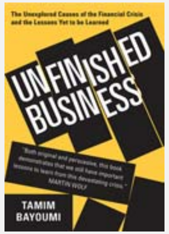
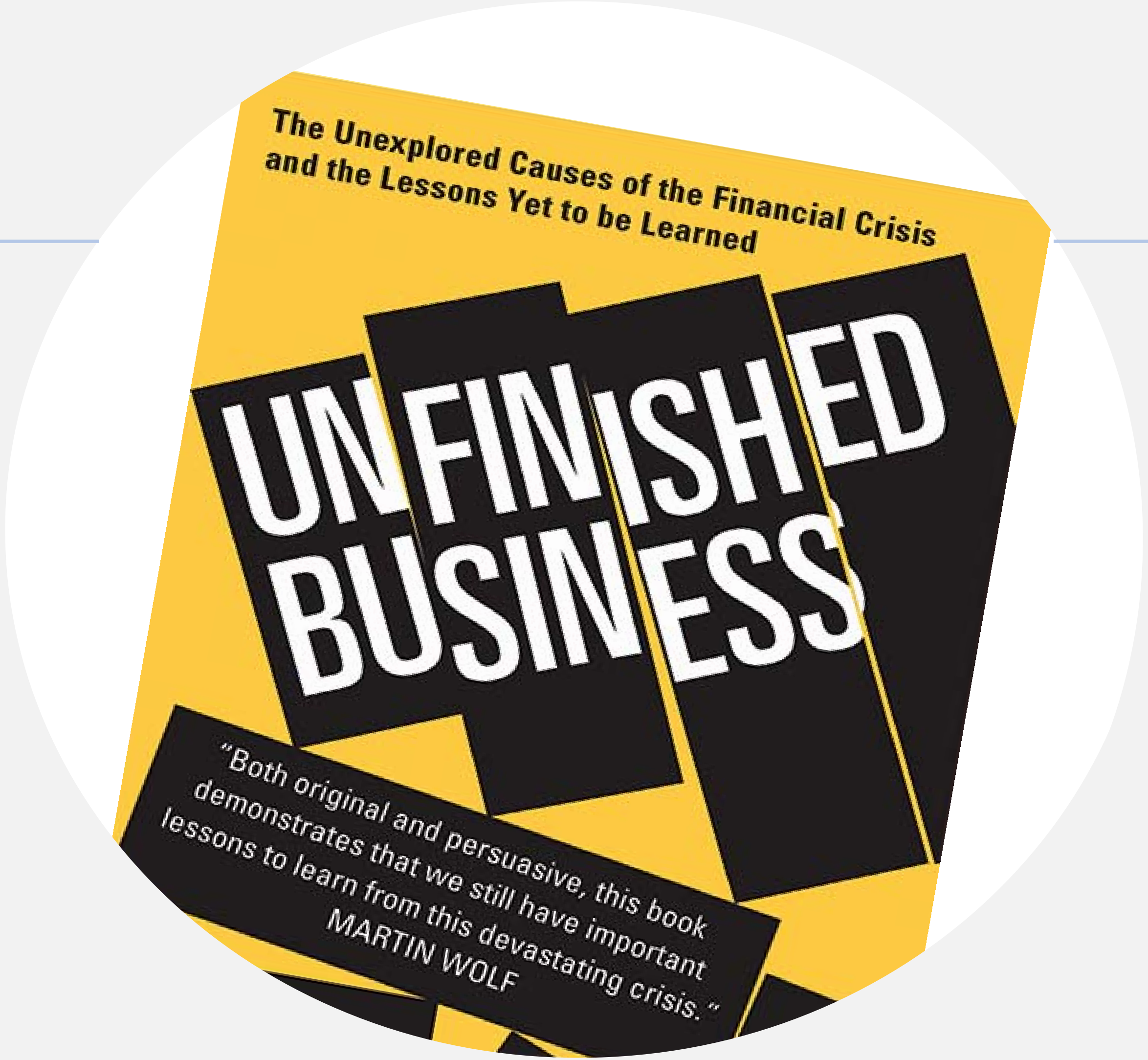


