BANKERS AND BROKERS FIRST: LOOSE ENDS IN THE THEORY OF CENTRAL-BANK POLICYMAKING*

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*It is not the horse that draws the cart, but the oats…Russian proverb.*

Representative democracy espouses the principle that all men and women are equal under the law: “Liberté! Égalité! Fraternité!” Nevertheless, throughout the housing bubble and the long-lasting economic slowdown that the bursting of this bubble brought about, governments in the US and Europe have put the interests of elite financial institutions far ahead of the interests of society as a whole.

Taxpayer interests were and are poorly represented because of regulatory hubris and regulatory capture. Influence-driven incentive conflict is a phenomenon that mainstream models of optimal macroeconomic and financial stabilization (e.g., Benigno and Woodford, 2003) studiously ignore. This paper seeks to demonstrate that this modeling failure has helped the financial industry to sow misconceptions, nontransparencies, and outright loopholes into the capital standards and regulatory definitions of capital and risk that --then and now-- are supposed to keep financial instability in check.

Misconceptions about crises and crisis response

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The strategies of financial stabilization embodied in the Dodd-Frank Act (DFA) and Basel III ignore the economic efficiency and distributional issues raised by back-door bailouts. They presume that central banks can “print” enough money to keep insolvent financial institutions afloat forever and that questions about the economic justice, efficiency, and time consistency of this strategy can safely be ignored. Neither DFA nor Basel tries to define systemic risk operationally or to decide onto just which taxpayers’ balance sheets the implicit debt created by US and European central-bank credit support will finally settle.

Because insolvency and unemployment are hard to cure, they may be compared to a pair of grievous plagues. To alleviate the nasty side effects of would-be therapies, authorities must prescribe a sustainable cocktail of interacting reforms. In the US, strategies for dealing with regulation-induced innovation and for disciplining the institutions that recklessly spawned these plagues have been assigned to teams of incentive-conflicted and understaffed regulators to work out. Scandals such as the Keating 5 or Abscam episodes document the willingness of legislators to transmit lobbyist pressure to regulatory personnel. Regulatory clientele are using Congress to fan the flames of incentive conflict as the rule-making that the DFA requires creeps forward. For example, Congress is refusing to give the agencies charged with implementing the DFA the funds needed to carry out their assignments and has held up political appointments at safety-and-soundness and consumer regulatory establishments. In the end, US regulators are unlikely to devise and enforce rules or policies that crack down heavily on politically influential firms. Sadly, even more-stressful political biases, turf issues, and budgetary pressures undermine efforts to resolve bank and sovereign insolvencies in the European Union as well.

Distressed institutions continue to shift accumulated losses and the downsides of still-expanding risk exposures to taxpayers and other counterparties. Bankers understand the
financial safety net—not as something external to their economic balance sheet—but as a politically enforceable implicit contract that they have negotiated with national governments. This contract allows governments to impose capital requirements in exchange for committing itself to bail out large portions of the financial industry in crisis circumstances. But it has proved counterproductive to impose requirements as complex and politically driven as those devised in Basel. The absence of cross-country accountability for individual-country rules and enforcement encourages forum shopping. This and other kinds of regulatory arbitrage enhance firms’ ability to hide risk-taking and to misrepresent the depth and timing of actual losses in ways that vaporize the social benefits of capital requirements.

Financial crises are battles over loss distribution. If they want to fight these battles more effectively, governments around the world need to sharpen the risk-control missions of regulatory agencies and rework bureaucratic incentives at these agencies. They also need to refocus reporting responsibilities for regulators and protected institutions on changes in the value of taxpayer safety-net support.

In principle, “capital” is a measure of a firm’s ability to sustain losses as a going concern (Hellwig, 1995). Acting in concert, market and regulatory discipline force a firm to carry a capital position that outsiders regard as large enough to support the risks it takes. When institutions are protected by the safety net, not all of this capital comes from shareholders. Taxpayers become enmeshed in supplying capital to such firms because creditors and other counterparties regard the conjectural value of government guarantees as a valuable option—a “taxpayer put.” The value of the government-contributed capital supplied by a firm’s taxpayer put serves as a substitute for ordinary on-balance-sheet capital supplied by the firm’s
shareholders. It frees up opportunities for managers to dividend out capital that shareholders would otherwise have to leave in the firm.

