PRESS REVIEW

Jackson Hole Speech
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Andy Haldane

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Kansas City Fed Jackson Hole 2012: Ben Bernanke Will Likely Disappoint On QE3 Hopes.

LENGTH: 890 words

Federal Reserve Chairman Ben Bernanke's much-anticipated speech on Friday at the Federal Reserve Bank of Kansas City Economic Symposium in Jackson Hole, Wyo., has every one in "wait mode."

The Fed Chairman's speech on "Monetary Policy Since the Crisis," scheduled at 10 a.m. E.T., follows weeks of speculation about whether the central bank will carry out a third round of quantitative easing, or QE3.

While this topic should give Bernanke plenty of room to review both the actions the Fed has taken to date and to discuss what remains in its "toolkit," economists and Fed watchers think investors looking for him to lay out specific plans for new stimulus are probably in for a disappointment.

"We anticipate a relatively dovish speech, signaling a high probability of additional Fed easing at their Sept. 12-13 meeting," Ethan Harris, North American economist at Bank of America Merrill Lynch, wrote in a report. "While a change in the Fed's rate guidance is very likely, Bernanke is probably not ready to pre-announce QE3. Hence his remarks could disappoint the markets."

The central bank bought $2.3 trillion of debt from 2008 to 2011 in two rounds of quantitative easing. It has also kept its benchmark interest rate at zero to 0.25 percent since December 2008 and has pledged to hold it there until at least 2014.

Bernanke's speech on Friday is the headline act, but investors were also keen to hear what European Central Bank President Mario Draghi has to say about the ECB's options for aiding the European debt crisis.

However, Draghi canceled his trip to Jackson Hole as he prepares for a meeting of the ECB's Governing Council that may see him announce details of a new bond-buying program. A spokesman in Frankfurt said Draghi won't go because of the "heavy workload" foreseen in the next few days.

While none of ECB's six-member Executive Board members will attend Jackson Hole, Bundesbank Chief Jens Weidmann, a member of the Governing Council, still plans to attend.

Bank of England's superstar Executive Director for Financial Stability, Andy Haldane, is also going.

The Fed signaled last week it's ready to take further steps to spur the economic recovery. The Aug. 1 Federal Open Market Committee minutes noted that "many members judged that additional monetary accommodation would likely be warranted fairly soon unless incoming information pointed to a substantial and sustainable strengthening in the pace of the economic recovery."

"This is a very strong easing bias. Thus, one question the markets will be looking for Bernanke to address is what conditions would lead the Fed to follow through with additional accommodation fairly soon? A second is what form any accommodation would take," Harris said.
Conventional wisdom views Bernanke's speech at Jackson Hole as a reliable signal of future Fed policy. However, a review of recent speeches done by Harris and his colleagues suggests it has not been quite so clear an indicator in real time.

For example, in 2010 Bernanke emphasized the cost-benefit trade-off for various tools, and the Fed did not implement QE2 until more than two months later. In 2011 he put substantial focus on the need for fiscal policy action and argued that "monetary policy is not a panacea." A repeat performance would likely result in markets pricing lower the probability of near-term Fed QE.

If Bernanke's speech on "Monetary Policy Since the Crisis" this Friday turns out to be just a walk down memory lane, the market would obviously be disappointed.

Bernanke has already done two retrospectives on what the Fed has done. In March he gave a series of lectures at George Washington University, with the last one on "The Aftermath of the Crisis" that described and defended the Fed's actions since late 2007. Then in April he gave a speech entitled, "Some Reflections on the Crisis and the Policy Response," although that speech focused on the emergency liquidity tools rather than the subsequent accommodating policy stance.

Market expectations about near-term Fed easing seem to be quite high going into the meeting. According to Bank of America Rates Strategists Priya Misra's estimates, the bond market is pricing in about an 80 percent chance of QE at one of the next several meetings.

Bank of America's U.S. equity strategist Savita Subramanian is also concerned about excessive optimism in the stock market. Stocks are more than 10 percent above their early June lows, despite generally disappointing data.

Presumably this reflects both the relative calm in Europe and expectations of QE3. If Bernanke does disappoint, one or both of the equity or rates markets could weaken modestly, according to Harris.

Harris expect Bernanke to take three further steps at Jackson Hole.

First, underscore the bias statement in the minutes: If the economy does not improve substantively we will ease further. Second, discuss the Fed's options in greater detail, building on some of the discussion already noted in the minutes. Third, argue vigorously that unconventional policy is both necessary and effective.

However, Harris does not expect an outright signal of QE3.

Furthermore, Bernanke will likely remind everyone that monetary policy is not a panacea and will likely point to the pressing need to deal with the fiscal cliff. Bernanke is also likely to note that unconventional policy comes with costs as well as benefits.

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Ben Bernanke gave another Augustinian give-us-QEn-but-not-yet* speech at Jackson Hole today and you could go read it but honestly why would you, you know what it says, which is everything is bad, but not as bad as it could be, and we want to make it a bit better, but only once it’s gotten a bit worse. Moving right along.

To Andrew Haldane’s speech, which is a treat! It is here and its title is The dog and the frisbee, so obviously he had Dealbreaker on his side right there. Haldane, the Bank of England’s financial-stability guy, basically argues that while the financial system is complex, it should be regulated simply. As you do not fight fire with fire, you do not fight complexity with complexity just as a dog uses only elementary trigonometry and differential calculus to solve the complex and multivariate problem of catching a frisbee.**

Haldane’s main example of overcomplexity in regulation is risk-based capital regulation, in which the Basel accords have moved from simple leverage tests common equity divided by total assets to complicated tests where the numerator is made up of different tiers of capital and the denominator uses risk-weights that are largely driven by the bank’s own models of riskiness. One thing you could do is compare the performance of those measures in the recent crisis, so he did. Here is how Basel risk-based capital did:

That looks bad and also is bad, with no statistically significant difference between banks that blew up and banks that did not. This is just boring leverage:

This looks better, and Haldane adds The pre-crisis leverage ratio of failing banks was statistically significantly lower than surviving banks at the 1% significance level, by on average 1.2 percentage points. Dumb leverage is much better at predicting bank failure than smart leverage.

He points out some other complexities that have had mixed results VaR being a big one*** and sums up: Over the past 30 years or so, the regulatory direction of travel has been towards pricing risk in the financial system, rather than prohibiting or restricting it. [R]egulators have pursued price over quantity-based regulation. That makes sense when optimising in a risky world.

It may make less sense when optimising in an uncertain world. Quantity-based restrictions may be more robust to mis-calibration. Simple, quantity-based restrictions are the equivalent of a regulatory commandment: Thou shalt not. These are likely to be less fallible than: Thou shalt provided the internal model is correct. That is one reason why Glass-Steagall lasted for 60 years longer than Basel II.

Zing!

The speech is very good but this sort of thing always leaves me a bit unmoved. That Basel leverage vs. regular leverage test is biased by the fact that banks were regulated to Basel leverage, meaning: everyone had to have roughly the same amount of Basel capital,**** and your incentive was to maximize the actual risk you took with each dollar of regulatory risk.
Thus higher total leverage in that regulatory regime is less about who was more levered and more about who was more aggressive in gaming capital requirements to maximize risks and returns; there's no reason to think that in a world regulated to total leverage the aggressive ones wouldn't be gaming that. (By, for instance, using all of their allowed leverage to buy risky assets.) Perhaps related is this interesting paper from Robert Jarrow claiming that capital-adequacy regulation based on VaR can increase systemic risk by encouraging banks to sell a lot of tail-risk insurance:

Under a VaR capital adequacy rule, firms can easily adjust their assets and liabilities to increase the probability of catastrophic losses, while improving or keeping VaR unchanged. Given limited liability and for banks (deposit insurance), management and shareholders would have an incentive to do so. The balance sheet modification is conceptually very simple. The firm needs to sell put options on the risks in the far left-tail of its loss distribution. These increased liabilities are not registered by VaR. But selling these put options brings in cash, which can be used to purchase additional assets. The newly purchased assets decrease VaR. This is an example of regulatory arbitrage.

That passage is model-based but grounded in history—basically it corresponds to write a lot of puts on AAA assets and pretty much describes how you get low levels of risk-weighted leverage but high levels of actual leverage. Jarrow's solution is to add another capital-adequacy metric, based on conditional expected loss given exceeding VaR, to make that arbitrage impossible; Haldane's would presumably be to subtract a metric: don't worry about VaR, just don't write too many puts on any assets. Either would probably work to shut down this particular game.

But this is just one game. And Haldane's other simplifiers aren't that encouraging:

Quantity-based regulatory solutions have gained currency during the course of the crisis. In the US, the Volcker rule is a quantity-based regulatory commandment: Thou shalt not engage in proprietary trading. In the UK, the Independent (Vickers) Commission on Banking has also proposed structural, quantity-based reforms: Thou shalt not co-mingle retail deposit-taking and investment banking.

Yet even these notionally simple, structural proposals run some risk of backdoor complexity. For example, the consultation document accompanying Volcker already runs to 298 pages.

Yeah yeah yeah the Volcker Rule is too complicated, it should be simpler, why not just say don't prop trade? But of course then no one could tell you what prop trading is. The Vickers/Glass-Steagall rule is simple, but a rule like don't use retail deposits to fund investment banking leads to money market funds that invest in repos on securities dealers inventories, which are very different words that mean using retail deposits to fund investment banking.

I feel like the model underlying these simplify-your-regulations arguments is:

risk and reward are correlated, bankers have asymmetric upside and so want more risk (as more risk = more upside, and their downside is floored at zero), regulators can price/limit/ban whatever any finite number of risks, with the cost in regulator heartache increasing in the number of regulated risks, but the number of possible risks is infinite and bankers only need to think of one that the regulators didn't think of to make a lot of money and maybe blow up the world, so regulators should stop trying to think of lots of things and try thinking of fewer things.

The first four of those points seem more or less inarguable. The fifth is a very natural thing to think in response, and solves the important (for regulators) optimization problem of reducing regulator heartache. I just don't see why it would work.

The dog and the frisbee paper by Andrew Haldane [BoE, and press release]

Jackson Hole Paper 2 Destroying the Tower of Basel [Money Supply]

Capital Adequacy Rules, Catastrophic Firm Failure, and Systemic Risk [Harvard Law and SSRN]

* That reference in this context feels like it is not original to me but I don't know who got it first. The Economist has used it with austerity. The original is of course.