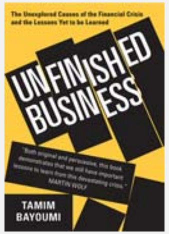
How Much Safer Are Banks? Assessing the Post-Crisis Reforms of Bank Regulation

Tamim Bayoumi

For the conference: *Lehman – 10 Years After*

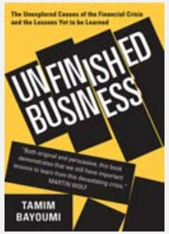
8 June 2018, Goethe University, Frankfurt


The Unexplored Causes of the Financial Crisis
and the Lessons Yet to be Learned
UNFINISHED
BUSINESS
"Both original and persuasive, this book
demonstrates that we still have important
lessons to learn from this devastating crisis."
MARTIN WOLF



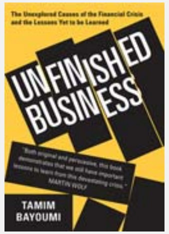
Unfinished Business: Banks

- North Atlantic crisis reflected the succession of regulatory mistakes going back to 1980s in the Euro area and the US.
- Mistakes were capped by a 2003 SEC decision on repo collateral that linked increasing fragile US and Euro area banking systems.
- How far have banks been repaired? Compare situation now with that of 2002, the year before the SEC decision.
- This provides an empirical metric to assess repair.