Differences in the protections afforded stakeholders in Bear Stearns, Lehman, and Goldman Sachs clarify that creditors of some institutions are more fully protected than others. What we can call an “elite institution” is one that possesses political clout as well as economic importance.

Given that financial safety nets transform taxpayers into unwitting equity investors of last resort, regulators and financiers owe taxpayer-investors duties of loyalty, competence, and care in return for their stakes in financial firms. The duties of care and competence imply three specific duties:

1. A duty of vision: Supervisors should continually adapt their surveillance systems to discover and neutralize innovative regulatee efforts to disguise their rule breaking;
2. A duty of prompt corrective action: Supervisors should stand ready to propose new rules and to discipline regulatees whenever a problem is observed;
3. A duty of efficient operation: Supervisors should strive to produce their insurance, loss-detection, and loss-resolution services at minimum cost.

In turn, the duty of loyalty entails both:

1. A duty of conscientious representation: Supervisors should be prepared to put the interests of the community they serve ahead of their own loyalty;
2. A duty of accountability: Implicit in the other duties is an obligation for safety-net managers to embrace political accountability by bonding themselves to disclose enough
information about their decision making to render themselves answerable for mishandling their responsibilities.

Unless these duties are honored on political battlefields and enforced in operational and accountable ways, it is unreasonable to believe that authorities can or will adequately measure and contain systemic risk as the next round of boom and bust unfolds.

A critical step would be to strengthen training and recruitment procedures for top regulators. Specialized educational programs are only beginning to emerge. For example, Macquarie University in Australia is planning a Masters in Financial Regulation and targeting it as an executive course for candidates currently employed as regulators. The most ambitious program is the European Supervisor Education Initiative (ESE). The ESE was formed in 2009 as a confederation of European supervisory authorities, central banks, and academic institutions. It seeks to promote “the concept of a joint supervisory culture in Europe.” It organizes its curriculum in a modular fashion. Table 3 lists the subjects to be covered in 2012.

Except for including segments on negotiating and communication skills, the ESE program focuses on techniques of supervisory risk assessment and control. Missing from the curriculum is explicit training in the ethics of regulation and in how to prevent bureaucratic incentives from being distorted by the industry’s revolving door and its participation in the patronage process. Incentive conflict is the number-one problem in regulatory and supervisory enforcement and placing political patronage rather than competence and character at the center of the appointment process amplifies incentive conflict.

One's ability to handle incentive conflict is shaped in large part by one's personal sense of honor and duty. In areas of public service that require individuals to put their lives on the line, a candidate's sense of honor and duty is honed by morale-centered training programs. Although
helpful, it is not enough for consortiums of individual agencies or universities to offer
specialized instruction in the theory and practice of financial regulation for existing staff.

Between them, the Federal Reserve and the European Central Bank have used risky
forms of collateralized lending and swap facilities to support troubled institutions all over the
globe. As a long-run way to give European and US taxpayer interests the primacy they deserve,
I believe that we need to establish a high-profile academy for training financial regulators
modeled on West Point and admit cadets from around the world. This would forge connections
between graduates at supervisory agencies in different countries and pave the way for more-
effective information flows and cross-border regulatory cooperation. Besides studying principles
of financial engineering and the ways in which past crises have unfolded, students need to be
drilled in the duties they owe the citizenry and in how to overcome the political pressures that
elite institutions exert when and as they become undercapitalized. It is striking how effectively
training for crises prepares police officers, firemen, and nuclear personnel to run without
hesitation toward --rather than away from-- danger when emergencies arise.

Central bank and government rescue programs

When regulators pander to the expedient interests of loss-making institutions, they
increase expected tax burdens on households and small business. The failure to perform triage
prolongs economic malaise rather than cures it. Table 1 summarizes the depth and breadth of the
subsidized credit support that the Fed supplied during 2007-2010. The voting and taxpaying
public recognizes that central bank and government rescue programs have placed heavy--and not
yet fully acknowledged-- burdens on the citizenry of the US and EU. Evaluating bailout
programs only against a totally irresponsible standard of doing nothing at all, high officials
characterize financial crises as generating ruinous external diseconomies for viable financial firms, and go on to make two self-serving claims: (1) that the indiscriminate use of government credit support is *necessary* to save us from worldwide depression and (2) that bailout arrangements actually *make money* for the taxpayer. Both claims are false, but in different ways.