** Haldane actually says For studies have shown that the frisbee-catching dog follows the simplest of rules of thumb: run at a speed so that the angle of gaze to the frisbee remains roughly constant, and I cannot stop myself imagining the dog reasoning that out with a few simple diagrams and an HP-12C.

*** This is a good thing to ponder:

To give some sense of scale, consider model-based estimates of portfolio Value at Risk (VaR), a commonly-used technique for measuring risk and regulatory capital in the trading book. A large firm would typically have several thousand risk factors in its VaR model. Estimating the covariance matrix for all of the risk factors means estimating several million individual risk parameters. Multiple pricing models are then typically used to map from these risk factors to the valuation of individual instruments, each with several estimated pricing parameters.
Taking all of this together, the parameter space of a large bank’s banking and trading books could easily run to several millions. These parameters are typically estimated from limited past samples. For example, a typical credit risk model might comprise 20-30 years of sample data—barely a crisis cycle. A market risk model might comprise less than five years of data—far less than a crisis cycle.

**** I mean, not really, but everyone had to have adequate Basel capital, and wanted to minimize capital subject to that requirement. Note that that chart has a narrower range than the total leverage chart. So you shouldn’t really expect differences in adequate Basel capital levels to distinguish failed and non-failed banks.
Simplify bank regulation, Haldane says;
Both banks and financial regulation need to be simplified if another crisis is to be averted, according to Andy Haldane, head of financial stability at the Bank of England.

BYLINE: By Philip Aldrick Economics Editor

SECTION: FINANCE

LENGTH: 532 words

In a speech to fellow central bankers at Jackson Hole, Mr Haldane called on regulators to rip up the Basel accord that has underpinned financial oversight since 1988 and start again with simpler rules based more on "supervisory judgement" than a "ticked box approach".

He also urged banks to respond to market pressure and break themselves up in a re-run of the 1930s. Proposals to ring-fence retail banking in the UK and ban proprietary trading in the US "may not go far enough", he said, as rules may be watered down through "backdoor complexity".

Instead, citing 1933 when "a number of banks began selling off their equity brokerage affiliates", he said: "Bankers today, many cursed and condemned, could make a virtue of necessity. The market could lead where regulators have feared to tread."

Regulation has chased financial innovation unsuccessfully, Mr Haldane said. To meet the new Basel 3 rules alone, Europe's banks will have to create 70,000 new full time compliance jobs, he calculated from a McKinsey study.

"Modern finance is complex, perhaps too complex. Regulation of modern finance is complex, almost certainly too complex," he said. "Applying complex decision rules in a complex environment may be a recipe not just for a cock-up but catastrophe."

"The general message is that the more complex the environment, the greater the perils of complex control. The optimal response ... is to simplify and streamline. Less may be more."

Allowing banks to become too complex has also made it near-impossible for investors to exert proper market control. "For investors today, banks are the blackest of boxes. Their multiplicity and complexity have undermined transparency and, with it, market discipline," he said.
Simplify bank regulation, Haldane says; Both banks and financial regulation need to be simplified if another crisis is to be averted, according to Andy Haldane, head of financial stability at the Bank of England.

To re-boot the system, he suggested regulators prioritise simple leverage ratios over complicated capital ratios, penalising banks that are too complex, and stripping regulation back to "fewer, more experienced supervisors, operating to a smaller, less detailed rulebook", and "re-configuring the financial system".

Current leverage ratios are still too high, he said. "Banks' equity can in principle be leveraged up to 33 times. Most banks would say a loan-to-value ratio of 97pc was imprudent for a borrower. A 3pc leverage ratio means banks are just such a borrower," he said.

"For the world's largest banks, the leverage ratio needed to guard against failure in this crisis would have been above 7pc. The leverage ratio that would have minimised crisis errors is around 4pc."

He also suggested imposing "an explicit regulatory charge on complexity", such as the capital surcharge on systemically important banks. "Re-configuring the financial system" could see banks broken back into separate retail and investment businesses.

"In forgone output, financial crises can be as costly as wars," Mr Haldane said. "Because complexity generates uncertainty, not risk, it requires a regulatory response grounded in simplicity, not complexity.

"Delivering that would require an about-turn from the regulatory community from the path followed for the better part of the past 50 years. If a once-in-a-lifetime crisis is not able to deliver that change, it is not clear what will."

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Haldane offers the vision thing at Jackson Hole;
There were quite a few interesting speeches at the Jackson Hole conference but Ben Bernanke's wasn't one of them.

BYLINE: By Damian Reece

SECTION: FINANCE

LENGTH: 624 words

Come November and a presidential election he could be out of a job, so it's not too surprising America's central banker chose to lay low in his Teton retreat.

He didn't need to rock the Rockies with promises of radical action on monetary policy. The official policy-making Open Market Committee sits in a fortnight and Bernanke can well afford to allow that body to take a collective decision on the next move - armed with the latest economic data.

I suspect last night's traditional barbecue and line dance was more interesting, when central bankers let down what little hair they have in the crisp night air of Wyoming.

But if you were there for the speeches, a much more interesting paper was presented by Andrew Haldane, the Bank of England's head of financial stability.

Haldane has made some of the smarter central bank interventions of recent years. His Wincott Memorial Lecture last October was particularly lucid, arguing for regulation that puts the real economy first rather than the needs of banks and bankers. His latest speech developed these arguments, laying out the case for much simpler regulation and allowing market forces to push banks into splitting themselves into much simpler institutions.

Haldane also enjoys the analogical. Being an effective regulator that can pre-empt a financial crisis is a bit like a dog, a watchdog perhaps, catching a frisbee. The dog doesn't stop to consider the highly complex aerodynamic factors making the frisbee fly, or how Newton's law of gravity might be applied to an assessment of the situation. Instead, it runs at a speed that keeps its angle of gaze to the frisbee constant. Humans do the same, apparently.

Yet while trying to catch a crisis, central bankers, policymakers and other regulators are complicating matters and thus making it less likely that they will succeed in their goal. Simplicity would make regulation more effective for all concerned. If markets can force a similar level of simplicity on the structure of banks, all the better.

Markets react to signals and Haldane argues that simpler banks should be rewarded with a regulatory dividend while
Haldane offers the vision thing at Jackson Hole; There were quite a few interesting speeches at the Jackson Hole conference but Ben Bernanke's wasn't one of them. telegraph.co.uk August 31, 2012 Friday 7:30 PM GMT

more complex ones are penalised. But the market also needs clarity on which institutions, or parts of institutions, will enjoy central banks' lender of last resort backing and which will not. It needs to be clear who will foot the bill when things go wrong and attach valuations based on that risk.

Shareholders, and their management, need to be able to make a distinction between the risks and returns of different activities. The proposed ring fence will help and the suspicion has always been it would be implemented in such a way as to make it obvious to the market that shareholders would be better off backing separate institutions. Until we see the final rules it's not clear that will happen. Haldane reckons financial crises can be as economically destructive as wars but the regulatory solutions so far being planned won't stop another one happening - and that's the biggest risk the financial system still poses.

A decent offer to take house builder private

Steve Morgan's 152p a share proposal to take house builder Redrow private looks fair. Shareholders will moan but many refused to buy in April at 130p in an open offer underwritten by Morgan so can hardly argue it's worth more than 152p now. They allowed themselves to be diluted, ceding control to Morgan with 40.4pc.

At 152p, the proposal's also pitched at the company's net asset value versus a share price that trades at a discount - in common with the sector. It's a 23.8pc premium to Redrow's 90 day average price but as Morgan's proposal is backed by Toscafund, with 13.8pc, he's not bidding for control so can't be expected to pay much more.

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Bernanke's promise of stimulus buoy US markets;
US stock markets rose after Ben Bernanke signalled he would be willing to inject fresh stimulus into the US economy, even though he failed to provide the specifics some had hoped for.

BYLINE: By Richard Blackden and Philip Aldrick

SECTION: FINANCE

LENGTH: 507 words

US stock markets rose after Federal Reserve chairman Ben Bernanke signalled he would be willing to inject fresh stimulus into the US economy, even though he failed to provide the specifics some investors were hoping for.

In an eagerly-anticipated speech at the annual gathering of central bankers in Jackson Hole, Wyoming, Mr Bernanke delivered a relatively downbeat picture of the world's largest economy five years on from the start of the financial crisis.

The Fed chief said the high level of unemployment - it climbed to 8.3pc in July - was a "grave concern", admitting that the "economic situation remains far from satisfactory". Although Mr Bernanke offered no clues as to what the Fed may do and when, his assessment of the economy seemed enough to convince investors that the central bank is likely to do more.

After dropping briefly after the release of the speech on Friday afternoon, the Dow Jones Industrial Average was up 1.1pc at 13,139.70 in late morning trading on Wall Street and the S&P 500 climbed 0.6pc to 1,408.

"The chairman is clearly hoping for another round of quantitative easing," said Chris Low, an economist at FTN Financial.

His comments came as the outgoing Bank of England rate-setter, Adam Posen, said the world's top central banks had room to ease monetary policy further.

Mr Posen, whose term ended on Friday, said the Fed had room to pursue further QE and that the Bank should consider buying assets other than government bonds if it chooses to ease monetary policy further.

Also speaking at Jackson Hole, Andy Haldane, head of financial stability at the Bank, called for drastic reforms to prevent another crisis that would see both banks and financial regulation simplified. He called on regulators to rip up the Basel Accord that has underpinned financial oversight since 1988 and start again with simpler rules, based more on
Bernanke's promise of stimulus buoys US markets; US stock markets rose after Ben Bernanke signalled he would be willing to inject fresh stimulus into the US economy, even though he failed to provide the specifics some had hoped for.

"supervisory judgement" than a "ticked box approach".

He also urged banks to respond to market pressure and break themselves up in a re-run of the 1930s. Proposals to ring-fence retail banking in the UK and ban proprietary trading in the US "may not go far enough", he said, as rules may be watered down through "backdoor complexity". Citing 1933, when "a number of banks began selling off their equity brokerage affiliates", he said: "Bankers today could make a virtue of necessity. The market could lead where regulators have feared to tread.

"Modern finance is complex, perhaps too complex. Regulation of modern finance is complex, almost certainly too complex," he said. "Applying complex decision rules in a complex environment may be a recipe not just for a cock-up but catastrophe."

