

# Finance Watch

**R.I.P. Lehman Brothers!**  
Have we learned any lessons?

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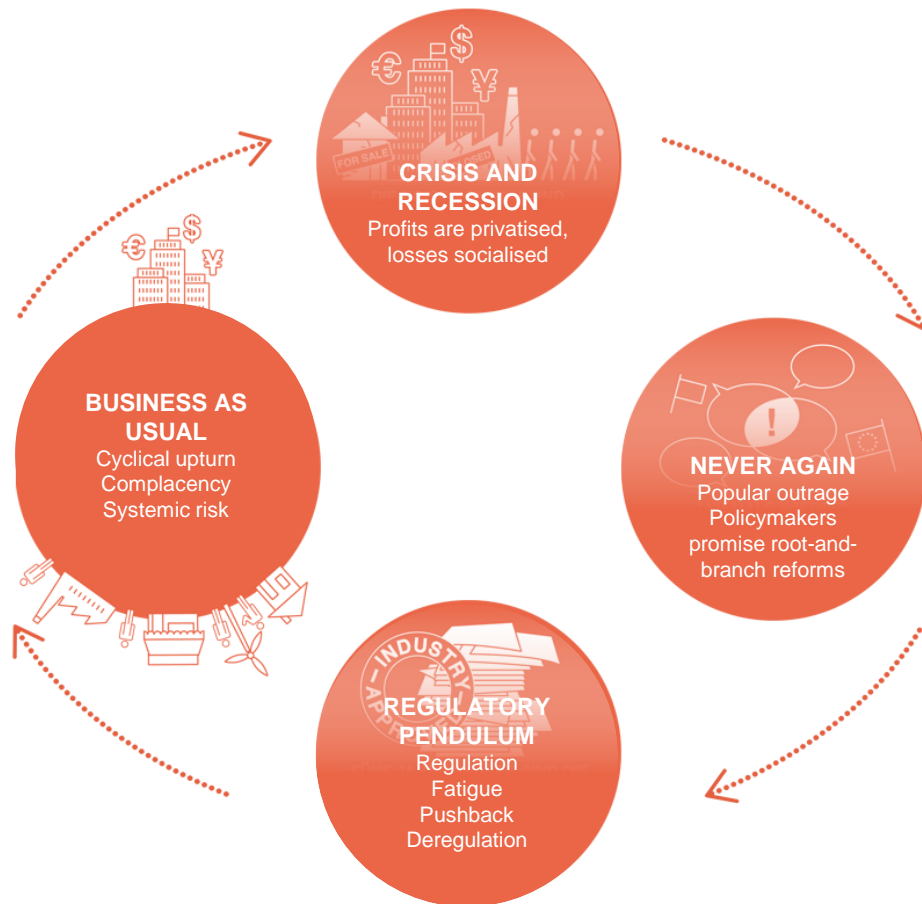
Brussels, 04 September 2018



**Finance Watch**

Making finance serve society

# Have we come full circle?



“We will not allow a return to banking as usual.”

Pittsburgh Leaders’ Statement (2009)

“History cannot be allowed to repeat itself.”

Barack Obama

“Nothing less than a global change is required.”

Gordon Brown / Nicholas Sarkozy

“We must show zero tolerance for any return to the bad old ways.”