Bailing out firms without conducting triage and taking control of zombie firms is not a reliable or efficient way to restore financial stability (Kane and Klingebiel, 2004). It wastes taxpayer resources by expanding the opportunity set of previously mismanaged firms and these firms’ attraction to longshot uses of funds undermines rather than promotes economic recovery. Leaving zombie firms in private hands evokes reckless gambles for resurrection and creates uncertainty about who will finally bear bailout costs and about when and how triage will— as it must eventually— be accomplished. The US S&L mess shows that, until these issues are resolved, gambles and uncertainties will continue to disrupt the flow of credit and real investment necessary to trigger and sustain a robust economic recovery (Kane, 1989; Kane and Yu, 1995).

In the US, the claim that the Fed and TARP programs actually “made money” for the taxpayer is half-true. The true part of the proposition is that, thanks to the heavily subsidized terms these programs offered, most institutions will be able to service the formal obligations they incurred. But the other half of the story is that US citizens had better ways to deploy bailout funds. Blanket rescue programs forced taxpayers to provide under-compensated equity funds to deeply troubled institutions, and the largest and most politically influential of these firms were allowed to gamble for resurrection. Government backing permitted insolvent financial firms to avoid having their debt explicitly downgraded to the junk status it deserved. It also allowed
some of the largest zombies to absorb the assets of other troubled firms, making them even bigger and harder to fail.

The payoff structures of lifelines provided to an underwater firm are not those of a loan. They are those of a long-shot equity investment whose substantial downside easily justifies a 15% to 20% return. For example, 3-year Irish government bonds yielded as much as 14% in July 2011 and the yield on 3-year bonds issued by Greece reached 25% in October. Hull, Predescu, and White (2005) calculate that during the noncrisis period of 1996-2003 the risk premium over Treasuries appropriate for comparably low-rated bonds averaged 13.21%.

Unbridled government credit support runs a tab for past and future losses at protected firms and puts the bill on taxpayers’ account. Running such a tab is demonstrably a short-run path of political and administrative least resistance. But in the long run, this strategy creates hard-to-contain social unrest. US and EU authorities chose this path without weighing the full range of out-of-pocket and implicit costs of indiscriminate rescues against the costs and benefits of alternative programs such as prepackaged bankruptcy or temporary nationalization and without documenting differences in the way each deal would distribute benefits and costs across the populace over time.

Rethinking systemic risk

This paper’s title metaphor of “loose ends in central-bank policymaking” puts one in mind of a figurative cable whose individual strands needs to be fused and joined to a nation’s (or region’s) real economic system. Regulators’ operative problem is to conceptualize the connection realistically and to assess the risk that it might unravel in particular ways.
The root problem in supervisory conceptions of capital and systemic risk is that they shield government and industry officials from accountability for the roles they play in generating adverse movements in the true value of each variable. Politicians and regulators are reluctant to acknowledge regulation-induced elements in innovative forms of risk-taking and loss deferral undertaken by client firms or to report publicly on the ways in which the industry exerts perverse lobbying pressure upon them. The primary task of so-called Wall Street lobbyists is to foster among politicians and regulators an inordinate fear of letting either the reliability of industry accounting standards or the health of major industry segments be called into serious question. These fears cement the taxpayer put and feed an expectation that officials will absorb losses and loss exposures in crisis situations. Despite the numerous changes promulgated in the DFA and Basel III, this expectation remains strong (see, e.g., Table 2). These fears and proclivities encourage opportunistic firms to cultivate turf battles and exploit incentive conflicts within the supervisory sector to make sure that tough decisions favor industry interests over those of other citizens.

