Has banking reform gone far enough?

John Vickers

Ten Years after the Crisis Conference
CEPR, 22 September 2017
Structural reform

• US: Dodd-Frank Act including Volcker rule ban on proprietary trading
  – Implementation battles
  – Dilution in prospect?

• UK: Banking Reform Act 2013 to implement ICB ring-fence
  – Would full separation have been better?
  – Add Volcker rule?

• EU: Liikanen report (2012) not pursued
The largest banks are required to have as much as ten times more of the highest quality capital than before the crisis and are subject to greater market discipline as a consequence of globally-agreed standards to resolve too-big-to-fail entities

Governor Carney, Chairman of the Financial Stability Board, to G20 Leaders, 3 July 2017
Major UK banks’ leverage ratios (Tier 1 capital, book values)

UK banks’ average price-to-book ratios

The great divide on bank capital policy

• Official view – job done
  – Don’t increase overall capital requirements across the banking sector any further
  – BoE 2016 decision on systemic risk buffer for large retail banks

• Most economists’ view – *far* too much leverage still allowed
  – 33x is grossly excessive
  – No more that 10x (Mervyn King)
  – No more than 7x (2010 FT letter authors)
  – ... Anat Admati & Martin Hellwig
Costs of higher equity capital requirements

• Costly to banks for tax, subsidy and externality reasons

• Costs to society?
  – “minimal, if any”
  – social costs of sharp increase
  – ... but not with gradual build-up, e.g. via retained earnings
Staff paper justifying(?) the BoE’s policy shift

Result stems from imprudent and untenable assumptions

• “Credible resolution strategies will reduce both the likelihood and probable impact of systemic bank failures, leaving the system less reliant ongoing concern capital to do the heavy lifting”
  – Very imprudent to rely on untested new instruments
  – Serious doubts about resolution in a systemic crisis
• BoE results “are explicitly focussed on the costs and benefits of higher capital on normal risk conditions (broadly equivalent to the ‘mid-point’ of the credit cycle)”
  – Like designing flood defences for normal weather
• So BoE’s own model implies need for much more equity capital
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No