To re-boot the system, he suggested regulators prioritise simple leverage ratios over complicated capital ratios, penalising banks that are too complex, and strip regulation back to "fewer, more experienced supervisors, operating to a smaller, less detailed rulebook", and "re-configuring the financial system".

"In forgone output, financial crises can be as costly as wars," he said.

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Bernanke's promise of stimulus buoys US markets

BYLINE: Richard Blackden; Philip Aldrick

SECTION: BUSINESS; Pg. 35

LENGTH: 502 words

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The Fed chief said the high level of unemployment - it climbed to 8.3pc in July - was a "grave concern", admitting that the "economic situation remains far from satisfactory". Although Mr Bernanke offered no clues as to what the Fed may do and when, his assessment of the economy seemed enough to convince investors that the central bank is likely to do more.

After dropping briefly after the release of the speech yesterday afternoon, the Dow Jones Industrial Average finished up 0.69pc at 13,090.84, while the S&P 500 climbed 0.51pc to 1,406.

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His comments came as the outgoing Bank of England rate-setter, Adam Posen, said the world's top central banks had room to ease monetary policy further.

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See Comment: P34

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GRAPHIC: Ben Bernanke said the high level of US unemployment was a 'grave concern'

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Haldane offers the real vision at Jackson Hole; Comment

BYLINE: Damian Reece

SECTION: BUSINESS; Pg. 34

LENGTH: 528 words

THERE were quite a few interesting speeches at the Jackson Hole conference yesterday but Ben Bernanke's wasn't one of them. Come November and a presidential election he could be out of a job, so it's not too surprising America's central banker chose to lay low in his Teton retreat.

He didn't need to rock the Rockies with promises of radical action on monetary policy. The official policy-making Open Market Committee sits in a fortnight and Bernanke can well afford to allow that body to take a collective decision on the next move - armed with the latest economic data.

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But if you were there for the speeches, a much more interesting paper was presented by Andrew Haldane, the Bank of England's head of financial stability.

Haldane has made some of the smarter central bank interventions of recent years. His Wincott Memorial Lecture last October was particularly lucid, arguing for regulation that puts the real economy first rather than the needs of banks and bankers. His latest speech developed those arguments, laying out the case for much simpler regulation and allowing market forces to push banks into splitting themselves into much simpler institutions. Haldane also enjoys the analogical. Being an effective regulator that can pre-empt a financial crisis is a bit like a dog, a watchdog perhaps, catching a frisbee. The dog doesn't stop to consider the highly complex aerodynamic factors making the frisbee fly, or how Newton's law of gravity might be applied to an assessment of the situation. Instead, it runs at a speed that keeps its angle of gaze to the frisbee constant. Humans do the same, apparently.

Yet while trying to catch a crisis, central bankers, policymakers and other regulators are complicating matters and thus making it less likely that they will succeed in their goal. Simplicity would make regulation more effective for all concerned. If markets can force a similar level of simplicity on the structure of banks, all the better.
Markets react to signals and Haldane argues that simpler banks should be rewarded with a regulatory dividend while more complex ones are penalised. But the market also needs clarity on which institutions, or parts of institutions, will enjoy central banks' lender of last resort backing and which will not. It needs to be clear who will foot the bill when things go wrong and attach valuations based on that risk. Shareholders, and their management, need to be able to make a distinction between the risks and returns of different activities. The proposed ring fence will help and the suspicion has always been it would be implemented in such a way as to make it obvious to the market that shareholders would be better off backing separate institutions. Until we see the final rules it's not clear that will happen. Haldane reckons financial crises can be as economically destructive as wars but the regulatory solutions so far being planned won't stop another one happening - and that's the biggest risk the financial system still poses.

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JOURNAL-CODE: DTL

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DAILY MAIL (London)

September 1, 2012 Saturday

BYLINE: BY

LENGTH: 54 words

* FINANCIAL regulation is too complicated and the rule book should be torn apart, a Bank of England official said yesterday. Complexity generates uncertainty and it requires a regulatory response grounded in simplicity,' said Andy Haldane, executive director for financial stability. Less may be more,' he added.

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El Mercurio (Chile)

September 2, 2012 Sunday

De Gregorio, en Jackson Hole: "Desarrollo financiero va mano a mano con más reglas"

BYLINE: El Mercurio

LENGTH: 334 palabras

El ex presidente del Banco Central José De Gregorio participa este fin de semana en Jackson Hole, en el 36º Simposio de Políticas Económicas de la Reserva Federal de Kansas, para comentar un trabajo sobre regulación financiera presentado por técnicos del Banco de Inglaterra ("The dog and the frisbee"), según el cual las nuevas normas para regular los bancos son complejas y pueden ser demasiado complicadas para proporcionar la supervisión necesaria para evitar otra crisis.El ex presidente del Banco Central José De Gregorio participa este fin de semana en Jackson Hole, en el 36º Simposio de Políticas Económicas de la Reserva Federal de Kansas, para comentar un trabajo sobre regulación financiera presentado por técnicos del Banco de Inglaterra ("The dog and the frisbee"), según el cual las nuevas normas para regular los bancos son complejas y pueden ser demasiado complicadas para proporcionar la supervisión necesaria para evitar otra crisis.

El sistema financiero requiere una regulación más estricta y más simple, pero "no hay almuerzo gratis", dice De Gregorio, señalando que eso tiene un costo que es asumido por las empresas y los hogares. Además, plantea que es mucho mejor pagar esos costos en tiempos normales, que son un mejor reflejo de los costos de oportunidad reales, y no costos mucho más altos en los momentos críticos.

Se pregunta si es realmente la complejidad más ineficiente lo que ha incrementado las reglas y el personal de agencias reguladoras o es que los bancos han aumentado el número de productos que ofrecen. "Nuevos productos requieren nuevas reglas y nuevos datos. El desarrollo financiero va mano a mano con más reglas", agrega. Su impresión es que los autores están concluyendo que lo que realmente se necesita simplificar es el mercado financiero y el sector bancario.

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PUBLICATION-TYPE: Periodico
Business: Analysis: Business leader: In a world where casino banks are out of luck, Barclays ought to gamble on getting smaller

SECTION: OBSERVER BUSINESS PAGES; Pg. 36

LENGTH: 577 words

Bob Diamond may have represented the showy, swashbuckling side of Barclays, but his successor, Antony Jenkins, is a reminder of its humbler, more boring roots, as a plain old deposit-taking high street bank. Where the US-born Diamond was smooth, unrepentantly proud of Barclays' record and desperate for the bank to hold its own against the likes of Goldman Sachs, Jenkins is quietly spoken, forged his reputation on the retail side - and quickly dropped Diamond's ambitious targets for boosting return on equity.

Jenkins has a tough task restoring the bank's reputation and rebuilding shattered relationships with regulators and politicians, against the background of twin Serious Fraud Office probes over Libor-rigging and payments to Qatari investors in 2008.

But he will also have to confront the question of what Barclays is for. Does it still cling to the dreams of Wall Street glory that saw Diamond slurp up the dregs of Lehman Brothers at the height of the crisis? Or does Jenkins's appointment signal an intention to make savings, loans and mortgages the heart of the business?

Of course, Barclays is not the only British bank forced to face such a dilemma: Jenkins's appointment marks the final stage in the wholesale clearout of the top echelons of the financial sector that started with Northern Rock's woefully out-of-his-depth boss Adam Applegarth in December 2007.

Investment banking, which seemed like a licence to print money, has become less profitable as regulators impose higher capital requirements on riskier activities. All the major banks are slimming down their investment banking operations, and selling off some of the other businesses they plunged into during the boom years.

Jenkins has stressed his allegiance to "universal banking"; but he might do well to heed the words of Andy Haldane, one of the Bank of England's biggest brains, who argued this weekend that banks might be wise to "make a virtue of necessity" and hive off their investment banking arms.

Much of the typically erudite speech Haldane delivered at the Jackson Hole meeting of the world's central bankers was aimed at regulators. He urged them to ditch 50 years of received wisdom and keep things simple, instead of imposing ever more complex rules, such as the byzantine Basel framework of capital requirements - the "tower of Basel", as he called it.

He compared the task of regulators trying to keep track of financial institutions with a dog trying to catch a frisbee. Research has apparently shown that a dog (and indeed a person) catches a Frisbee by following a simple rule: "run at a speed so that the angle of gaze to the Frisbee remains roughly constant". So regulators would do better to concentrate on a few rules of thumb - such as "more leveraged banks are more risky" - rather than a battery of mind-boggling models.
Business: Analysis: Business leader: In a world where casino banks are out of luck, Barclays ought to gamble on getting smaller

But Haldane had advice for banks, too: he ended his speech by pointing out that in the 1930s the Glass-Steagall regulation that imposed a clean cut between retail and investment banking in the US was only implemented after some banks responded to their sickly valuations on the equity markets by splitting themselves up. "The market could lead where regulators have feared to tread," he said.

Barclays' valuation will inevitably be seen as one metric of Jenkins's performance. If, like Haldane, he believes that simple is better, he could split the bank in two, and make Barclays a world leader - but not in quite the way Diamond had in mind.

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LANGUAGE: ENGLISH

PUBLICATION-TYPE: Newspaper

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The dog, the Frisbee and Basel III

LENGTH: 802 words

"To ask today's regulators to save us from tomorrow's crisis using yesterday's toolbox is to ask a border collie to catch a Frisbee by first applying Newton's law of gravity," said a Bank of England regulator.

In a paper given at the Federal Reserve Bank of Kansas City's 36th economic policy symposium in Jackson Hole, Wyoming, Andrew Haldane - Bank of England Executive Director for Financial Stability and member of the Financial Policy Committee - explores why the type of complex financial regulation developed over recent decades may be sub-optimal for crisis control (regulator speak for "It's not going to work"). In doing so, he draws out a number of public policy lessons. The paper is co-written with a Bank colleague, Vasilios Madouros.

Andrew Haldane presents evidence from a range of real-world settings to demonstrate that decision-making in a complex environment can benefit from the use of simple decision rules of thumb. He argues that complex rules often: have punitively high costs of information collection and processing; rely on "over-fitted" models that yield unreliable predictions; and can induce defensive behaviour by causing people to manage to the rules.