Definitions of systemic risk used by the Basel Committee and other policymakers focus on contagion: i.e., a concern for avoiding potential spillovers of institutional defaults across important firms in the financial sector and from this sector to employment and asset values in the real economy. This perspective conceives of safety-net costs simply as negative externalities and fails to acknowledge that safety-net arrangements are rooted in an implicit political contract. In crisis circumstances, legislators and regulators renegotiate the terms of this contract and its enforcement with their counterparties, with little input from taxpayers. The understanding that this will occur helps to complete financial markets by credibly segregating downside risk in protected institutions and assigning the deepest tail-risk exposures to taxpayers. If tail events do
not materialize, the institution reaps most of the gains. But when and if things go disastrously sour, the management "puts" substantial losses to taxpayers.

This two-piece contractual conception of systemic risk clarifies that it comes from an option-like equity investment that government officials make in protected firms. As agents, government officials and the managers of protected firms owe taxpayers complementary duties of loyalty, competence, and care. Taxpayers' position in each protected firm provides an insurance-like benefit to shareholders and creditors that in competitive markets firms would be required either to surrender or pay for. The value of this benefit can be shown to vary inversely with the risk that an institution might sustain a series of losses that exceed its ownership capital (i.e., with the expected value of a firm's deepest downside risks) and with the percentage of a firm’s tail risk that the government is likely to absorb if this were to occur.

Research indicates that bond, stock, and swap markets reward elite institutions for increases in asset size and tail risk. See, for example, Brewer and Jagliani (2009), Penas and Unal (2005), and Völz and Wedow (2009). Hence, empirical research supports the common-sense view that implicit and explicit government guarantees distort the ways in which banks conduct and report their risk-taking. This is why policymakers should interpret taxpayer exposure to tail risk at systemically important firms as an implicit market-completing contract rather than as an external diseconomy. The taxpayer put makes taxpayers unacknowledged equity investors in major firms. The value of their stake can and should be measured jointly by managers and regulators and be supported by an appropriate annual or quarterly dividend. As contracting structures for other stakeholders routinely require, taxpayers deserve to have their stake in financial firms monitored and serviced fairly.
Usefulness of capital requirements has been oversold

Regulation may be likened to medicine and systemic risk to a disease. Medicines and other kinds of therapeutic treatments are bundles of good and bad side effects. Therapies seldom prove beneficial for all *intervals of time* or for all *types of patients*. In the financial sector, treatment protocols should be judged by their ability to create net value for patients and society through time.

To evaluate regulatory treatments properly, one must look beyond their immediate palliative effects. One must also worry about both the long-term comprehensiveness of the diagnosis regulatory “doctors” have adopted and the limitations of the therapy they prescribe. In the laboratory in which global regulatory strategies are crafted today (the Basel Committee on Banking Supervision), the diagnosis that regulators are pursuing is misconceived. They acknowledge that financial crises are socially costly to cure, but pretend that they can be avoided by aligning what turns out to be a firm’s understated leverage with politically negotiated conceptions of its exposure to risk. But their treatment plans misperceive capital and misweight risk. Regulators seem to believe it is sufficient to force protected institutions to accept a marked increase in their equilibrium ratio of *accounting net worth* to total assets. But games that can be played with loan-loss reserves and other discretionary items make accounting net worth a loophole-ridden concept whose value is ultimately driven by an institution’s appetite for risk. In practice, a firm whose books make a show of higher capital is often more risky than a firm whose books show less.

Hence, the preventive leg of the Basel diagnosis is overly hopeful and not supported by empirical research. On the contrary, financial crises seem *inevitable*. Where data exist, they show that every country’s financial sector passes through a succession of three-stage sequences:
a pre-crisis bubble in credit, an actual crisis, and a post-crisis period of creative destruction and healthy recovery (Kindleberger, 1978; Reinhart and Rogoff, 2009). Of course, the durations of the different stages vary across countries and across time, and transitions from one stage to another become clear only in retrospect.

Historical data do support a less sweeping hypothesis: namely that bubbles and crises can be amplified by weaknesses in insolvency detection and by subsidies to risk generated by zombie firms' ability to battle for bailouts. In practice, crises and subsidies arise dialectically from path-dependent collisions of efforts by: (1) regulators in their supervisory capacity to control leverage and other forms of risk-taking with (2) disruptive efforts by regulated and “shadow” financial institutions to expand risks in nontransparent ways and to shift responsibility for ruinous outcomes onto national safety nets. Bank managers face a threefold incentive: to lobby for lenient standards, to hide and understate risk exposures, and to overstate accounting net worth. This set of incentives makes risk and stockholder-contributed net worth hard to measure accurately and reliable standards by which to judge improvements in incentive alignment difficult to set and enforce.

