

**Presentation to
Regulatory Policy Institute
Merton College Oxford**

14 September 2010

Crisis

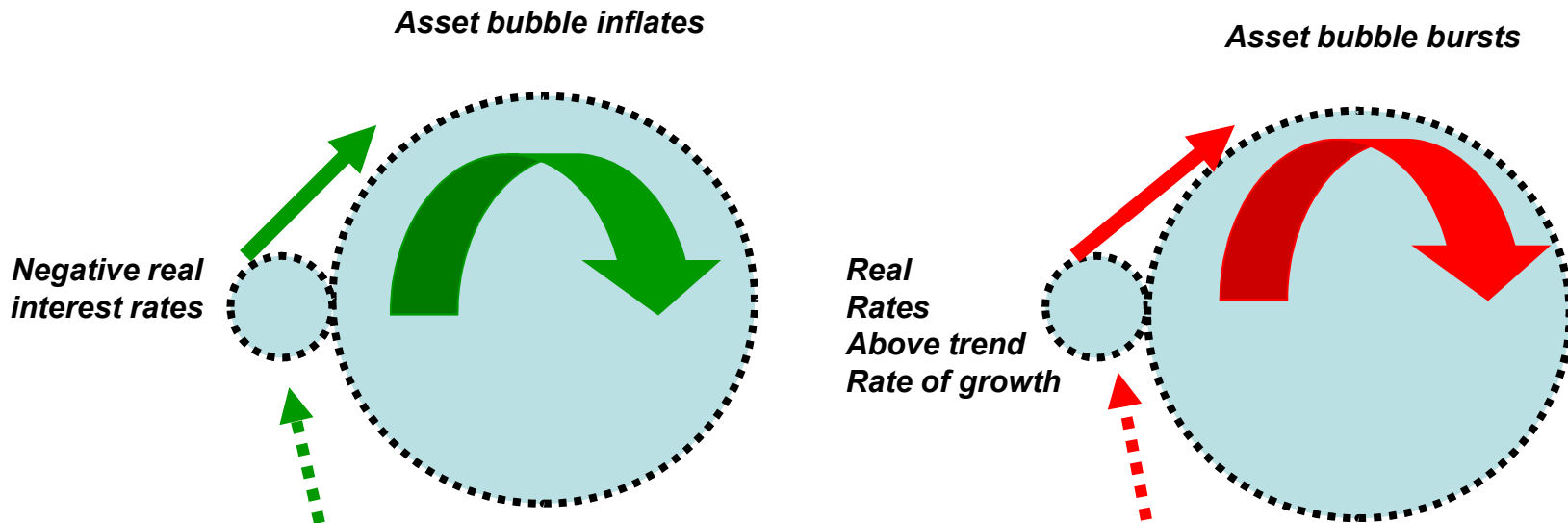