He argues that regulatory responses to financial crises, past and present, have been to increase complexity with "...a combination of more risk management, more regulation and more regulators". As the Basel Accords have evolved over time, he notes, so has opacity and complexity associated with increasingly granular, model-based risk-weighting. Meanwhile, detailed rule-writing in the form of legislation has increased dramatically, as has the scale and scope of resources dedicated to regulation.

Andrew Haldane uses a set of empirical experiments to measure the performance of regulatory rules, simple and complex. He finds that simple rules such as the leverage ratio and market-based measures of capital outperform more complex risk-weighted models and multiple-indicator measures in their crisis-predictive performance. He says that: "The message from these experiments is clear and consistent. Complexity of models or portfolios generates robustness problems when understanding a complex financial system over plausible sample sizes. More than that, simplicity rather than complexity may be better capable of solving these robustness problems."

Andrew Haldane considers five policy lessons that financial regulation can draw from these findings. First, he suggests that the Basel framework could take: "...a more sceptical view of the role and robustness of internal risk models in the regulatory framework...simplified, standardised approaches to measuring credit and market risk, on a broad asset class basis, could be used."
Second, he says the leverage ratio could be placed on an equal footing with capital ratios, an approach taken by the Bank of England's Financial Policy Committee, and market-based indicators of capital adequacy added to regulators' and investors' indicator set.

Third, Andrew Haldane calls for a fresh approach to financial supervision, one which is less rules-focussed and more judgment-based. He notes that this approach, "...will underpin the Bank of England's new supervisory model when it assumes prudential regulatory responsibilities next year." To be effective, he says that will require more experienced regulators working to a smaller, less detailed rulebook. He adds that greater simplicity and consistency in disclosure practices could also strengthen market discipline.

Fourth, he considers the case for tackling complexity directly and at source. He says that recent events have re-demonstrated the problems that arise in risk-managing large, complex banks, "At present, no explicit regulatory charge is levied on those complexity externalities. Doing so would help protect the system against failure, while providing explicit incentives to simplify balance sheets."

Finally, Andrew Haldane notes that, while quantity-based restrictions such as the Independent Commission on Banking proposals in the UK and the Volcker rule in the US are robust to complexity and uncertainty, they risk being mired in detail in their implementation. He argues that cleaner solutions could be considered, or that the market could lead by encouraging banks to sell-off assets and reduce complexity.

Andrew Haldane says that, "Modern finance is complex, perhaps too complex...As you do not fight fire with fire, you do not fight complexity with complexity. Because complexity generates uncertainty, not risk, it requires a regulatory response grounded in simplicity, not complexity." That would require "...an about-turn from the regulatory community from the path followed for the better part of the past 50 years." But when it comes to financial regulation, concludes Andrew Haldane, "...less may be more".

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Fewer and simple regulatory ratios floated by BoE's Haldane

LENGTH: 497 words

The complexity of Basel III and other regulatory responses to the global financial crisis may be misplaced, Andy Haldane, director of financial stability at the Bank of England, argued in a paper delivered at the US Federal Reserve's annual economic symposium at the end of last week.

Haldane presented analysis drawn from a sample of 100 of the world's most active banks at the end of 2006. Thirty-seven of these needed aid from the public sector as the crisis progressed.

Drawing on the (so far unpublished) work of BoE colleagues, Haldane argued that:

-- Simple weighted measures have greater predictive power than the risk-weighted measures that are the cornerstone of banking supervision at present.

-- Simpler measures of accounting capital, based on equity capital, outperform broader, more complex measures.

-- Simple market-based measures of banks' equity dominate accounting measures in their ability to predict the performance of a bank in a crisis.

"The regulatory response to the crisis has largely been based on the level of thinking that created it," Haldane said.

"The Tower of Basel, like its near-namesake the Tower of Babel, continues to rise.

"An alternative point of reference when regulating a complex system would be to simplify and streamline the control framework. Based on the evidence here, this might be achieved through a combination of... policy measures."

Haldane spelled out five of these, including "de-layering the Basel structure", "strengthening supervisory discretion" and "structurally re-configuring the financial system".

By the latter Haldane appears to mean carving retail and commercial banking away from investment banking (and possibly asset management), a theme he has pushed in the past.
Of the complicated rules that permeate the present approach to bank regulation, Haldane said: “The quest for risk-sensitivity in the Basel framework, while sensible in principle, has generated problems in practice.”

"It has spawned startling degrees of complexity and an over-reliance on probably unreliable models.

"The Tower of Basel is at risk of over-fitting - and over-balancing. It may be time to rethink its architecture."

Haldane pushed for reliance on a straightforward leverage ratio - common equity divided by assets - of the kind the Australian Prudential Regulation Authority has resolved to push into the background in Australia.

The BoE executive pointed out that banks must now produce tens of thousands of items of data in regular reports to regulators, the utility of which he doubted.

Haldane also questioned the use of internal risk models that rely on data-sets that are simply not available.

"With thousands of parameters calibrated from short samples, these models are unlikely to be robust for many decades, perhaps centuries, to come.

"It is close to impossible to tell whether results from them are prudent.

"One simple response to that concern may be to impose strict limits, or floors, on model outputs," he said.

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PUBLICATION-TYPE: Newspaper
Parijs redt hypotheekbank;
Frankrijk moet bank te hulp schieten die geen toegang meer heeft tot kapitaalmarkt

SECTION: Ondernemen; Blz. 9
LENGTH: 440 woorden

Frankrijk moet bank te hulp schieten die geen toegang meer heeft tot kapitaalmarkt

Van onze redacteur

Amsterdam

De Franse overheid dreigt voor de tweede keer sinds de kredietcrisis een bank te moeten redden van de ondergang.

Volgens dagblad Le Figaro staat de overheid op het punt om Crédit Immobilier de France (CIF), een relatief kleine hypotheekbank met een balanstotaal van 40 mrd, te hulp te schieten. Het ministerie van economische zaken heeft aan de Franse krant bevestigd bereid te zijn garanties te verlenen voor de financiering die de bank wil aantrekken.

Eerder moest Parijs al Dexia te hulp schieten, de Belgisch-Franse bank die in grote problemen was gekomen na de overname van een Amerikaanse kredietverzekeraar.

Waar Dexia struikelde over onbesuisde overnames, zijn het bij CIF vooral de kapitaalmarkten die het voortbestaan in gevaar brengen. De hypotheekbank heeft nauwelijks spaargeld, maar is voor het grootste deel gefinancierd via (gedekte) obligaties. Beleggers steken hun geld de laatste jaren echter alleen nog in Europese banken als het topnemen zijn.

Voor CIF is een afwaardering door Moody s, vorige maand, de druppel die de emmer deed overlopen. Beleggers zijn minder dan vroeger bereid om de obligaties te financieren. In het najaar loopt een gedekte obligatie af met een omvang van 1,75 mrd, en daar is een herfinanciering voor nodig.

De Franse overheid moet wel langs de Europese Commissie, die toestemming moet geven voor het reden van bedrijven.
Parijs redt hypotheekbank; Frankrijk moet bank te hulp schieten die geen toegang meer heeft tot kapitaalmarkt Het Financieele Dagblad 3 september 2012 maandag

Waarschijnlijk kiest Parijs, dat nog vergeefs heeft geprobeerd een koper te zoeken voor CIF, voor een uitdoofscenario. Volgens Le Figaro kost de redding dan per saldo geen belastinggeld, want het -eigen vermogen van de bank (2,4 mrd) moet voldoende zijn om -tegenvallers op te vangen.

Volgens de Franse overheid kampt CIF niet alleen met financieringsproblemen op de korte termijn, maar heeft de bank ook structureel een probleem als straks de nieuwe internationale bankenregels (Basel 3) van kracht worden. Die maken het onaantrekkelijk om sterk afhankelijk te zijn van de kapitaalmarkten.

Dit weekend kwam er kritiek vanuit de Bank of England op Basel 3. De directeur Financiële Stabiliteit, Andy Haldane, zei op de jaarvergadering van centrale bankiers in Jackson Hole (VS) dat Basel 3 te complex is. Complexiteit genereert onzekerheid, en daarom is er een antwoord in de regulering nodig dat gebaseerd is op eenvoud, aldus Haldane. Hij sprak overigens vooral over de kapitaaleisen en minder over de liquiditeitseisen die voor CIF het belangrijkst zijn.

CIF heeft niet alleen nu een probleem, de regels van Basel 3 zijn ook nog een structurele uitdaging

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LANGUAGE: DUTCH; NEDERLANDS

PUBLICATION-TYPE: Krant

JOURNAL-CODE: HFD

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Der Turmbau zu Basel;
Ökonom der Bank of England übt in Jackson Hole scharfe Kritik an neuen Eigenmittelvorschriften für Banken

RUBRIK: WIRTSCHAFT; S. 19
LÄNGE: 1003 Wörter


Weniger ist mehr

Seiten - 20 Mal mehr als «Basel I».

«Leverage ratio» zu niedrig


Die entscheidende Frage lautet letztlich, ob das Finanzsystem durch den «Turmbau zu Basel» sicherer geworden ist. Die zusätzliche Komplexität der Basler Eigenmittelvorschriften wäre dann gerechtfertigt, wenn sie zur Krisenprävention beiträge. In diesem Fall hätten aber Banken mit hohen regulatorischen Eigenmittelquoten (Tier-1-Ratio), wie sie im Rahmen des Basler Ansatzes ermittelt werden, besser durch die Krise kommen müssen als solche mit einer niedrigen Quote. Haldane fokussiert auf 100 grosse, komplexe Institute mit einer Bilanzsumme von je über 100 Mrd. $, um diese Hypothese zu prüfen. Von diesen wurden 37 aufgelöst oder vom Staat aufgefangen. Doch Ende 2006 und damit unmittelbar vor Ausbruch der Krise unterschied sich die Tier-1-Ratio der untergegangenen Banken statistisch nicht von derjenigen der Institute, die ungeschoren davongekommen sind. Eine hohe Tier-1-Ratio versprach somit nicht grössere Stabilität - ein entmutigender Befund für Anhänger komplexer Risikomodelle.

