

CARIBBEAN BUSINESS EXECUTIVE SEMINAR

*The Future of the Financial Services Industry  
after the Crisis*

Hosted by

*The Caribbean Centre for Money and Finance*

*The University of the West Indies*

*30th April, 2010*

*Port of Spain, Trinidad and Tobago*

Why the Bailouts Aren't Working and Why a New  
Financial System is Needed

**Professor Jan Kregel**

Senior Scholar and Program Director

Monetary Policy and Financial Structure Program



# Objectives Differed by Stage of Crisis



- **Financial Crisis**

- **ASSETS:** Sub-Prime Mortgage Crisis:  
Spring 2007 (New Century, Citi SIVs)

- **FUNDS:** Structured Finance Crisis:  
March 2008 (Bear Stearns Funds  
Collapse)

- **INSTITUTIONS:** September 2008  
(GSE, Lehman, AIG)

- **Real Sector Crisis: Output and  
Employment**

# Crisis Response: More than Bailouts



- **Federal Reserve Support (LoL, Liquidity)**
  - Section 13 (3) Assistance
  - Expansion of Balance Sheet
  - ZIRP
  - Quantitative Easing
- **Treasury Policies (Solvency)**
  - TARP (Too Big To Fail)
- **FDIC (Insolvency, Recapitalisation)**
  - 215 Resolutions 2008- 16 April 2010 (8 on this date)
  - \$300 B Temporary Liquidity Guarantee Program
- **GSE Policies (Market support)**
  - Purchase of Securitised Mortgage Product

# Differing Objectives

- Support Mortgage Market
- Support Intermediaries
- Support Institutions
- Recapitalisation
- Provide Liquidity
- Resolve Insolvent Banks
- Support TBTF Banks

# Only Short Term Objective



- Prevent Systemic Collapse
  - Post Lehman all Institutions Insolvent
- Save Individual (TBTF) Banks
- Eliminate Toxic Assets
- Restore Lending to Private Sector
- Get the Taxpayer's Money Back



# No Long-Term Structural Objectives

- Avoid Another Collapse
- Change Business Model:
  - Originate and Distribute
  - Off Balance sheet
  - Shadow Banking
- Regulate Problem Products
  - Derivatives: Credit Default Swaps
  - Securitisation
- Problem of Size
- Competition – Anti Trust
  - Profitability – Leverage:  $ROA = ROE * Leverage$

# Current Legislation Fails this Test



- **OPEN LETTER TO CONGRESS:**
- **Neither the bill passed earlier this year by the House, nor the one currently under consideration in the Senate would have prevented the crisis. Without serious restructuring, they will not prevent a future crisis.**
- **Sound financial markets are the bedrock of a strong economy. Over the last decade our financial sector moved away from core market principles - transparency, competition, free flow of information and the essential discipline of failure - that allowed the US economy to thrive.**
- **Restoring the integrity of our financial markets and providing the foundation for economic recovery, requires re-committing to these principles**

# Legislation Must:



- **Eliminates perpetual government sponsored corporate bailouts**
- **Increase minimum capital requirements for banks to no less than 8%.**
  - Apply additional risk-weighted capital requirements for: a) risk concentration, b) significant interconnectedness with other financial institutions and c) illiquidity which assumes a decline in collateral values. Create standard metrics for these variables.
- **Require on balance sheet reporting of all liabilities with disclosure of related material information including all contingent claims .**



# Legislation Must:



- **Require derivatives to be traded over regulated exchanges**
- **Create standardized Pooling and Servicing Agreements and availability of electronic loan level information for asset backed securities, covered bond and similarly structured transactions **prior to sale.****
- **Resolution of Fannie Mae and Freddie Mac.**
- **Mandate that credit rating agencies be subject to the same fiduciary legal standards as other market participants.**

# **Goal of Regulation: Future Structure of Financial Services**



- **Ensure Stability**
- **This Requires Financial Structure Appropriate to Production Structure**
- **Glass-Steagall fit the Postwar Mass Production Tech Paradigm**
- **The new ITC Paradigm changed Business Model from Economies of Scale to Economies of Scope (Flexible Production)**
- **We Need a Financial Structure to Fit the ITC Revolution**
- **Flexible Financial Structure**



**[www.levy.org](http://www.levy.org)**