Cause,
Containment
and Cure



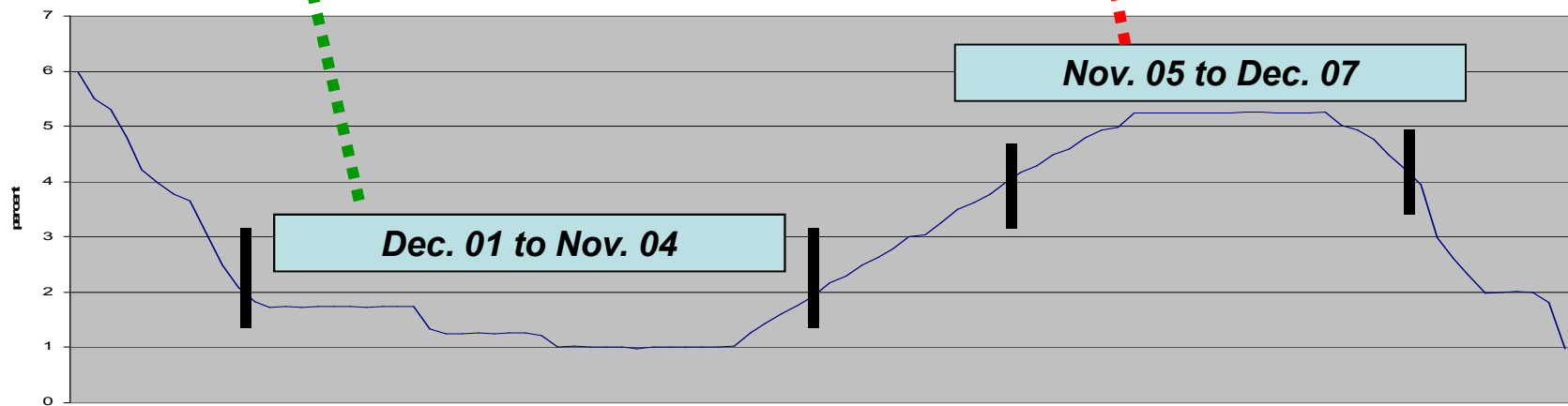
Thomas F. Huertas



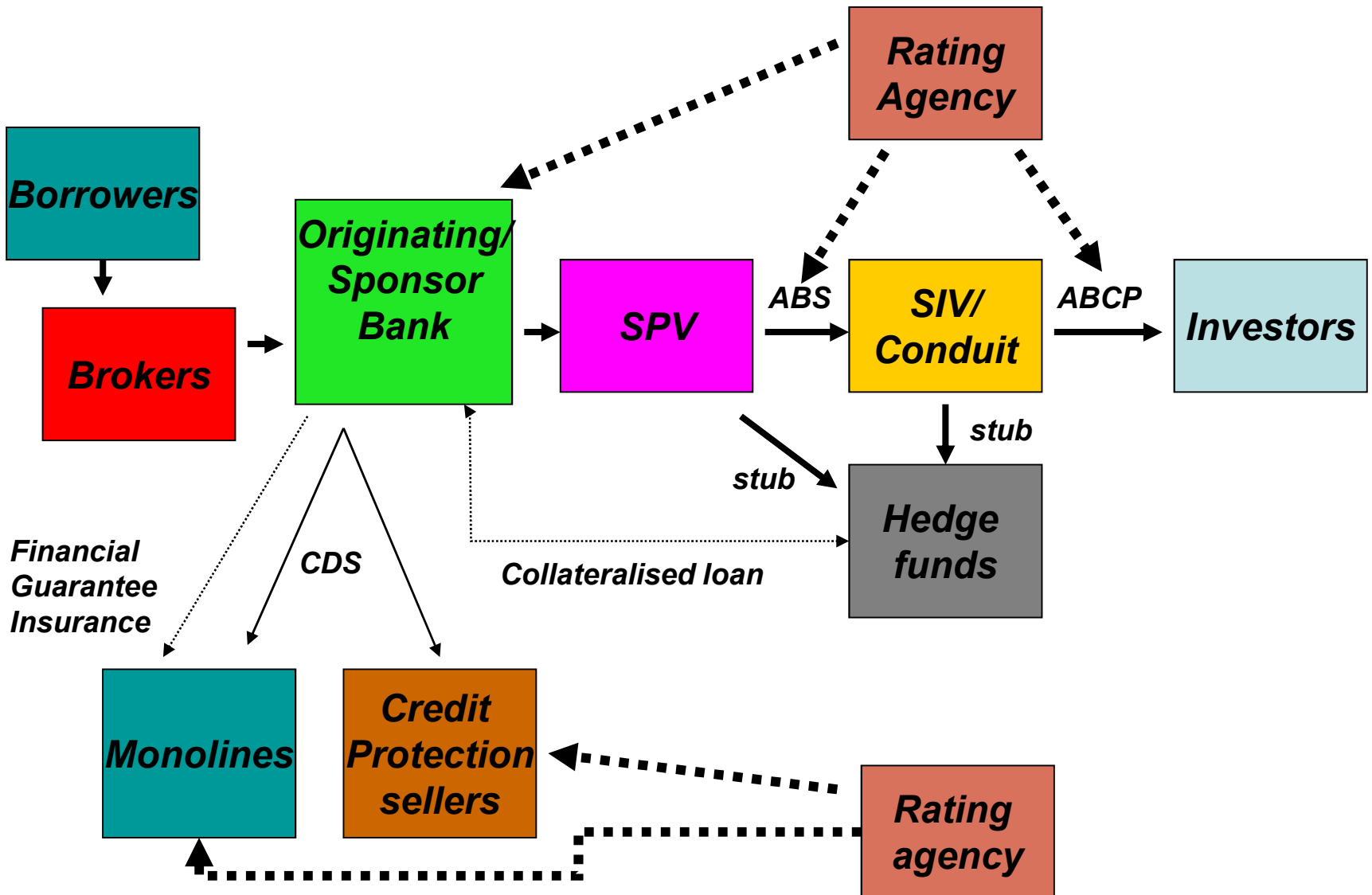