Aussagekräftiger war ein viel simpleres Mass, das keine Risikogewichtung verlangt - die «leverage ratio». Sie misst, wie hoch der Anteil des Eigenkapitals an der Bilanzsumme einer Bank ist. Bei den gescheiterten Instituten war nun die «leverage ratio» im Schnitt um 1,2 Prozentpunkte niedriger als bei denjenigen, die die Krise überstanden. Dieser Unterschied war statistisch signifikant. Im Rahmen von «Basel III» wurde nun erstmals auf internationaler Ebene eine «leverage ratio» eingeführt, die die risikobasierten Eigenmittelanforderungen ergänzt. Sie beträgt 3%. Auf 3 Dollar Eigenkapital kommen somit aber immer noch 97 Dollar Fremdkapital. Um die grössten Banken vor einem Scheitern in der Krise zu schützen, hätte die «leverage ratio» laut Haldane aber über 7% liegen müssen.


Ausserende Regularien


Christoph Eisenring, Washington

UPDATE: 2. September 2012
Der Turmbau zu Basel;
Der Ökonom Andrew Haldane von der Bank of England übt in Jackson Hole scharfe Kritik an neuen Eigenmittelvorschriften für Banken

RUBRIK: WIRTSCHAFT; S. 8
LÄNGE: 992 Wörter


Grosse Banken schätzen in ihrem Bank- und ihrem Handelsbuch laut Haldane mittlerweile Millionen Risikoparameter.
Der Turmbau zu Basel; Der Ökonom Andrew Haldane von der Bank of England übt in Jackson Hole scharfe Kritik an neuen Eigenmittelschriften für Banken Neue Zürcher Zeitung (Internationale Ausgabe) 4. September 2012 Dienstag


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Christoph Eisenring, Washington

UPDATE: 3. September 2012

SPRACHE: GERMAN; DEUTSCH

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The Pragmatic Capitalist

September 6, 2012 Thursday 5:30 PM EST

How to Unscramble an Egg

LENGTH: 3767 words

By Niels Jensen, Absolute Return Partners

"I think we will look back in ten years' time and say we should not have done this, but we did because we forgot the lessons of the past." - U.S. Senator Byron L. Dorgan in 1999 on the repeal of the Glass-Steagall Act.

John Mauldin often jokes that when a banker becomes a central banker he is taken into a back room where he is re-programmed to say and do only what central bankers are meant to say and do. Following John's logic, the Bank of England's 'DNA adjustment' team was obviously on leave when Andy Haldane was recruited, such was the audacity of Haldane's speech in Jackson Hole last week. Mind you, Jackson Hole has developed a bit of a reputation for being the one venue where central bankers can speak their mind without taking too much career risk and last week's annual gathering didn't disappoint in that respect. This year's 'cat amongst the pigeons' award went to Haldane for suggesting that bank regulators should tear up the Basel III rule book and start all over again with a few simple rules on borrowing and capital standards (see here for details). When Haldane made his speech I had already written most of this letter, so his delivery came as manna from heaven. I couldn't have asked for a better endorsement of what is to come in this letter.

Having spent much of the summer on a mountain side in Mallorca where there is not much else to do but read and think, I have given a great deal of thought over the last few weeks to what I call 'root problems' versus 'symptoms'. Excess leverage in UK households or Spanish banks is a symptom, not a root problem. If we are going to give ourselves an odds-on chance of disentangling the almighty mess we have created for ourselves, we must begin to address the root problems in earnest. 'Fixing' symptoms fixes nothing. All you achieve is to kick the proverbial can another 10 metres down the road.

A root problem, on the other hand, is usually a policy mistake created by policy makers - not as a result of any ill intentions but because our political leaders are often misguided or misinformed. So let's jump straight in. I have identified five policy mistakes all of which must be sorted out but none of which are straightforward. Addressing them will be painful, it will take time and, lo and behold, if certain elements inside the Republican Party get their way, we will soon add a sixth root problem to the already long list - more about that at the end of the letter.

Policy Mistake #1 - The repeal of the Glass-Steagall Act

The U.S. Banking Act of 1933, better known as the Glass-Steagall Act, limited the ability of commercial banks to engage in investment banking activities. Unwinding the Glass-Steagall act in 19992 allowed for the introduction of financial supermarkets and resulted in a massive escalation of leverage on the banks' balance sheets.

You know something is not quite right when the leading proponent of financial supermarkets - none other than former Citi boss Sandy Weill - openly admits that it was a mistake to repeal the Glass-Steagall Act. Although Sandy only said what the rest of us have been thinking for at least a couple of years, his remarks should prompt some soul searching amongst everyone involved in the running of our banks, and that would include regulators and policy makers as well.

Now, the 1999 repeal alone is not to blame for all of the problems in the banking industry today. The rating agencies did
their very best to get in on the act by adopting a more lenient approach when applying their ratings. Junk was magically turned into investment grade and everyone was happy. The Basel II rules, which took a risk-based approach to leverage, suddenly allowed sleepy retail banks, which had never before ventured into anything more exotic than commercial property loans, to fill up their balance sheets with Ladas and Trabants, labelled as Audis and BMWs.

The balance sheets of the banks ballooned in the process. In Europe, banks that had hitherto never gone beyond 10-12 times leverage, suddenly found themselves with a balance sheet over 40 times the size of their equity capital. In fairness to the American banks, the madness over there didn't go quite so far. At the peak of the leverage bubble, if my memory serves me well, the average U.S. bank balance sheet was 20-25 times leveraged, yet enough to cause serious constipation, when it was found out that the emperor wore no clothes.

In one of the banks I worked for before I started Absolute Return Partners, the then CFO even bragged to me one day how he could - and did - 'play the system' by ramping up the balance sheet as soon as a new month had begun, only to bring it back down to more modest levels again as the next month-end approached. This way the stated leverage was rarely more than 25-30 times whereas, in practice, it was almost always over 40 times - sometimes well over. There wasn't even a hint of shame when he told me the story. He was in fact quite proud that he had it all figured out.

The problem with such an approach is that, for the model to work, you need liquidity - in fact a lot of it - as the same bank was later to find out. The true lesson of this story, though, is that more regulation isn't always the answer. On balance, Canada's banks are not more regulated than US or European banks, yet they weathered the financial crisis much better than their colleagues south of the 49th parallel.

Enter Haldane. The rules need to be simple to work. Keeping retail banking separate from investment banking is a simple rule. We can then all go to bed every night not having to worry about our hard earned dough, should the derivatives desk blow up overnight, because the retail bank that holds our deposits doesn't have a derivatives desk. And should the investment bank that does speculate in those markets get it horribly wrong, there will be no need to apply taxpayers' money for a rescue mission as there is no systemic risk. (And I note that the mere fact that the investment bank operates under the knowledge that there is no tax payer financed rescue package waiting for them, should things go haywire, should be enough to change the attitude towards risk.) Maybe we should learn from the lessons learned in the Dutch town of Drachten. A number of years ago the local council took the seemingly drastic step of removing all traffic lights, most road signs, lane markers and other devices designed to control the traffic flow through the city centre.

The result? The local residents complained at first because they felt less safe, which was exactly the objective of the exercise. When you feel less safe, you slow down and you seek eye contact with your fellow drivers and pedestrians. The experiment has since been repeated elsewhere and the result is the same - a dramatic reduction in the number of accidents everywhere the 'naked street' approach (as they call it) has been introduced.

What has this got to do with risk taking in the financial markets you may wonder? A lot, I would argue. The rating agencies told us that any AA or AAA rated paper was safe, just like the little green man does when he shows up at my local traffic junction to tell me that it is now safe to cross the street. Human beings have an inclination to switch their brains off when operating within a system that is perceived to be safe. Hence a (part) solution to the financial crisis could very well be to make it appear as if the financial system is less safe. Fewer and simpler rules will achieve precisely that. Regrettably, policy makers - bar Haldane - appear to be moving in the opposite direction.

Policy Mistake # 2: Permitting mercantilism

The Asian financial crisis of 1997 was resolved through massive devaluations in the foreign exchange markets. Along the way someone forgot to insist on the devaluing countries gradually bringing their currencies back to 'fair' level, resulting in the mercantilist approach that continues to permeate the region and which has resulted in monstrous imbalances in global trade.

I have discussed this topic before - most recently in the July 2012 Absolute Return Letter - so I shall spare my readers too much added colour; however, this topic is too important to let go. For well over a decade now, China has managed to persuade the West that what is good for Chinese stability (i.e. more job creation in China) is somehow good for the rest of the world. The argument has been used to justify a closed capital account combined with a currency pegged to the U.S. dollar. And the amoebae running the show in the West have taken it at face value and let the Chinese get away with 'murder', resulting in the loss of millions of jobs in the West.
More specifically, when China entered the WTO in 2001 it was on the strict condition they opened the capital account which they promised to do. At the same time they agreed to remove a number of other trade policies designed to protect their industries. When the Chinese didn't deliver on their promises, the amoebae sat back and did nothing. I rest my case. Woody Brock, our economic adviser, puts it better than I ever could: "The governments of the West really do rate a D- in Bargaining Theory 101, whereas China rates an A+.")

One day the West will appoint a government, be it in Europe or the U.S., who won't play to the Chinese tune anymore and trade war will be the inevitable outcome. In the meantime, the Chinese and, not to forget, many of the ASEAN countries in South East Asia will continue their mercantilist approach to the detriment of jobs in the West. Sadly, the amoebae will continue to think that it is over-consumption in the U.S. that is the root problem when it is in fact the West permitting many countries not to play by the rules of true capitalism that is the root cause of today's imbalances.

The solution is astonishingly simple. Do not make empty threats. The moment Asia realises that Western threats are to be taken seriously, their behaviour will change. It will be a true game changer.

Policy Mistake # 3: The European Monetary Union

Most currency unions fail, and they do so because the building blocks for a successful union are not in place. The euro has been no exception. In short, the economic conditions of all member countries must be broadly similar for a currency union to prosper. Introducing the euro back in 20024 was in principle a good idea but it was poorly executed.

The public was led to believe that the 'experiment' was successful, which was possible only because economic conditions in the first six or seven years of last decade were extremely benign. The moment the economy turned ugly, the wheels came off one by one. Throwing money after Greece is akin to applying morphine to a cancer patient. The euro will not become a sustainable currency before its root problems are addressed. The good news is that it is indeed possible to do so but it will take years to fix these problems. When you follow the eurozone crisis in the media you are frequently led to believe that the root problem is just that - a simple, easy to understand, problem. At least nine out of ten commentators have pointed at the lack of competitiveness in the periphery due to an escalation of unit labour costs relative to those of the core; however, unit labour costs are only half the story. The truth is somewhat more complex.