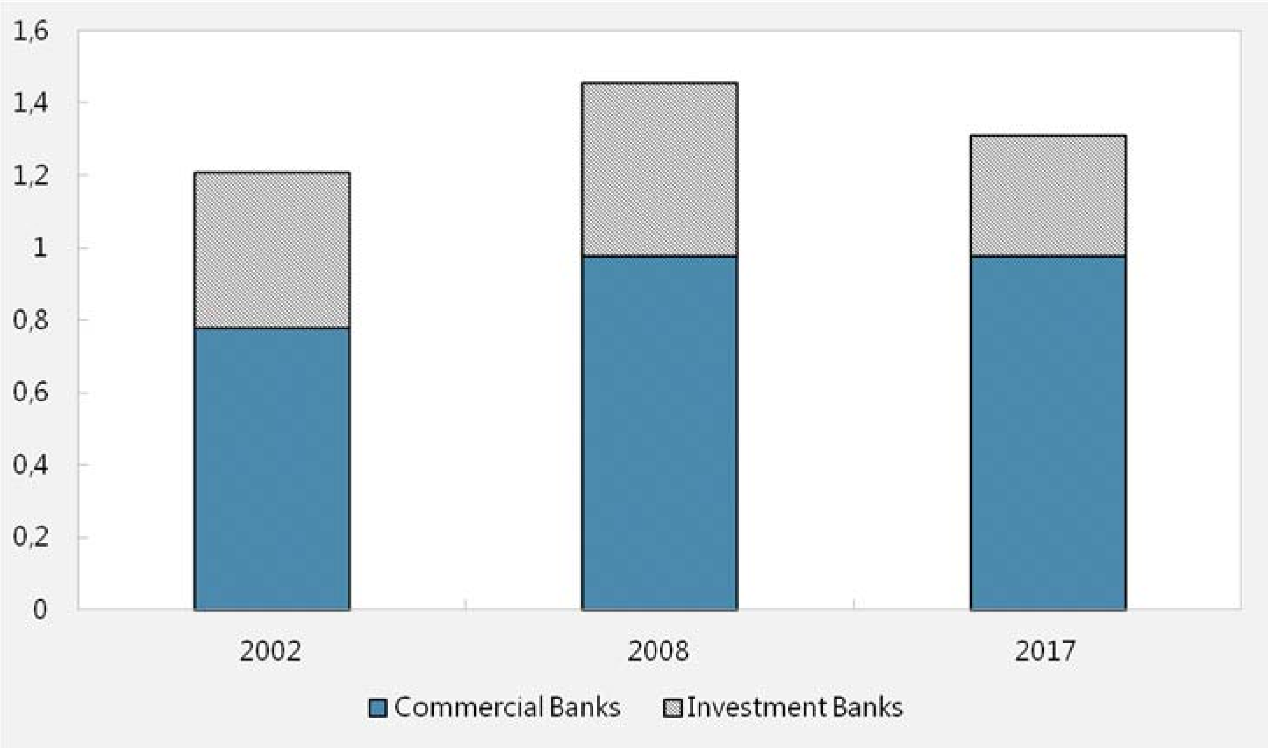
Unfinished Business: United States

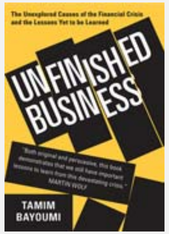
- Pre-crisis: US was undermined by under-regulated investment banks.
- Regulatory arbitrage let better capitalized commercial banks sell loans to under-capitalized investment banks through securitizations.
- Post-Crisis Reforms have delivered:
  - A unification of investment and commercial banking regulation.
  - A meaningful leverage ratio for major banks of 5-6%.
  - A meaningful floor on risk-weighted assets through the Collins amendment.
  - Tough stress tests that have maintained bank capital.
- Recent reforms: Erosion of leverage ratios as well as Volker rule.