Cause 1: Monetary policy



Fed funds rate 2001 - 2008

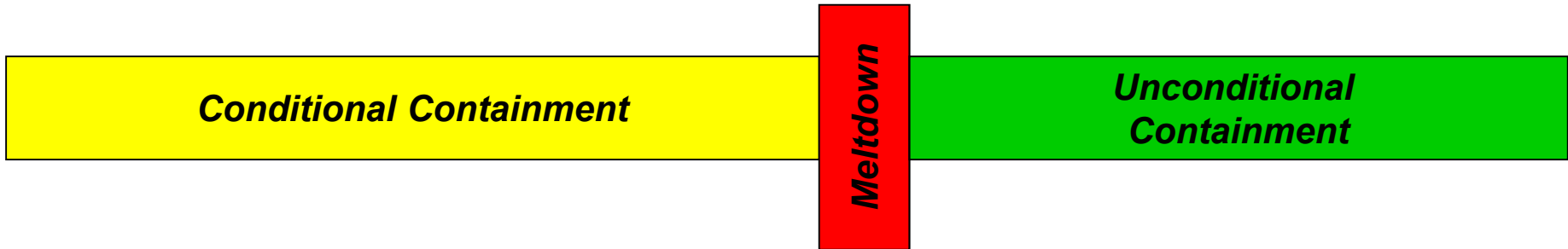
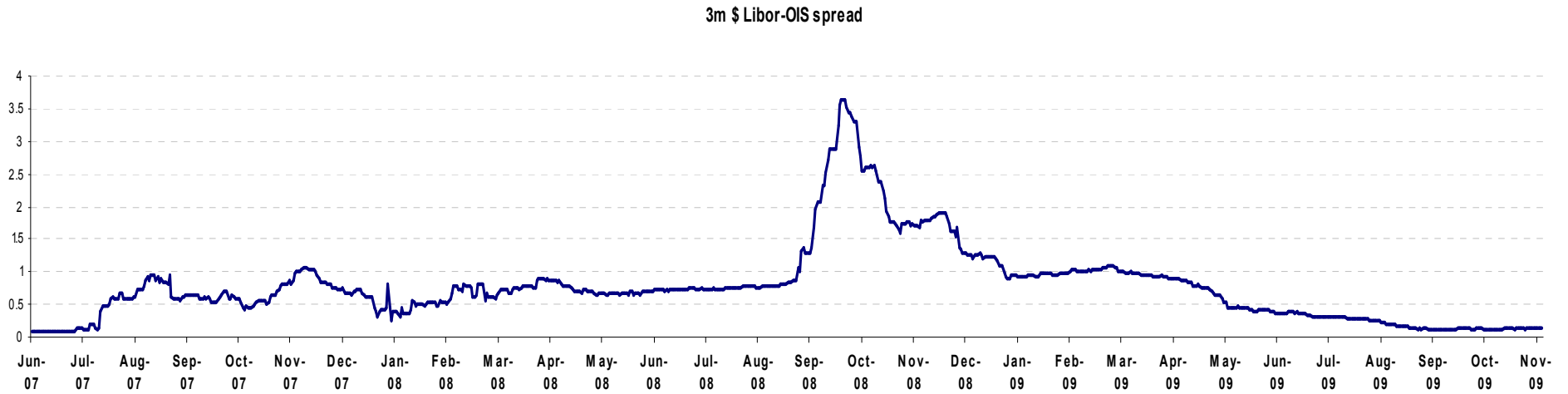