Undone by the regulatory dialectic

Because regulators have relatively short terms in office, they are attracted to temporary, rather than lasting fixes. The costs and benefits of capital requirements extend far into the future and are by no means fixed or exogenous. Regulatees search tirelessly for ways to reduce the burdens of regulation. Value maximization leads bankers to devise progressively lower-cost ways to exercise political clout, to adjust and report their asset and funding structures, and to choose the jurisdictions in which they book particular pieces of business.
This kind of financial engineering resembles what happens on a “makeover” television show. Top managers deploy the equivalents of fashionistas, cosmeticians, and hairdressers to revamp their firm’s external appearance without changing the underlying character of the risk exposures that they expect taxpayers to support.

The endogeneity of regulatory burdens leads us to view: (1) ongoing negotiations in the Basel Committee on Banking Supervision that seek to establish global risk-based capital rules and (2) disruptive bank objections to—and circumvention of—emerging rules as conflicting forces in a dialectical evolutionary process:

**Regulation** (e.g., Basel I) immediately begets and subsequently perfects patterns of avoidance.

Avoidance begets (after a long delay) **re-regulation** (Basel II & III), often in response to crisis pressures and a credit “crunch.”

**Re-regulation** spawns further rounds of avoidance.

Weaknesses in the way US and EU regulators chose to implement Basel standards create differences in the costs of loophole mining that help explain why the crisis hit their financial systems harder than those of Canada, Asia, Latin America, and Oceania [see Shadow Financial Committee Report (2011), posted at aei.org]. Although Basel II ties risk weights for sovereign debt to credit ratings, it permits national authorities to go below those weights for central-government debt (or debt guaranteed by a central government) that is issued and funded in the currency of the country in question. For political reasons, US regulators assigned unrealistically low weights to mortgage-backed securities and EU officials set zero risk weights for member-state debt. The European Central Bank (ECB) contributed to the process by accepting the sovereign debt of all Eurozone countries at par value when posted as collateral for ECB loans.
When and as the debt of the “GIPSI” nations of Greece, Ireland, Portugal, Spain and Italy began to be downgraded, the EU and the ECB failed to “haircut” their treatment of these countries’ increasingly risky debt.

All this was part of a larger strategy of cross-country denial and concealment. EU stress tests and Basel’s risk-weighted capital ratios (Demirgüç-Kunt, Detragiache, and Merrouche, 2011) failed demonstrably to distinguish between failing and viable banks. The fundamental weakness in Basel arrangements is their contractual incompleteness. Basel accords fail to make credit-rating organizations and individual-country regulators accountable either to the Basel Committee or to banking regulators in other member countries.

My Hegelian perspective dramatizes the incentive conflicts that regulators and regulatees face. Crises and subsidies arise in a path-dependent manner from prior tensions between efforts by regulators in their supervisory capacity to control leverage and other forms of risk-taking and efforts by regulated and “shadow” financial institutions to expand risks in nontransparent ways and to shift responsibility for ruinous outcomes onto national safety nets.

Loopholes make lobbyists’ disinformational claim that tougher capital requirements will make banks pass up profitable, but socially risky financial opportunities seem distressingly dishonest. Hopefully, the crisis is teaching the public some important lessons about the game regulators and regulates have been playing on them. Accounting ratios are not difficult to overstate and bankers do not accept high statutory burdens passively. Other things equal, higher capital requirements lead banks to choose riskier strategies and to conceal the resulting loss exposures from regulators’ losses so as to minimize adverse effects on bank profits and stock prices.
This perspective clarifies that the Dodd-Frank Act and the Basel III framework are using stress tests and higher capital requirements to treat only a subset of the problem: the extent to which institutions expose themselves in directly observable ways to credit risks that transmit exposures to default across a chain of possibly fragile counterparties. But to be effective, the medicine of capital requirements must be adapted to take fuller account than Basel does of a firm’s asset-liability maturity mismatch and to treat a second and more subtle source of subsidies. This second problem is the ease with which regulatory arrangements continue to allow actual or potential zombie institutions to use financial accounting tricks and innovative instruments to hide risk exposures and to accumulate fresh losses until their insolvency becomes so immense that they can panic regulators and stampede them into providing life support indiscriminately to insolvent firms.