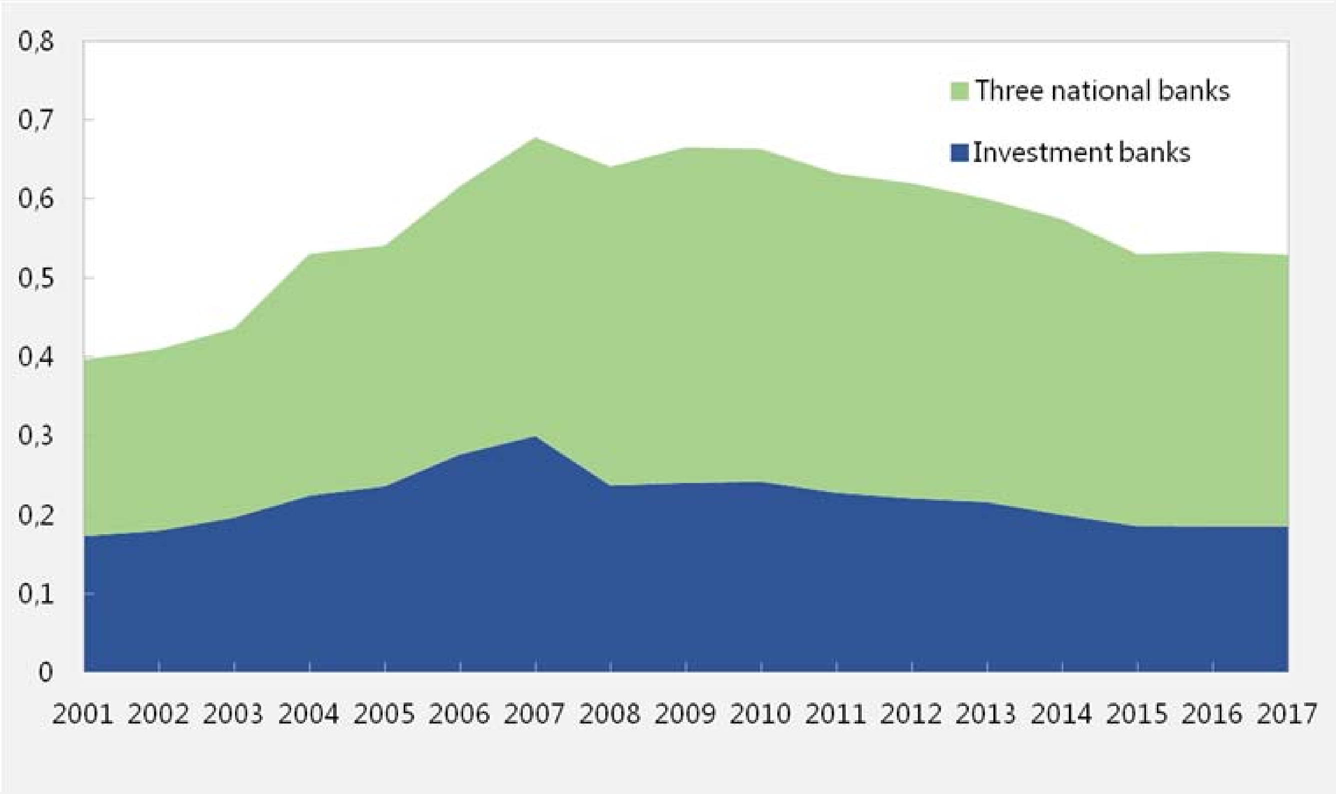
US banking shrank after crisis

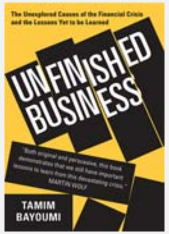
(Assets as a ratio to GDP)





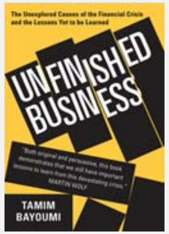
National banks remain large
(Assets over GDP)





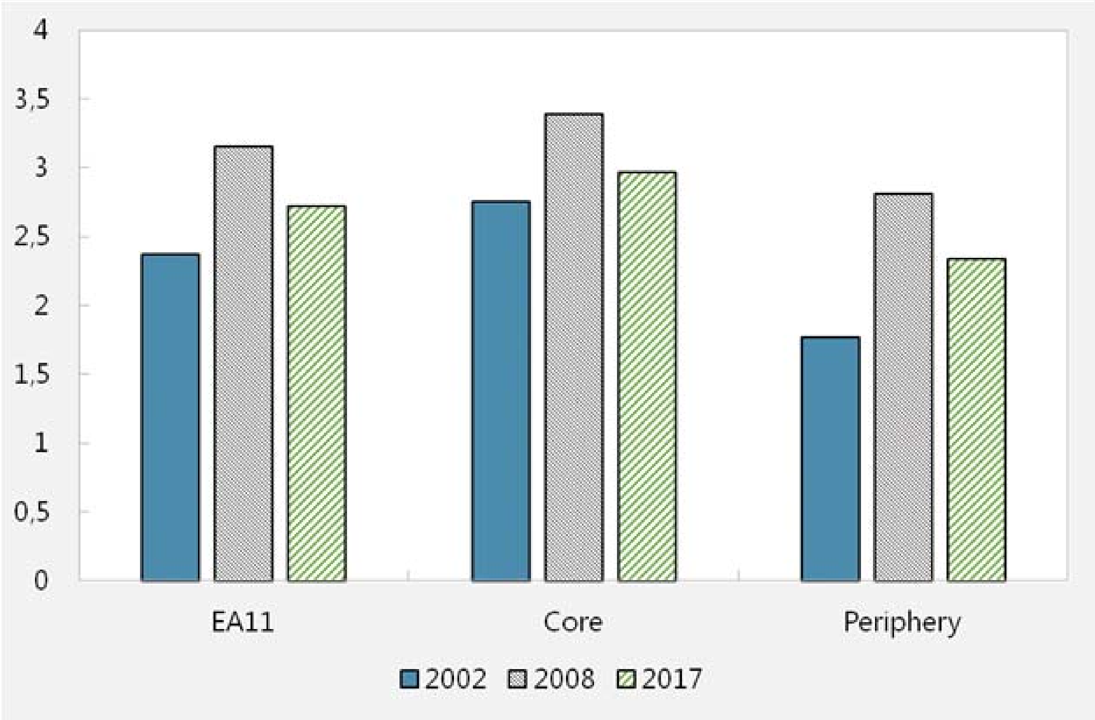
Unfinished Business: Euro Area

- **Pre-crisis: Euro area was undermined by mega banks that manipulated their internal risk models and reduced capital.**
- **Post-crisis reforms have delivered:**
  - **A better definition of capital and higher capital ratios.**
  - **A modest 3% leverage ratio internal risk models (finally!).**
  - **A future modest backstop to risk-weighted assets (eventually).**
- **Post-crisis reforms have not delivered:**
  - **A level playing field between small and large banks.**
  - **An integrated financial system that can serve the entire Euro area.**
  - **An end to procyclical bias; what will happen to capital in boom?**
  - **A credible Euro area backstop; who can recap in a crisis?**