Cause 2: Shadow Banking



Cause 3: Shift in US resolution policy

3 month USD LIBOR-OIS spread in percent,
June 2007 – November 2009

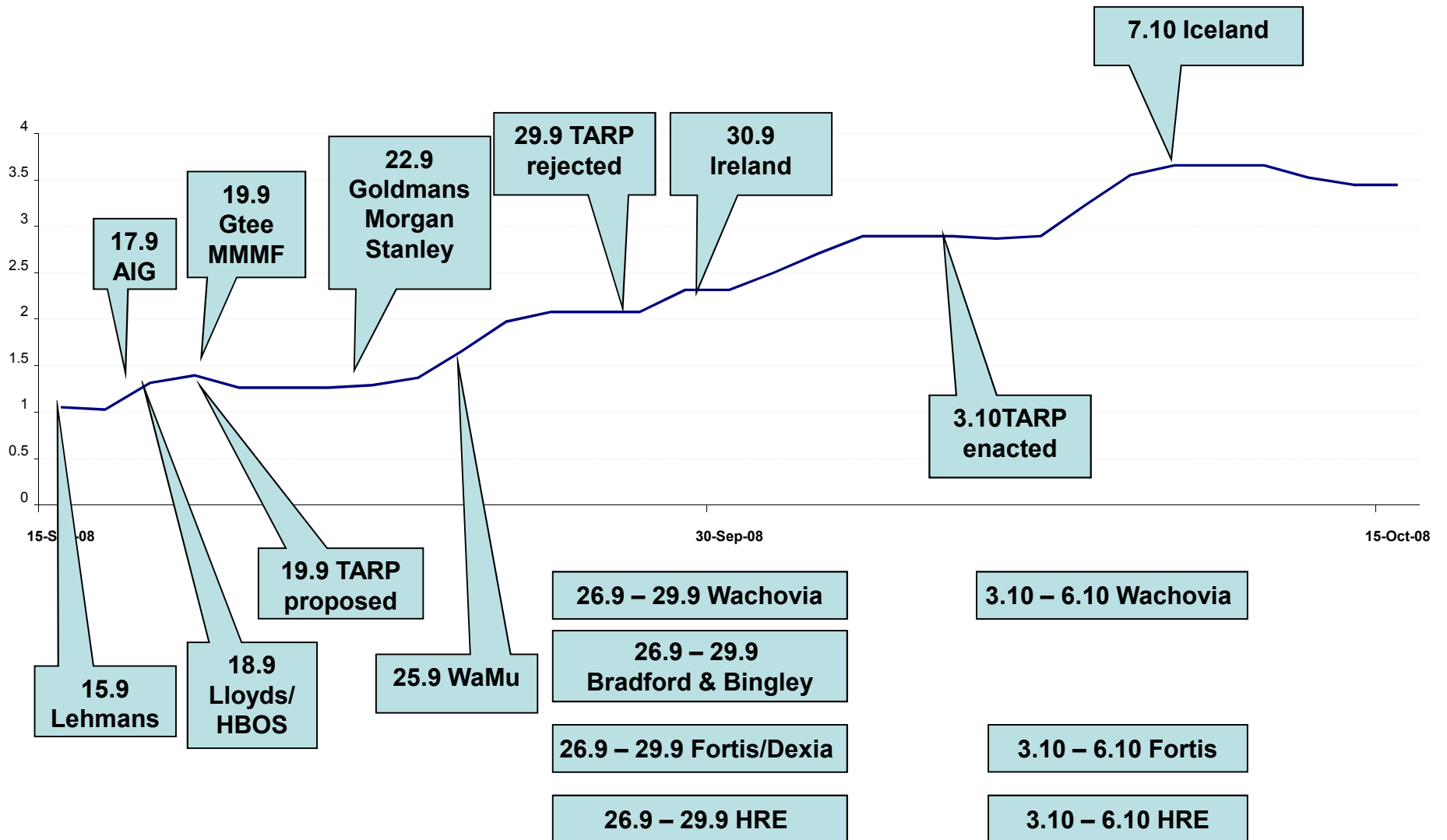


Probability of bail out determines risk

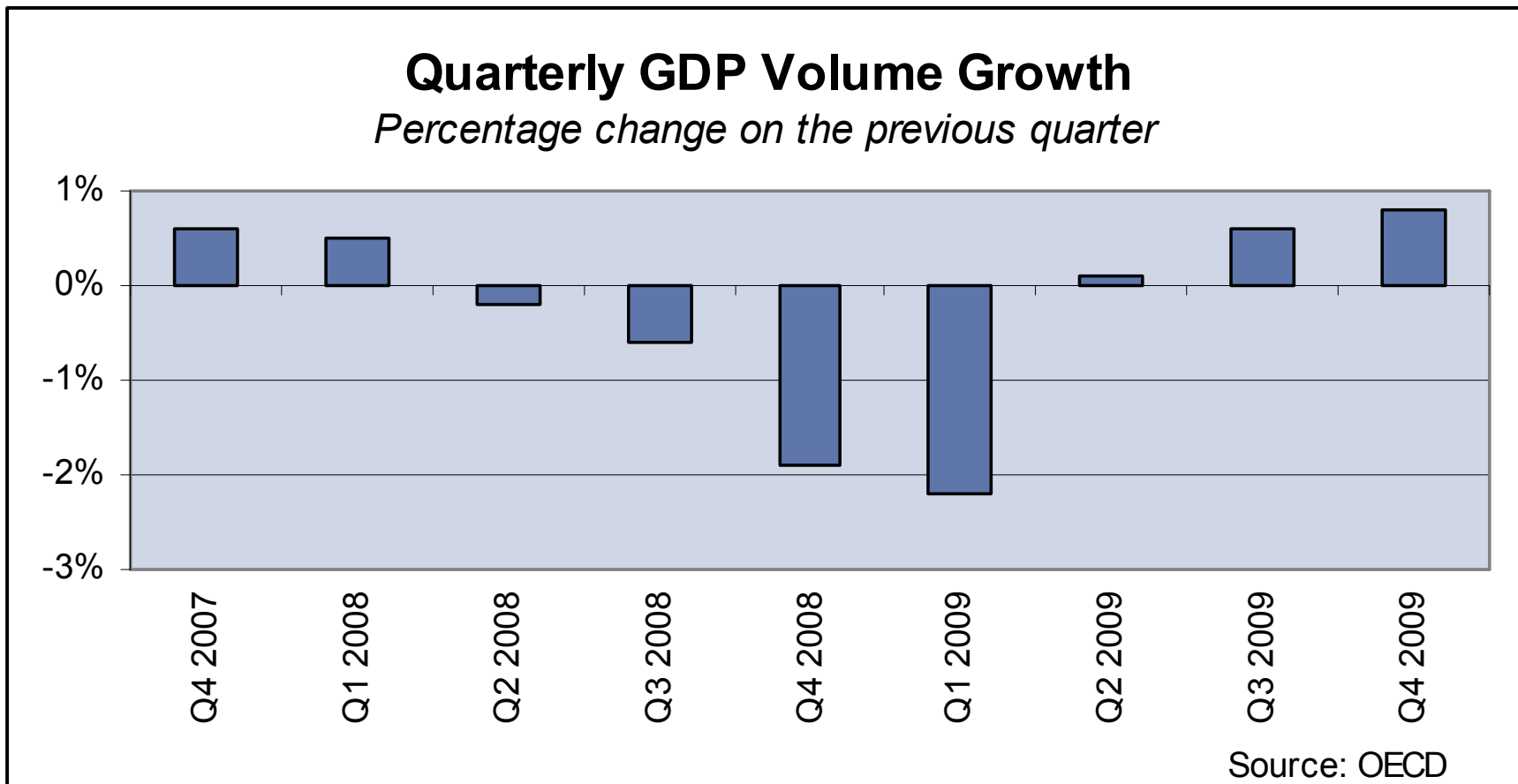
	Likely to be rescued	Likely to be abandoned