It should come as no surprise that the key drivers of economic output within a country include factors such as the size and growth of the workforce and the capital available for investments. What is less obvious is that a number of 'soft' variables such as labour market flexibility, economic freedom, the quality of the legal system (contract rights and property rights are particularly important in this respect) and the intrusiveness of the government into the business sector all play a role in defining the quality of a country's economic life. Jointly, all these soft factors are known as the incentive structure. Back in 2010, Woody Brock invited management consultant Dietmar Meyersiek to do a study on the link between incentive structures and the quality of economic life in many countries around the world. Meyersiek measured a country's incentive structures through a number of variables, and found that many of these had a significant impact on income and wealth in a country. I have included a couple of Meyersiek's tests in charts 1-2 below.

Chart 1: Quality of Legal Structure Correlates with Income

Source: SED Profile # 102, October 2010, Dietmar Meyersiek, Fraser Institute

Chart 2: Less Regulation Means Higher Income

Meyersiek subsequently went beyond a simple bi-variable analysis and found that three variables between them - property rights, government intrusiveness and business regulation - explained about 77% of the variance of GDP per capita amongst the approximately 140 countries in the study.

These results have profound implications for the eurozone crisis because, on all three factors, Latin Europe falls well short of Northern European countries. The conclusion is obvious: For the euro to become a sustainable currency, not only must Southern Europe deal with its unit labour cost problems but it must also change some far more fundamental things in life, such as the quality of its legal system, how it regulates businesses, etc. etc. Issues such as these are not easily changed and will, even under the best of circumstances, take many years to address.

Policy Mistake # 4: Austerity misunderstood

Austerity has been branded as the all-singing, all-dancing solution to Europe's problems, but it carries severe side effects. It destroys economic growth, leading to a fall in tax revenue (how could that possibly come as a surprise?) and thus to a rise in sovereign debt - precisely the opposite of the policy target. Worst of all, it leads to a sharp increase in
unemployment with potential catastrophic consequences - social unrest at best, possibly worse, which is an extraordinary price to pay for an economic experiment.

The solution is simple, yet poorly understood. Let's start by lining up a simple piece of arithmetic. Take country X which runs an annual budget of £700 billion a year of public spending. Tax revenues amount to £600 billion so, according to conventional thinking, there is a deficit in the public finances of £100 billion. This country has a government that has been led to believe that the deficit must be eliminated at all cost, so it engages in some rather severe cost cutting. The size of the public sector is cut back, new public investments are curtailed, more children are stuffed into each class room, etc. etc. You know the drill. What the rather one-dimensional finance minister (some might know him better as the Chancellor of the Exchequer) didn't quite understand when implementing these spending cuts was the effect the cuts would have on taxes and unemployment benefits. Taxes collapsed. Unemployment benefits took off. Suddenly, what looked like a brilliant idea on paper didn't quite work in practice. The country got stuck in economic quicksand from which it is finding it near impossible to escape.

Now, let's assume that the £700 billion this country spends is divided into £600 billion of what I will call unproductive spending and £100 billion of productive spending. Productive spending means anything that the government can earn a return on in the future, e.g. toll roads, airports, and other income-generating, infrastructure-enhancing projects. Unproductive spending is everything else - interest on public debt, public administration, defence, social benefits, etc. This distinction is critical because the bond vigilantes will see a rise in unproductive spending as a problem for future generations, hence the cost of borrowing may go up. On the other hand, a rise in productive spending will be seen as a non-event as it will be self-financing over time.

The solution is thus glaringly obvious - the aim must be to re-distribute public expenditures away from unproductive spending towards productive spending. By doing that, our country in question can continue to run a deficit whilst maintaining its good standing with the bond vigilantes (and the ratings agencies, should anyone still care what they have to say). Most importantly of all - the economy continues to grow which is a pre-condition for digging itself out of the mountain of debt that it is currently stuck in.

The obvious challenge is that unproductive spending buys votes (mainly through transfer payments such as social benefits) whereas productive spending does not. Since most policy makers find it next to impossible not to bribe the electorate, it would require an altogether different mentality amongst the political leadership to steer the country in our little example towards long term prosperity through such policy change.

Policy Mistake # 5: Ignoring pension liabilities

Pension and other age related liabilities have been largely ignored by our political leadership in recent years; however, ignoring the problem will only make it bigger with potentially devastating consequences, as the ostrich found out a long time ago. I have written about unfunded pension liabilities before so no need to dwell too long on this topic. However, the problem continues to grow and nothing is done. It is quite simply a disgrace. The newly elected French president even had the nerve to increase the retirement age for some people. Admittedly a small number of people were affected, but it sent all the wrong messages in terms of what is required to solve the pension crisis.

Chart 3: UK DB Plans’ Pension Deficits at Record Levels

Meanwhile, here in the UK, unfunded pension liabilities for defined benefit plans have reached £300 billion (see chart 3) whilst our political leaders continue to sit on their hands in the belief that it will be the next generation of parliament who will have to deal with this little 'inconvenience'. And do not for one second believe that this problem is confined to the UK. To varying degrees, virtually every country with a pension industry has a massive task ahead of it in terms of explaining to its people that the pension model as we know it is bankrupt.

Again, the solutions are relatively simple, yet immensely painful and cannot exactly be described as vote winners. Increase the retirement age to 70, possibly even 75 (note to President Hollande: dust off your English dictionary - 'increase' means 'up', not 'down'). Convert all defined benefit schemes to market based schemes and have every pension scheme member take a haircut so that the 30 year olds won't wake up in 20 or 30 years' time realising that they have just been subject to the biggest Ponzi scheme fraud in history. Any takers?

Policy Mistake # 6? A return to the gold standard

On 23 August the FT ran a story that caught the eye of even the most casual reader - "Republicans eye return to gold
standard". The Republican Party in the United States is apparently taking a serious look at whether the link between the U.S. dollar and gold should be restored, yet it remains unclear what the true motive is. Maybe the aim is just to appease the Tea Party movement who have long expressed their dislike of the policy currently being pursued by the Federal Reserve Bank which they believe will ultimately result in (hyper) inflation. Maybe there is another agenda. Maybe, just maybe, they truly believe that a return to the gold standard is the solution to our current predicament.

Anyone who believes that should be forced to read Lords of Finance by Liaquat Ahamed. The book, which I rate as the best business book I have read in recent years, spells out why the gold standard didn't work and why it was a major contributor to the great depression in the 1930s. The gold standard amplified the economic cycle back then just like the modern gold standard - also known as the European Monetary Union - has amplified the economic cycle in recent years. For those of you with not enough time on your hands to go through Ahamed's masterpiece, I suggest you read Barry Eichengreen's piece from last year called A Critique of Pure Gold. Now, if you are still not convinced, I kindly ask you to provide a valid response to the following question raised by Ambrose Evans-Pritchard in the Daily Telegraph recently:

"Quite why gold bugs think that the Gold Standard prevents asset bubbles and excess debt is beyond me. The 1920s saw US debt levels surge to around 300pc to 350pc of GDP. It is very similar to what occurred in our own Noughties up to 2008."

Re-introducing the gold standard would be a monster mistake on par with the (premature) introduction of the European Monetary Union. It will certainly become policy mistake # 6 on my list of major policy blunders.

(For the record, please note that my views on the gold standard have nothing to do with my views on gold as an investment object. Just because the gold standard is a seriously bad idea doesn't mean that gold is a bad investment - actually far from it. We hold gold in virtually all our private client portfolios and are likely to continue to do so.)

I note that several of the policy mistakes listed above date back to the same period, namely the late 1990s. Not only does it demonstrate the gung-ho approach of the time, but it also goes to show that policy mistakes do not necessarily rear their ugly heads immediately and, by the time they do, the damage has been done.

The unintended consequence of these, and other, policy mistakes is uncertainty. Uncertainty has a nasty habit of creating sub-par economic growth for the simple reason that it holds back the inclination to invest as pointed out by good friend Sushil Wadhwani in a recent piece in the FT. One study suggests that US GDP growth was impaired by over 3% between 2006 and 2011 due to uncertainty (see Sushil's article here). I can only speculate about the corresponding number for Europe! Now to the good news. The optimist in me sincerely believes there is a way forward. As I have demonstrated above, there is indeed a solution to each and every of the policy mistakes made in the past. Admittedly, some are more easily addressed than others, but they are all fixable. However, the most important point you should take away from this month's Absolute Return Letter is that the eurozone crisis cannot be viewed, neither can it be solved, in isolation. Several root problems lie underneath it. Only when policy makers begin to realise this will we be able to, once and for all, leave the problems of the past few years firmly behind us.
The Economist

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Rover the regulator;
Buttonwood

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HIGHLIGHT: Regulating the banks

Simple rules may be best for monitoring banks

PITY the financial regulator. The evidence suggests that bank executives, and the independent directors on their boards, fail to understand the complex organisations they control. How is an outside supervisor to manage, particularly when the best and brightest of its staff can be lured away by the higher salaries on offer in the City or on Wall Street?

In practice, as Andrew Haldane of the Bank of England highlighted in a speech at the recent Jackson Hole meeting of central bankers (see Free Exchange), regulators have responded by trying to match the complexity of the firms they supervise. The first set of Basel rules on bank capital was just 30 pages long; the second go had 347 pages; Basel 3 has 616. In America the Glass-Steagall act of 1933, which separated commercial and investment banking, was a concise 37 pages; the Dodd-Frank act of 2010 ran to 848, and may spawn a further 30,000 pages of detailed rule-making by various agencies.

All these rules require banks to fill in reams of forms, and regulators to monitor the results. Mr Haldane estimates that Basel 3 may consume the time of 70,000 workers in the European banking industry. In 1935 there was one American financial regulator for every three banks; now there are three regulators for every bank.

The financial crisis of 2007-08, and the continued weakness of banks, suggest that complexity has not served its purpose. In a world of multiple connections, where the distribution of future probabilities cannot be known (unlike the probabilities involved when spinning a roulette wheel), simple rules of thumb may be more useful than sophisticated models.

Mr Haldane uses the analogy of dogs, such as border collies, which are very reliable catchers of Frisbees without being aware of the complex calculations (wind speed, air resistance, etc) that might be involved. The rule which the dog's brain has subliminally worked out is to run at a speed so that the angle of gaze to the Frisbee remains constant. Baseball players and cricketers follow similar strategies.