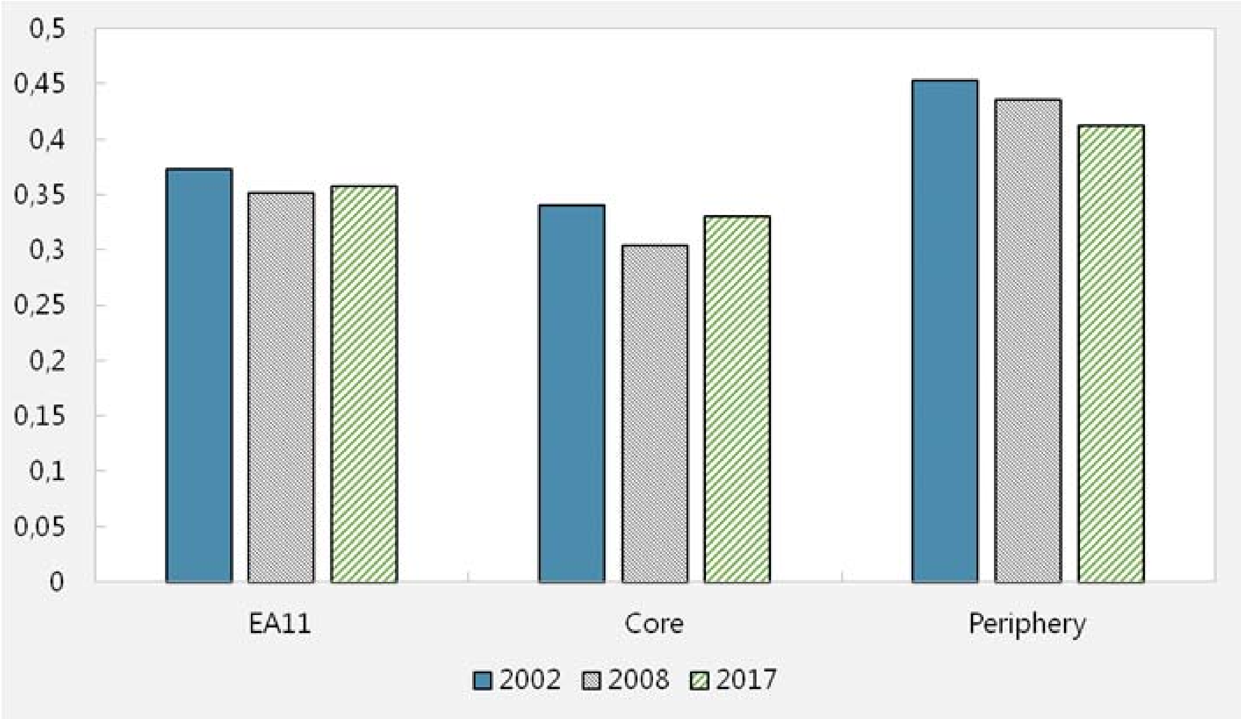
Euro area bank assets remain large

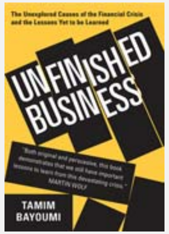
(Bank assets as a ratio to GDP)