Probability of default	20%	20%
Loss given default	25%	25%
Loss given bail out	0%	0%
Probability of bail out	95%	5%
Expected loss	25 bp	475 bp

Moving toward Meltdown

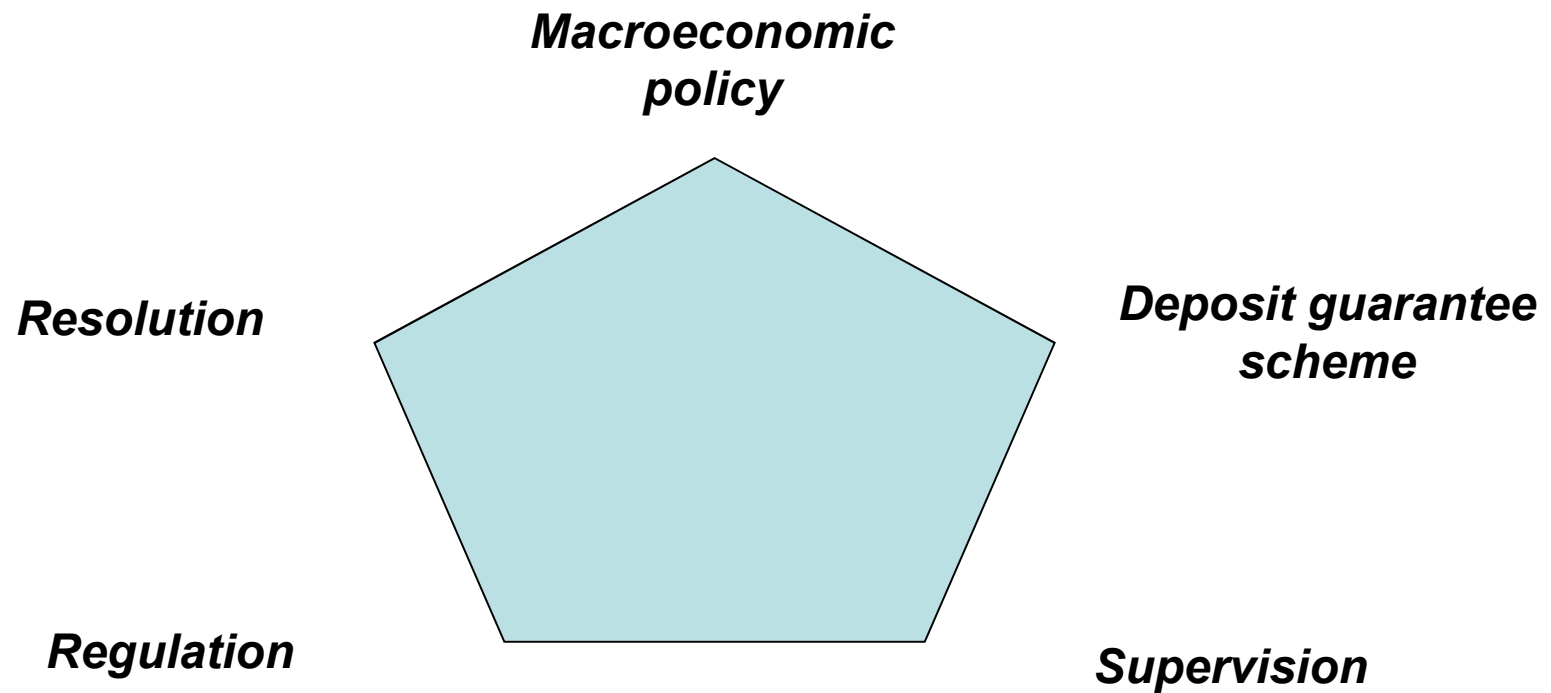
3 month \$ LIBOR – OIS spread in percent
15 September 2008 to 15 October 2008