Without the taxpayer put, creditors of a weak bank would face haircuts and excessively risky banks would have risk retrenchment forced on them by market and regulatory discipline. This disciplinary pressure is likely to lead to a “credit crunch” at troubled firms, but so does forbearance. The problem is that indiscriminate bailouts are the opposite of discipline. They lead banks to eschew healthy positive net-present-value lending programs to business in favor of negative-NPV “gambling for resurrection.”

In good times and in bad, the “taxpayer put” allows elite private institutions to issue the equivalent of government debt and makes ordinary citizens uncompensated equity investors in such firms. Offering endless credit support to zombie firms impedes macroeconomic recovery by making crippled institutions look stronger than they are and turns a blind eye to the ways in which their underlying weakness creates additional damage by incentivizing managers of such
firms to waste taxpayer resources by undertaking reckless long-shot investments instead of fostering flows of healthy business and consumer credit.

**Recommendations for reform**

My recommendations for regulatory reform are rooted in the straightforward ethical contention that protected institutions and regulatory officials owe the same fiduciary duties to taxpayers --as implicit equity investors-- that corporations owe to stockholders. The existence of a safety net makes taxpayers silent equity partners in major financial firms. As *de facto* investors, taxpayers deserve to be informed by institutions and regulators at regular intervals about the value of their side of the taxpayer put. Consistent with US and European securities laws, managers of important financial firms should measure and report --under penalties for fecklessness, deception, and negligence-- the value of taxpayers’ stake in their firm on the same quarterly frequency that they report to stockholders. Estimates prepared by individual institutions ought to be vetted by regulators and aggregated within and across countries. To make regulators more accountable for their performance as supervisors, government officials should be required to examine, challenge, and publicize any concerns they may have about the assumptions used by different firms and regulators and to expose themselves to sanctions for defects in the ways in which they acquit these tasks.

Defining systemic risk as taxpayers' side of an unfavorably structured option claim also provides a metric for tracking systemic risk over time. Requiring authorities to calculate and disclose fluctuations in the aggregate value of the taxpayer puts enjoyed by elite institutions would make regulatory authorities operationally accountable for the quality of their supervisory performance in booms and recessions alike.
Considerable disagreement exists about how to define and measure systemic risk. In reviewing the literature, Bisias, Flood, Lo, and Valavanis (2012) distinguish 31 different ways of measuring this variable. Still, nearly everyone agrees that it arises from mixing leverage with loan and investment strategies that create volatility in financial-institution returns. Most existing measurement strategies incorporate the pioneering perspective of Nobel Laureate Robert Merton (1977, 1978). Studies using his approach show that regulators could have tracked the growing correlation of institutional risk exposures and used it as an early warning system with which to track the increase in systemic risk that resulted in the current crisis. For example, research by Carbo, Kane, and Rodriguez (2011) indicates that at large US and EU banks during 2004-2008 safety-net benefits per dollar, euro, or pound of assets averaged about 15 basis points and that, in the years leading up to the crisis, estimated benefits were significantly higher at banks that eventually received bailout assistance.

The most difficult part of calculating the taxpayer put is to track the changing volatility of a firm’s returns on assets. Expanding the format for collecting information from covered institutions in individual countries to include estimates of the actual and future variability of their returns (i.e., the "volatility" of their positions over different horizons) and the value of the taxpayer put could improve the precision of systemic-risk estimates and officials’ accountability for regulatory and supervisory performance.

**Traditional reporting and incentive frameworks are inadequate**

Accounting standards for recognizing emerging losses make evidence of an institution’s insolvency inefficiently slow to surface. Moreover, during this and other crises, officials have
proved reluctant to prepare and publicize timely estimates of the financial and distributional costs of bailing out firms that benefited from open-bank assistance.

By engaging in regulation-induced innovation, nurturing clout, and exerting lobbying pressure, a country’s systematically-important-financial institutions (SIFIs) have kept their pursuit of tail risks from being adequately monitored and disciplined. The nontransparent role of political, bureaucratic, and career interests in regulatory decision-making is dangerous. It encourages elite firms to demand the right to screen regulatory appointments, to distort regulatory protocols, and to undermine strategies of enforcement.