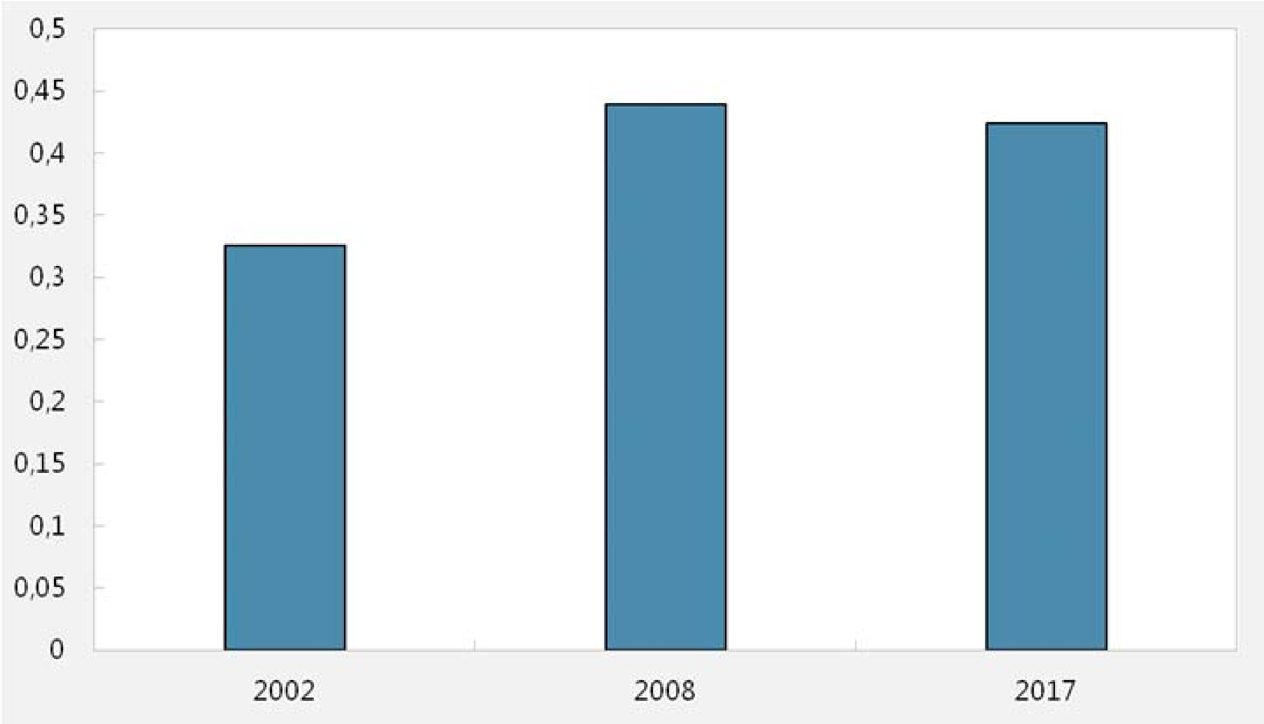
Business Models Remain Problematic

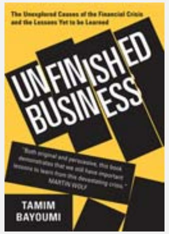
(Loans to EU residents/assets)