The world economy goes into free fall



**A cure for crises
requires a comprehensive and consistent framework**



Regulation

- ✓ **Capital**
 - ✓ **Correct trading book regime**
 - ✓ **Improve quality of capital**
 - ✓ **Increase quantity of capital**
 - ✓ **Introduce leverage ratio as back-up**
- ✓ **Liquidity**
 - ✓ **Introduce global liquidity standard**
- ✓ **Remuneration**
 - ✓ **Introduce regulation to assure that remuneration promotes effective risk management**

Supervision

- ✓ **Change approach**
 - ✓ **Pro-active**
 - ✓ **Forward looking**
 - ✓ **Stress testing**
 - ✓ **Recovery plans**
 - ✓ **Intrusive**
- ? **Change organisation**
 - ? **In UK**
 - ? **In EU**
 - ? **In US**

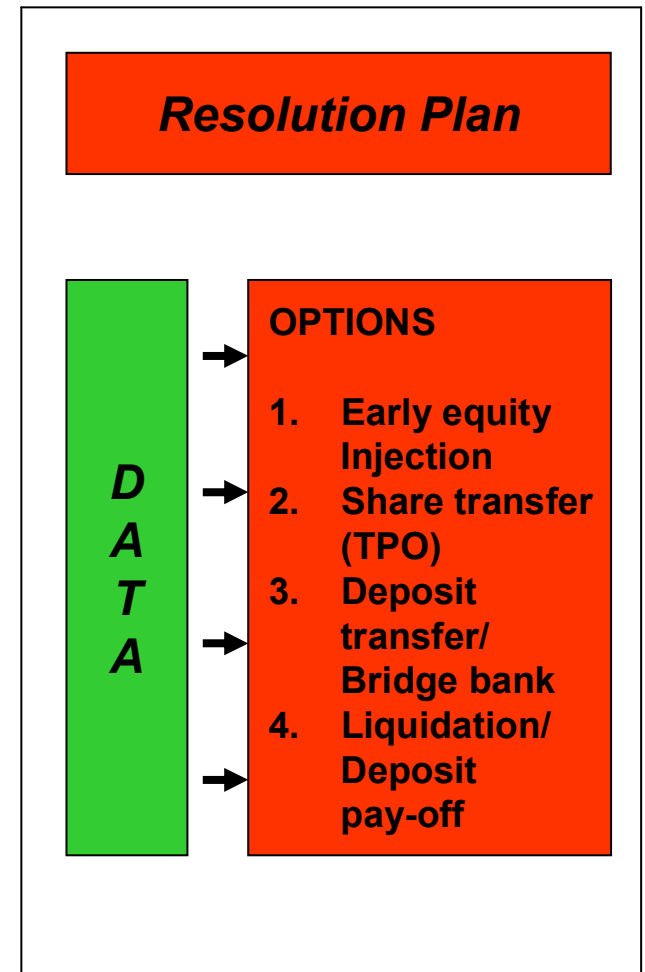
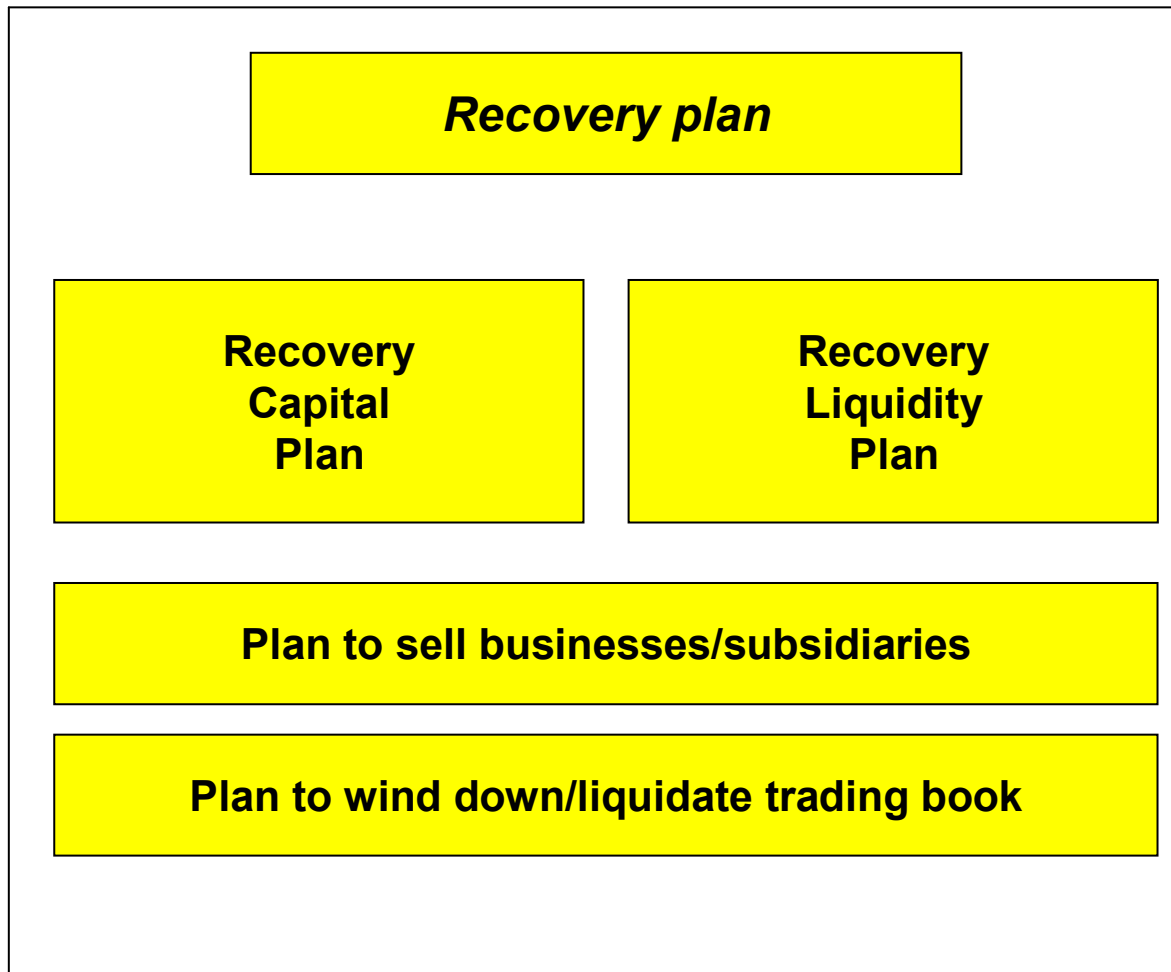
Deposit guarantee schemes

- ✓ **Co-insurance eliminated**
- ✓ **Limits raised**
- ? **Operations improved to enable prompt pay out**
 - ✓ **In US**
 - ✓ **In UK**
 - ? **In EU**
- ? **Funding**
 - ? **Backstop from government**
 - ? **Pre-funded**
 - ? **If so, risk-based?**

Resolution

- ✓ **Special resolution regimes for banks**
 - ✓ In US
 - ✓ In UK
 - ? In EU
- ✓ **Recovery and resolution plans**
- ? **Resolution funds**
- ? **Bank taxes**
- ? **Restructuring**
 - ? **Make banks smaller**
 - ? **Make banks simpler**

Recovery and resolution plans ('living wills')

