processes meaning enough intrusive supervision: as usual, the cobs must be smarter than gangsters)

To answer your question, I would like to say that economic growth should be the first priority of governments. The possibility of a double dip situation is not yet excluded in the USA, the pace of growth in Europe is more than likely to stay really slow for the next five years for various reasons.

Large banks have warned policymakers that they will be able to cope with the higher capital requirements imposed by Basel 3 and the forthcoming CRD4, at the price of a reduction of some of their activities. If it is decided to impose a new layer of capital it will not prevent another systemic crisis, but it is bound to affect the economic growth. I will add that the current account imbalances and the permissive monetary policy, which were at the very

beginning of the financial crisis, are still there and provide the fuel for the next crisis which will probably occur in a less regulated segment of the financial markets. Besides, policymakers are going to miss the real issue which is about preparing a sustainable long term growth, about reflecting on long term investment and on the way to finance it.