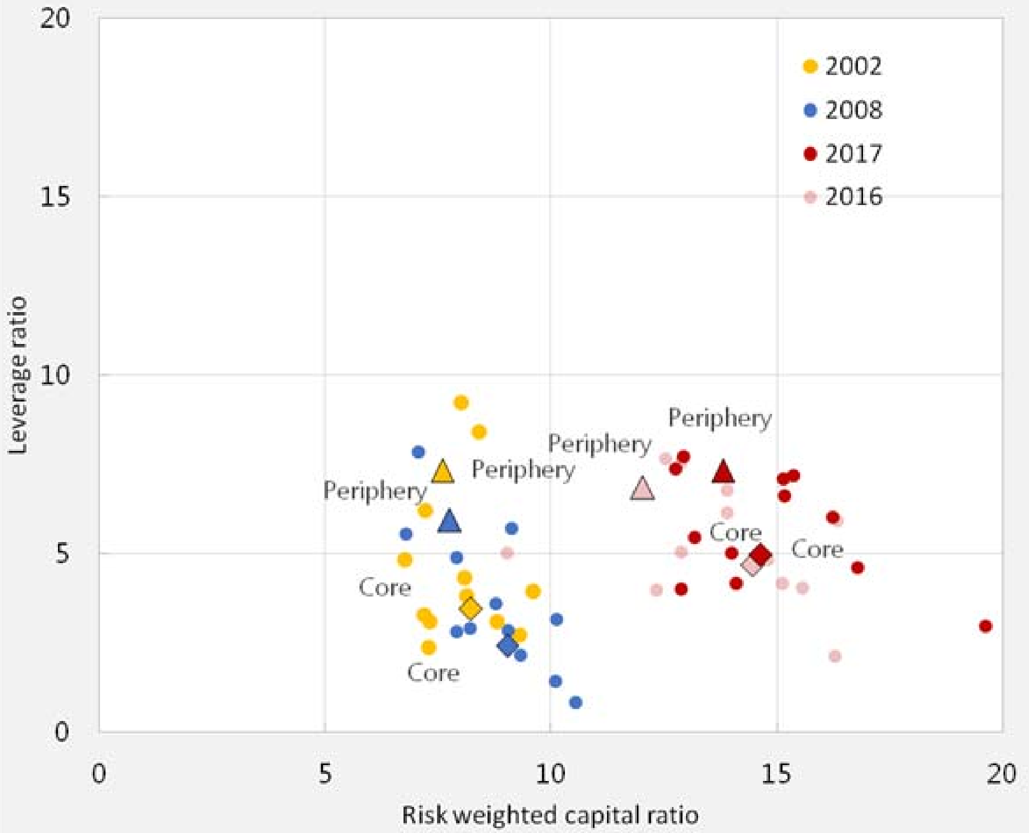


Mega Banks still dominate
(Assets of 12 largest banks in 2008 to all bank assets)



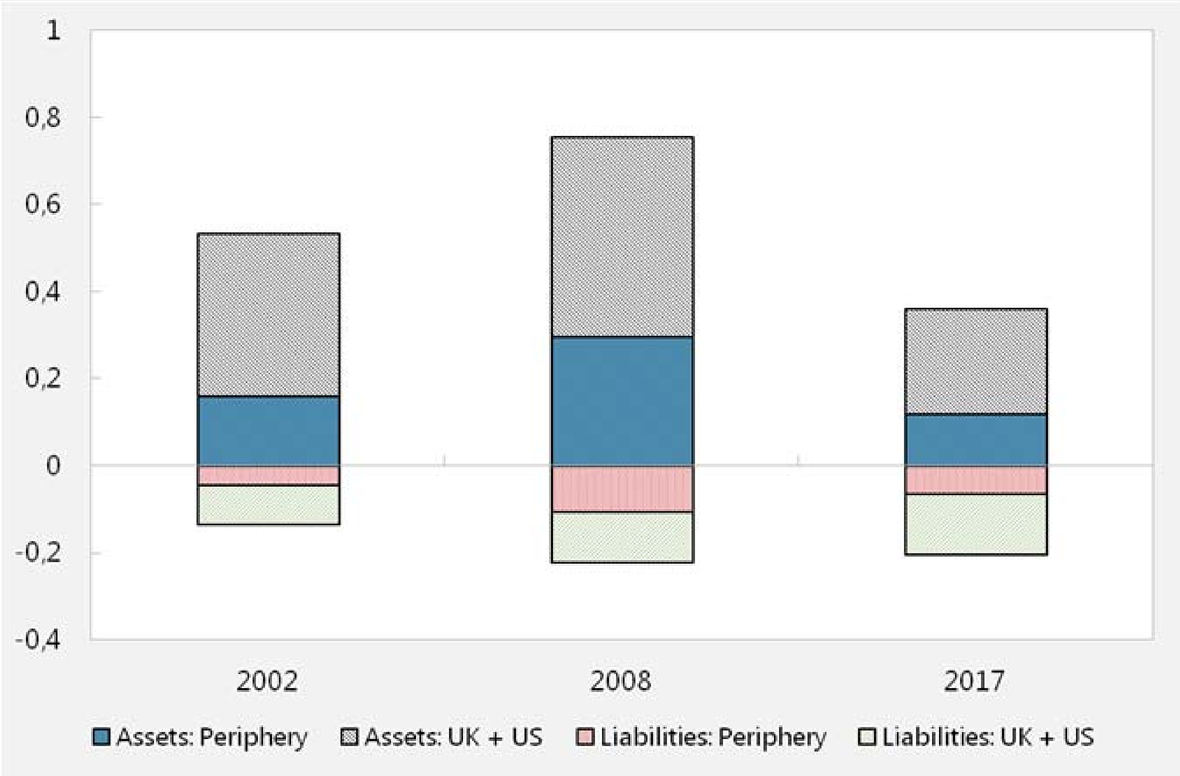


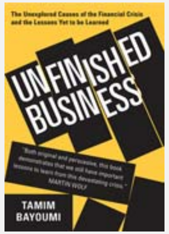
Mega banks have stronger capital
(leverage ratio versus risk-weighted capital ratio)