The simple rule that Mr Haldane suggests for regulators is to look at the "leverage ratio", the relationship between a bank's equity capital and the assets on its balance-sheet. (A bank's assets are, largely, the loans it makes; customer deposits count as liabilities.) A low leverage ratio is (counterintuitively) a bad thing: if a bank's loans turn bad, there is
more risk that its equity will be wiped out.

The regulators behind the Basel rules have tended to think a leverage ratio is too unsophisticated. Take two banks, each with $4 billion of equity and $100 billion of assets. On a simple measure of leverage, they look equally risky. But Bank A's assets are invested entirely in Treasury bonds and Bank B's are lent to Miami condominium developers. Common sense suggests Bank B's balance-sheet is much more risky, and the Basel rules "risk-weight" assets so that it ends up holding more capital.

But risk weighting creates problems of its own. Before the crisis, the Basel rules provided an incentive to create AAA-rated securities (such as the infamous structured products linked to subprime mortgages), since they carried a low capital charge for banks. In addition, banks were allowed to use their own models to calculate the riskiness of their balance-sheets. Unsurprisingly they erred on the side of optimism. The result, as the world headed into 2007, was that banks' balance-sheets were much riskier than they appeared.

Of course, no regulation is foolproof. American commercial banks were subject to a leverage ratio in the run-up to the financial crisis: they still ran into trouble. Herein lies the regulators' dilemma. Focus on any one measure and banks will find ways to get around it. The temptation is to add further measures to restrict their wiggle-room (Basel 3 uses both risk weights and a leverage ratio). But the more measures that are used, the more complex the system becomes.

Although the thrust of Mr Haldane's analysis is surely right, it is surprising that he does not focus on another simple factor: change. As Peter Hahn of the Cass Business School in London points out, a bank that suddenly increases its market share, or expands its balance-sheet, is usually the one to watch. That was the case with Northern Rock, a British bank that grew explosively before failing in 2007. There is always a chance that the bank has a new model that is transforming the industry. But the odds are that the bank is either lowering its credit standards or undercharging for the risks it is taking. A regulator who has lived through a few cycles should be able to spot the danger, without the need for a sophisticated model.

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Las finanzas necesitan una legislación más clara y efectiva

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Las finanzas necesitan una legislación más clara y efectiva

Por Kenneth Rogoff | Para LA NACION

CAMBRIDGE.- La gente a menudo pregunta si los funcionarios de entes reguladores y legisladores han arreglado las fallas en el sistema financiero que llevaron al mundo al borde de la segunda Gran Depresión. La respuesta es no.

Si se han reducido mucho las probabilidades de una repetición inmediata del derrumbe financiero agudo de 2008 por el hecho de que la mayoría de los inversores, reguladores consumidores e incluso políticos recordarán por bastante tiempo su roce con la muerte financiera. Como resultado de ello, podría tardarse un tiempo en llegar a la plena irresponsabilidad nuevamente.

Pero fuera de ello, es poco lo que ha cambiado fundamentalmente. La legislación y regulación producida luego de la crisis han servido como parche para preservar el statu quo. Los políticos y reguladores no tienen el coraje político ni la convicción intelectual que se necesita para volver a un sistema mucho más claro y directo.

En su discurso ante la conferencia anual de la elite de los bancos centrales en Jackson Hole, Wyoming, Andy Haldane del Banco de Inglaterra hizo un llamado a retornar a la simpleza en la regulación bancaria. Haldane se quejó de que la regulación bancaria ha evolucionado de una pequeña cantidad de guías muy específicas a algoritmos estadísticos que abomban la mente para medir el riesgo y la adecuación de capital.

La complejidad legislativa crece paralelamente en forma exponencial. En los Estados Unidos, la Ley Glass-Steagall de 1933 tenía 37 páginas y ayudó a producir estabilidad financiera por casi siete décadas. La reciente ley Dodd-Frank de Reforma de Wall Street y Protección al Consumidor tiene 848 páginas y requiere una agencia regulatoria para producir documentos adicionales con reglas más detalladas. En total parece ir en camino de alcanzar las 30.000 páginas.

Como señala Haldane, incluso la celebrada "regla Volcker", que buscaba crear un mejor muro de separación entre la banca comercial más mundana y las operaciones de banca más riesgosas, ha sido muy diluida al atravesar el proceso legislativo. La idea simple del ex presidente de la Reserva Federal ha sido cooptada y diluida a través de cientos de páginas de jerga legal.

Aún en la década de 1990 los funcionarios de los entes reguladores se quejaban en privado de la dificultad de retener personal capaz de entender el mercado de derivados en rápida evolución. Asistentes con un año de experiencia trabajando en la cuestión e los derivados serían ganados por el sector privado con ofertas de salarios cinco veces mayores de lo que podía pagar el estado. Para la misma época, a mediados de la década de 1990, hubo académicos que comenzaron a publicar trabajos sugiriendo que la única manera efectiva de regular los bancos modernos era alguna forma de auto regulación. Que los bancos diseñaran sus propios sistemas de manejo del riesgo, auditárolos en la medida
de lo posible y castigarlos severamente si producen pérdidas fuera de parámetros acordados.

Muchos economistas argumentaron que estos ingeniosos modelos eran fallidos, porque la amenaza de castigo no era creíble, en particular en el caso de una caída sistémica que afectara una gran parte del sistema financiero. Pero los trabajos se publicaron igual y las ideas fueron implementadas.

La manera más clara y efectiva de simplificar la normativa ha sido planteada en una serie de trabajos por Anat Admati de Stanford (con coautores, como Peter DeMarzo, Martin Hellwig y Paul Pfleiderer). Su argumento es que se debiera obligar a las firmas financieras a obtener fondos de modo más equilibrado y no depender tanto de la financiación en base a deuda.

Admati y sus colegas recomiendan imponer requisitos que fuercen a las firmas financieras a generar fondos de capital, ya sea reteniendo ganancias o, en el caso de firmas que cotizan en Bolsa, a través de la emisión de acciones. El statu quo permite en cambio que los bancos apalanquen la ayuda del contribuyente teniendo encajes muy limitados, dependiendo del endeudamiento en mucho mayor medida que las firmas no financieras grandes típicas. Algunas firmas grandes, tales como Apple, prácticamente no tienen deuda. Una mayor dependencia del capital propio daría a los bancos un colchón más grueso para absorber pérdidas.

Por supuesto que no es fácil legislar la reforma financiera en una economía global estancada, por temor a impedir el crédito y convertir una recuperación lenta en una recesión declarada.

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Leading article: Finance and risk: On knowing too much

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Called upon at the start of the credit crunch to explain the collapse in value of a Goldman Sachs investment fund, the bank's chief financial officer did some high-net-worth head-scratching: "We were seeing things that were 25-standard deviation moves, several days in a row." Which all sounds plausibly lofty and technical until you are reminded of the observation from the economist Tim Harford that one wouldn't expect to see three 25-standard deviation days in a row for far longer than the 13bn years the universe has been in existence. Goldman's David Viniar was effectively saying that his models weren't at fault; it was reality that was wrong.

Laughable though that sounds, financial regulators - the people paid to protect the rest of us from overconfident financiers - have trusted the bankers and their highly sophisticated models of risk. Indeed, the watchdogs have themselves adopted ever more complex models of risk - thus taking the bankers at their own word. As the Bank of England's Andy Haldane points out in an important new paper, The Dog and the Frisbee, the first international Basel rules on finance reached in 1988 ran to only 30 pages. The latest incarnation, Basel III, weighs in at 616 pages. In America, the Dodd-Frank act on financial regulation is more than 20 times as long as Glass-Steagall, the 1933 law that split investment banks away from savings banks. All this complexity costs: the number of people employed in the UK's financial sector has barely increased over the past 20 years (despite the lobbyists' promises, finance does not create jobs); the number of regulators has leapt almost six-fold.

Yet all this detail and sophistication is a less effective guide to regulation than the old trusty rules of thumb. As Mr Haldane effectively demonstrates, looking at how much banks had borrowed by the end of 2006 - their leverage ratio - would have been a better predictor of which would go bust than all the rest of the armoury. As the Bank's head of financial stability sums up: "Modern finance is . . . too complex. . . As you do not fight fire with fire, you do not fight complexity with complexity."

Two obvious conclusions flow from this. The first is that financial economics is heading back towards the world as Keynes and Hayek knew it: where economic uncertainty was recognised as such, rather than.mathematised and missold as controllable risks. Second, that regulators really ought to deal with bankers using a regime of brutal simplicity that errs on the side of caution. If a bank looks like it's borrowed too much, it probably has - no matter what the risk models say - and should be stopped. Mr Haldane's view makes far more sense than that described in the Basel agreements or Vickers commission: and in its simplicity, it is pleasingly radical.

LOAD-DATE: September 10, 2012
Two Days Ahead Of More QE, JPM Finds That World Is Already "Drowning In Liquidity"

LENGTH: 669 words

Submitted by Tyler Durden.
A few days ago, the BOE's Andy Haldane, rightfully, lamented that the apparent "solution" to the exponentially growing level of complexity in the financial system is more complexity.

Alas, there was little discussion on the far more relevant central planning concept of fixing debt with even more debt, especially as the US just crossed $16 trillion in public debt last week, right on schedule, and as we pointed out over the weekend, there has been precisely zero global deleveraging during the so-called austerity phase. But perhaps most troubling is that with 2 days to go to what JPM says 77% of investors expect with be a NEW QE round (mostly MBS) between $200 and $500 billion in QE, the world is, also in the words of JP Morgan, drowning in liquidity. In other words, according to the central planners, not only is debt the fix to record debt, but liquidity is about to be unleashed on a world that is, you guessed it, already drowning in liquidity. The bad news: everything being tried now will fail, as it did before, because nothing has changed, except for the scale, meaning the blow up will be all that more spectacular. The good news: at least the Keynesians (or is it simply Socialists now?) out there will not be able to say we should have just added one more [ ]illion in debt/liquidity and all would have worked, just as our textbooks predicted. Because by the time it's over, that too will have happened.