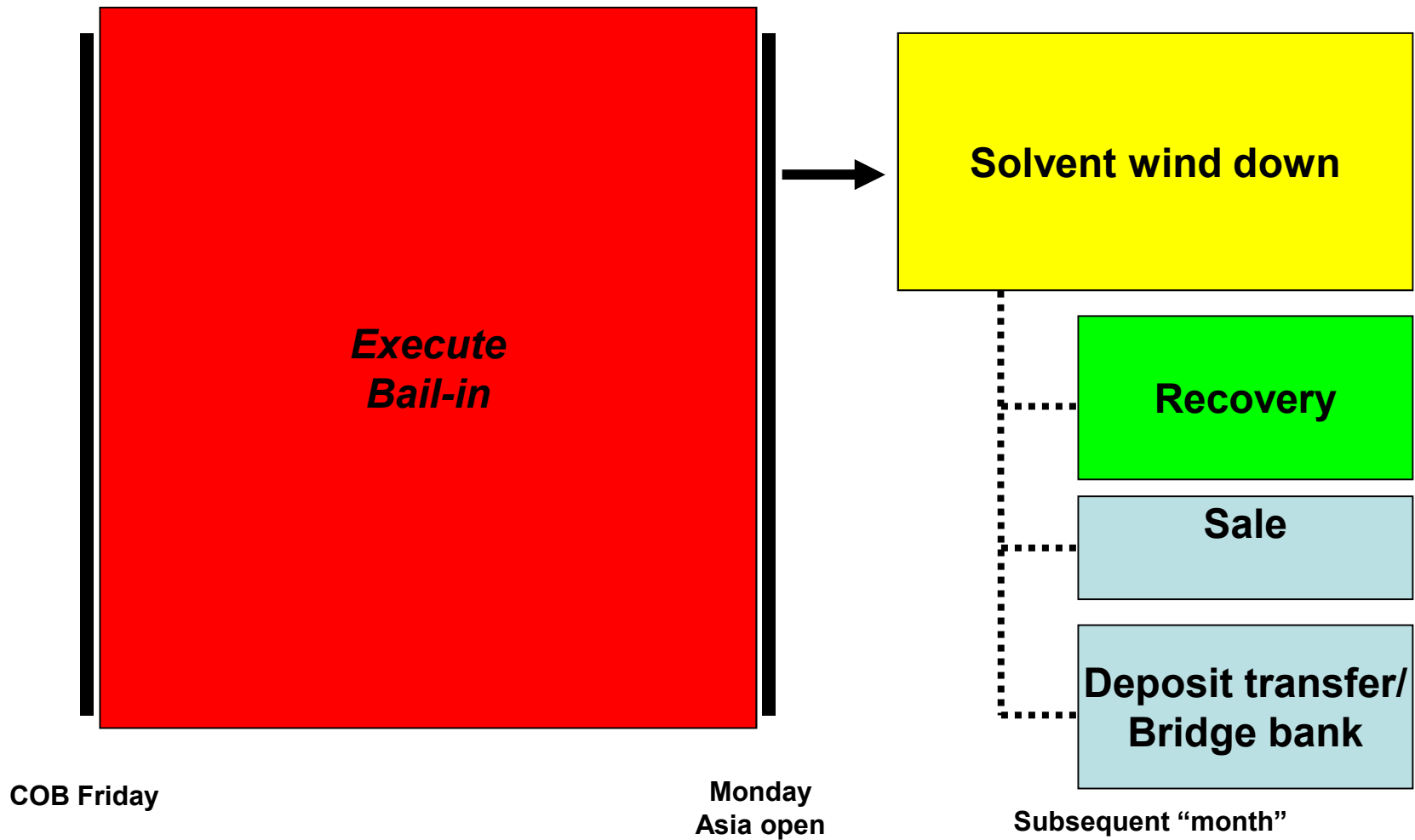


Overview of Resolution Methods

	Taxpayer support	Immediate impact/cost	Long-term impact/cost (moral hazard)	Going/gone concern
Options under SRR				
1. Liquidation/ deposit payoff	None	Very high	Eliminates moral hazard	Gone
2. Deposit transfer/ bridge bank	Limited	High	Improves market discipline and reduces cost	Gone
3. Share transfer/TPO	TBD	TBD	TBD	Going
Option outside SRR				
Early equity injection	Very high	Limited	High (increases moral hazard)	Going

From bail-out to bail-in

intervention



Macro-policy

- ✓ **Introduce macro-prudential policy**
 - ✓ **Create counter-cyclical buffer in banks**
 - ? **Develop other macro-prudential tools**
 - ? **Limits on loan to value ratios**
 - ? **Direct transactions to central counterparties**
 - ? **Others?**
- ✓ **Introduce systemic risk boards**
 - ✓ **In US**
 - ✓ **In UK**
 - ✓ **In EU**
- ? **Have systemic risk boards identify and mitigate systemic risks in a timely fashion, including those risks that emanate from policymakers themselves**