Euro area banks are less global

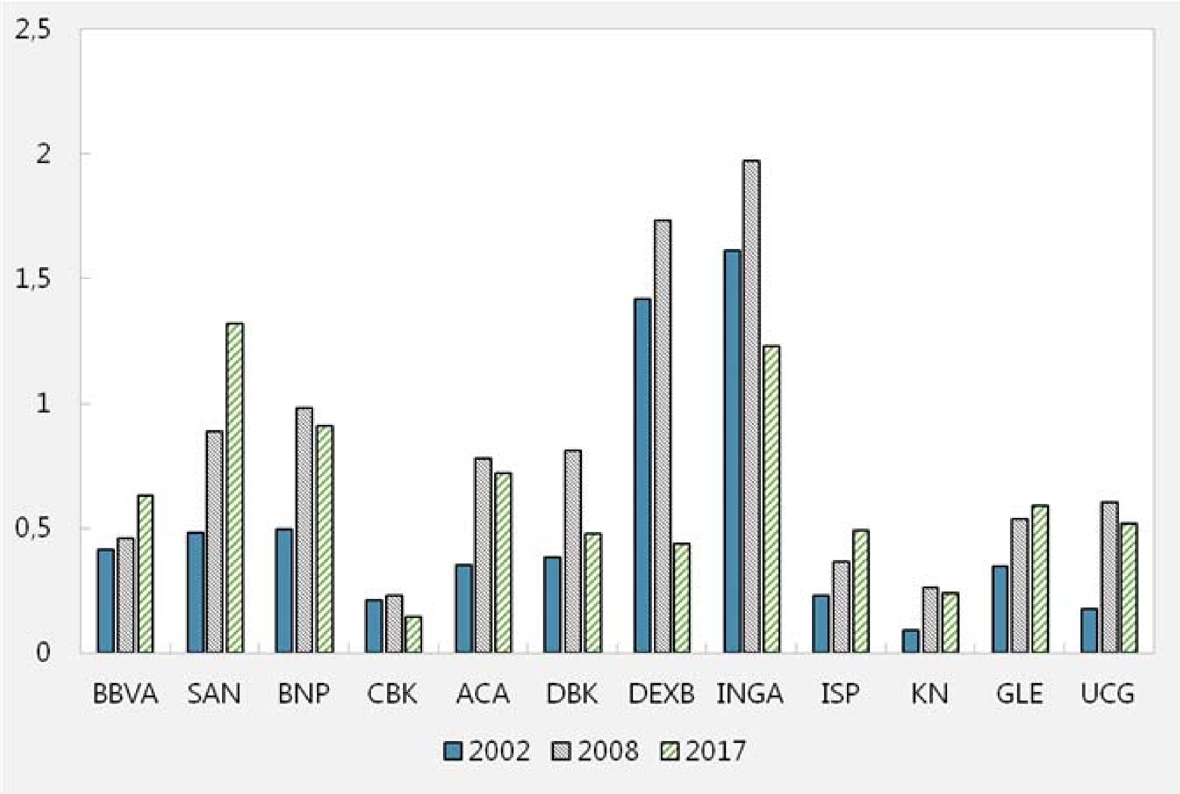
(Overseas assets/GDP)

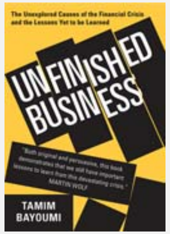




Too big to save is still an issue

(Assets over GDP by Mega bank)





Is the system patched up?

- After the crisis there was pressure for a radical rethinking of banking, but the final result was more of a patch.

- Still have large, universal banks that are difficult to save using internal risk models, although regulations have been tightened.

- Feels more like Versailles Treaty than Bretton Woods agreement. Are the changes enough, or will banks continue to exhibit instability?