From JPM's Michael Cembalest:

It has been a strange year. If you were concerned about the global economy this year, you were right:
Leading indicators of manufacturing, such as new orders, are weakening just about everywhere Chinese, Korean and Taiwanese exports are slowing sharply; China may be growing at only 6% European growth is ~0%, with the periphery in recession. Germany business surveys also fading Last week's US jobs report was weak across the board (payrolls, work week, labor force participation and wages) US capital spending trends are slowing (e.g., capital goods orders ex-aircraft) Countries like Brazil are showing signs of industrial fatigue due to an overly strong currency in 2010-2011 The US election does not look like it will bring clarity to the US fiscal/debt ceiling divide (polls show Democrats keeping the White House and Republicans keeping the House of Representatives) US housing is staging a modest recovery, but it's not a game-changer given its smaller contribution to employment Corporate profits are high, but the trend in EPS revisions is negative and profits growth is slowing
However, global equity markets have done well, up 13% so far in 2012. The bottom line: with the world drowning in liquidity, the right portfolio moves this year have been to take advantage of low equity valuations, look through all the economic weakness and expect that continued monetary stimulus will eventually bear fruit. We have done some of that but not as much as we might have, and as things stand now, global equity markets have outperformed what I had expected. The world's Central Banks have made it clear that inflating their way out is preferable to the alternatives, an environment that is conducive to risky assets that are priced very cheaply, until and unless they lose control of inflation
For those confused, Cembalest only added "unless" out of political courtesy, because as even the Fed itself admitted last night, first via St. Louis Fed's James Bullard and soon everyone else, the Fed has finally been exposed as being nothing but a puppet tool of politicians, who in turn have always been sponsored muppets of Wall Street (Who can possibly forget Chuck Schumer telling Bernanke to "get to work Mr. Chairman")). In other words, we now know politicians run not only fiscal, but monetary policy. How to hedge against this apocalyptic proposition? Simple. Cue Kyle Bass: "Buying gold is just buying a put against the idiocy of the political cycle. It's That Simple."

It really is.
Dogs Don't Think Like Central Bankers

BYLINE: cfaille

LENGTH: 773 words

That Frisbee example stole the show at Jackson Hole, Wyoming. The unexpected question: how can a mere dog, uneducated in Newtonian physics, figure out the dynamics of a flying disk in an often unpredictable atmospheric environment? And what might central banks learn from that?

At least some of the headlines out of the big confab at the end of August concerned the latest observations by Chairman Ben Bernanke. Let's do justice thereto before getting back to our Best Friends. The Chairman said, in essence, that the Fed under his leadership has done what it has had to do, and he countered critics who complain either that it has done too little or that it has done too much. Bernanke finds it "noteworthy," for example, "that the expansion of the balance sheet to date has not materially affected inflationary expectations, likely in part because of the great emphasis the Federal Reserve has placed on developing tools to ensure that we can normalize monetary policy when appropriate..." in other words, that it will be able to exit from its positions. Someday.

Stealing the Hearts of Pundits

The Chairman spoke early Friday morning, August 31. After some discussion and a coffee break, Andrew Haldane, executive director, financial stability, and the Bank of England, had his turn at the podium later that morning. On the Fed's agenda, the name of Haldane's speech was couched in the usual bland bankerese that he surely knows how to employ at will. It was, "Ensuring Long-Term Financial Stability." But on the front page of the address itself, available here, he has given it a more intriguing title: "The dog and the frisbee." That is what has stolen the show, in terms of post-Wyoming commentary. The Financial Times gave Haldane's speech lengthy respectful coverage, though relegating the canine analogy to the final graph. "Total Return," a WSJ blog, gave the dog higher play, and called the speech the one "people should long remember." The invaluable folks at Dealbreaker treated us to a photo of a border collie in mid air, with Frisbee in mid mouth, and a long thoughtful post.

Angle of Gaze

But let's start at the beginning: why are border collies better at catching a flying disk than humans? Maybe because they keep it simple: their rule is to "run at a speed so that the angle of gaze to the Frisbee remains roughly constant." As a clueless human myself, I had to work this through after reading it. But I think I 'got it' at last. Imagine a dog running a certain distance behind a Frisbee, both of them moving forward at a constant speed, and the Frisbee slowly descending. The dog is looking up at the Frisbee and finds that, in order to keep the angle of his gaze constant, he has to run more rapidly. In time he'll catch up to it and catch it before it hits the ground.

On the other hand, suppose (to complete the thought experiment) that as dog and Frisbee proceed, a gust of wind raises the frisbee higher. The dog will now have to drop back in order to keep the angle of its gaze constant. And dropping
back in that situation turns out to be the sensible thing to do.
The point: central bankers have failed to "catch the crisis Frisbee" because they have made matters too complicated. How many parameters are necessary for a "typical large international bank" to calculate the probability of default of retail mortgages in order to apply credit risk capital charges? Haldane estimates between 400 and 600.

Raze the Tower of Basel
This turns into a call for a thorough overhaul of the Basel system for international banking supervision, a system Haldane playing the biblical card calls the "Tower of Basel." Part of the complexity arises from the uncontroversial-seeming idea that disclosure is good, transparency is good. Here, though, more is not better.
"The explosion in banks' reporting over the past decade has not conspicuously helped in pricing bank risk," he says, adding that regulators and investors alike end up seeking needles of relevance in the "rising haystack of information." Unfortunately, Haldane doesn't really have a simple single rule to propose, an analog to "keep the angle of your gaze constant" that could replace the present dangerous "subsidy to complexity." When he discusses simple rules, like Paul Volcker's "thou shalt not engage in proprietary trading" it is only to warn that they "run some risk of backdoor complexity."
So maybe the dog can't help central bankers or other bank regulators after all. Maybe such folk simply aren't capable of thinking like a sensible disk-chasing pooch. Still, it was fun to work through the imagery, and razing that tower, rather than raising new ones, is a good idea.

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HIGHLIGHT: Regulierungsbehörden wollen mit immer komplizierteren Gesetzen die Finanzbranche in den Griff bekommen. Dabei wäre eine Vereinfachung der richtige Weg

Kenneth Rogoff

Viele Menschen stellen sich die Frage, ob Regulierungsbeamte und Gesetzgeber eigentlich die Fehler im Finanzsystem behoben haben, die die Welt fast an den Rand einer zweiten großen Depression gebracht hätten. Die kurze Antwort lautet: Nein.


verwässert.

Zumindest das Problem ist einfach: Da das Finanzwesen komplizierter geworden ist, haben die Regulierer versucht, durch immer kompliziertere Regeln Schritt zu halten. Bei dieser gegenseitigen Aufrüstung haben unterfinanzierte Regierungsbehörden aber keine Chance auf einen Sieg. Schon in den 1990ern haben sich Regulierungsbeamte hinter vorgehaltener Hand beklagt, wie schwierig es sei, Personal zu halten, das in der Lage ist, die sich rasant entwickelnden Derivatemarkte zu verstehen. Forschungsassistenten mit einem Jahr Berufserfahrung im Derivatbereich wurden von der Privatwirtschaft mit dem Fünffachen dessen abgeworben, was die Regierung ihnen zahlen konnte.


Die Finanzindustrie warnt, Versuche zur Durchsetzung höherer Eigenkapitalfinanzierung würden die Kreditvergabe blockieren. Aber im Rahmen eines allgemeinen Marktgleichgewichts ist das einfach Unsinn. Trotzdem bewegen sich die Regierungen an dieser Front nur zögernd vorwärts, und die neuen Basel-III-Regeln sind bestenfalls ein winziger Schritt hin zu echter Veränderung.


Die modische Idee, Banken die Ausgabe von "bedingtem Kapital" zu ermöglichen, also von Schulden, die sich bei einer Systemkrise in Eigenkapital verwandeln, ist genauso wenig praktikabel wie die Idee, sie im Fall einer Krise zu bestrafen. Ein einfacheres und transparenteres System würde letztlich zu höherer Kreditvergabe und größerer Stabilität führen und nicht umgekehrt. Es wird höchste Zeit, wieder Vernunft in die Regulierung der Finanzmärkte zu bringen.

www.ftd.de/topoekonomen

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**Counterparties: Unintended collateral**

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Welcome to the Counterparties email. The sign-up page is here, it's just a matter of checking a box if you're already registered on the Reuters website. Send suggestions, story tips and complaints to Counterparties.Reuters@gmail.com

Financial reform was always going to be accompanied by unintended consequences. And Bloomberg's Bradley Keoun has found a great one, in his piece on the rise of "collateral transformation" at big banks.

Under the Dodd-Frank Act, most derivatives deals - the things which sunk AIG, remember - are meant to be forced into public clearinghouses. The idea is to bring the opaque, hard-to-price derivatives onto an open forum, with each party setting aside safe collateral in case things go sour.

The problem is, good collateral, like those once-pristine sovereign bonds FT Alphaville has extensively cataloged, is in short supply. Enter banks like JPMorgan, BofA, Goldman Sachs and Barclays. Never ones to let an unintended consequence go unmonetized, they're now offering clients services that take these assets and magically transmogrify them into safer ones:

The process allows investors who don't have assets that meet a clearinghouse's standards to pledge corporate bonds or non-government-backed mortgage-backed securities to a bank in exchange for a loan of Treasuries. The investor then posts the Treasuries - the transformed collateral - to the clearinghouse. The bank earns fees plus interest, and the investor is obliged at some point to return the Treasuries. In effect, the collateral is being rented.

This is pretty much the opposite of what was intended. Loaned collateral only serves to increase complexity of the derivatives market, and will likely make it harder to unwind contracts when things go bad. "The point of the initiatives on derivatives was that derivatives can hide a lot of risk," finance and economics professor at Stanford told Bloomberg. "Now they're going to just shuffle the risk around".

A better regulatory approach, for people Harvard's Kenneth Rogoff; John Kay; the Bank of England's Mervyn King and Andy Haldane; and our own Felix Salmon, is that less is more. In a buzzy speech at Jackson Hole late last month, Haldane made the case for a financial regulatory regime "which is less rules-focussed, more judgement-based". As Haldane put it, "As you do not fight fire with fire, you do not fight complexity with complexity":

Dodd-Frank rulemaking in the 12 months after its enactment covered thirty new rules or less than 10% of the total. A survey of the Federal Register showed that complying with these new rules would require an estimated 2,260,631 labour hours every year, equivalent to over 1,000 full-time jobs. Scaling this up, the compliance costs of Dodd-Frank will run to tens of thousands of full-time positions.

In this world, rather than adding things like layers of executive branch oversight, banks would be rewarded for simplicity. - Ryan McCarthy