In a world of derivatives transactions, top regulators need special training to understand -- and considerable mental toughness to discipline abuses of -- the incremental taxpayer exposures to risk that innovative instruments and portfolio strategies might entail. Efficient safety-net management requires a more sophisticated informational framework than current methods of bank accounting and examination provide. To protect taxpayers and to enhance financial stability, examinations and bank accounting reports should not focus narrowly on measures of tangible capital. They should also develop and report explicit estimates of the intangible value of an institution's evolving claim on taxpayer resources. To hold themselves accountable for carrying out these tasks conscientiously, regulators and protected institutions must accept a system of ethical constraints that would make them reveal and defend the forward-looking assumptions they use in calculating their enterprise’s share of the taxpayer put.

Summarizing, regulators need to measure and publicize the costs taxpayers incur in supporting national and international safety nets. To help authorities to do this skillfully and conscientiously, governments need to change the way regulators are trained, recruited, and
incentivized. I believe that a National or International Academy for Financial Regulators could assist in these tasks.
REFERENCES


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Reinhart, Carmen M., and Kenneth S. Rogoff, 2009. This Time is Different: Eight Centuries of

Too-Big-to-Fail in the CDS Market.” Frankfurt: Deutsche Bundesbank Discussion Paper
TABLE 1
THE FED, SHOWING GREAT CREATIVITY, USED ITS LAST-RESORT LENDING POWERS TO FUND MANY OF THE LARGEST BANKS IN THE WORLD

<table>
<thead>
<tr>
<th>Borrowing Company</th>
<th>Peak Amount Borrowed</th>
<th>Average Daily Balance</th>
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<tbody>
<tr>
<td></td>
<td>$2B</td>
<td>$3B</td>
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<tr>
<td>Morgan Stanley Citigroup Inc.</td>
<td>2018</td>
<td>2019</td>
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<tr>
<td>Bank of America Corp</td>
<td>2018</td>
<td>2019</td>
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<tr>
<td>Royal Bank of Scotland Group PLC</td>
<td>2018</td>
<td>2019</td>
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<tr>
<td>State Street Corp</td>
<td>2018</td>
<td>2019</td>
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<tr>
<td>UBS AG</td>
<td>2018</td>
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<td>Goldman Sachs Group Inc</td>
<td>2018</td>
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<tr>
<td>JPMorgan Chase &amp; Co</td>
<td>2018</td>
<td>2019</td>
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<tr>
<td>Deutsche Bank AG</td>
<td>2018</td>
<td>2019</td>
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<tr>
<td>Barclays PLC</td>
<td>2018</td>
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<td>Merrill Lynch &amp; Co. Inc</td>
<td>2018</td>
<td>2019</td>
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<tr>
<td>Credit Suisse Group AG</td>
<td>2018</td>
<td>2019</td>
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<td>Dexia SA</td>
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<td>2019</td>
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<tr>
<td>Wachovia Corp</td>
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<td>Lehman Brothers Holdings Inc</td>
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<td>2019</td>
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<tr>
<td>Wells Fargo &amp; Co</td>
<td>2018</td>
<td>2019</td>
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<td>Bear Stearns Co., LLC</td>
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<td>SNP Partners SA</td>
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<td>Hypo Real Estate Holding AG</td>
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<td>Fortis Bank SA/NV</td>
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<td>National Bank</td>
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<td>Commerzbank AG</td>
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<td>Guggenheim Partners LLC</td>
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<td>General Electric Co.</td>
<td>2018</td>
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TABLE 2
SURVEY EVIDENCE ABOUT THE CREDIBILITY OF FINANCIAL REFORMS

Given Moody’s recent downgrades and the passage of Dodd-Frank, Does Too Big to Fail still exist?

Source: American Banker On-Line Subscriber Survey
Survey Questionnaire Was Posted online from 9/25/11 through 10/2/11
## TABLE 3
European Supervision Education Initiative Seminar Program For 2012

<table>
<thead>
<tr>
<th>Topics</th>
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<th>Planned Dates</th>
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