José Manuel Barroso

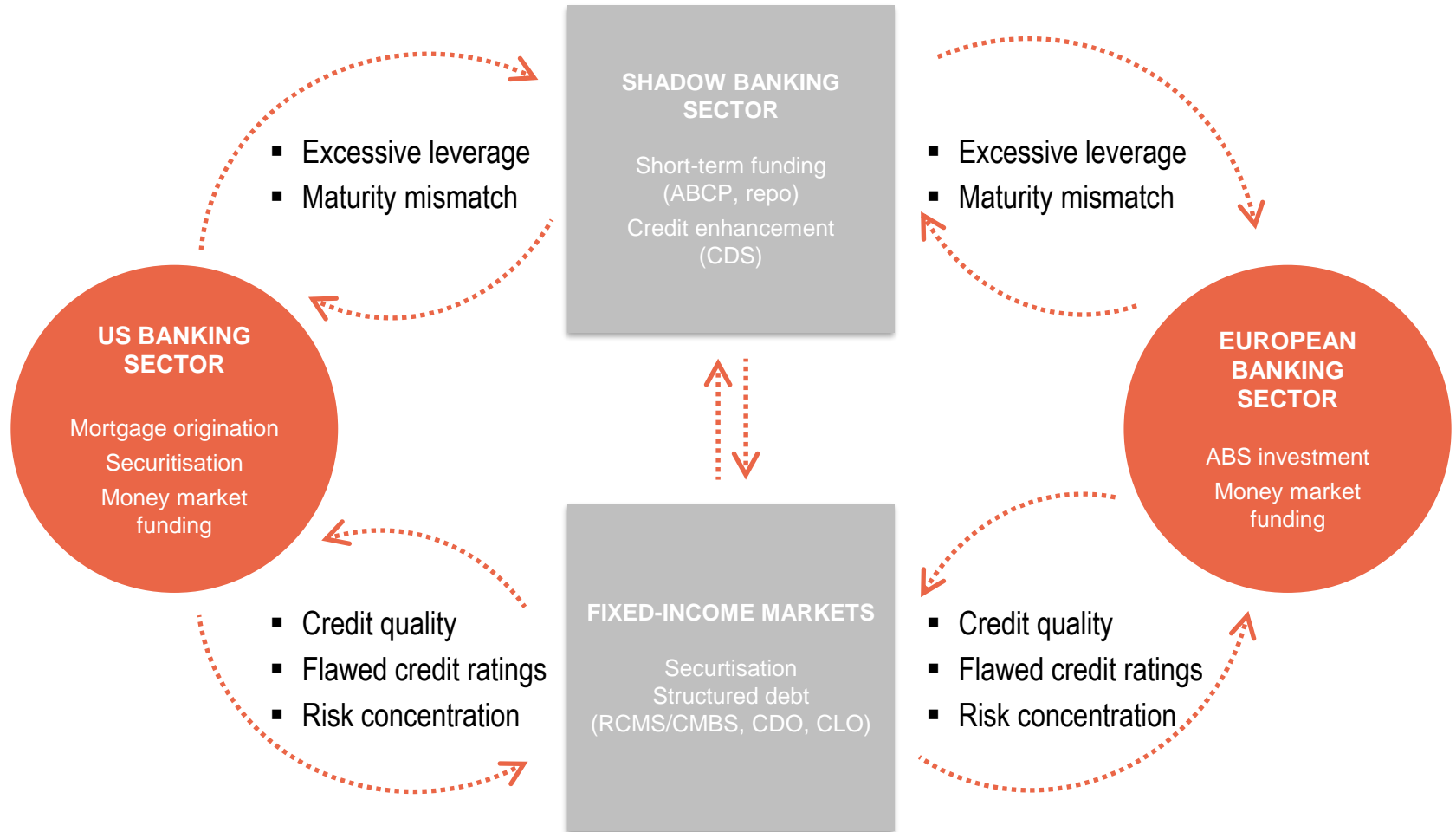
# 2008: Macro factors

- Housing policy
  - ‘Zero Down Payment’ and ‘NINJA Loans’
- Monetary policy
  - ‘dot com’ bubble and ‘Greenspan put’
  - post 09/11 monetary easing
- Credit expansion
  - Investment banks enter the mortgage market
  - ‘Originate to distribute’ business model
  - Decline in lending standards

# 2008: Micro factors

- Competition policy
  - Bank consolidation and ‘too big to fail’
  - Repeal of Glass-Steagall
- Prudential regulation
  - Basel II and ‘balance sheet optimisation’
  - Credit rating agencies’ conflicts
- Financial innovation
  - New financial instruments
  - Growth of the ‘shadow banking’ sector

# Contagion



# Cost of the crisis

- Direct costs

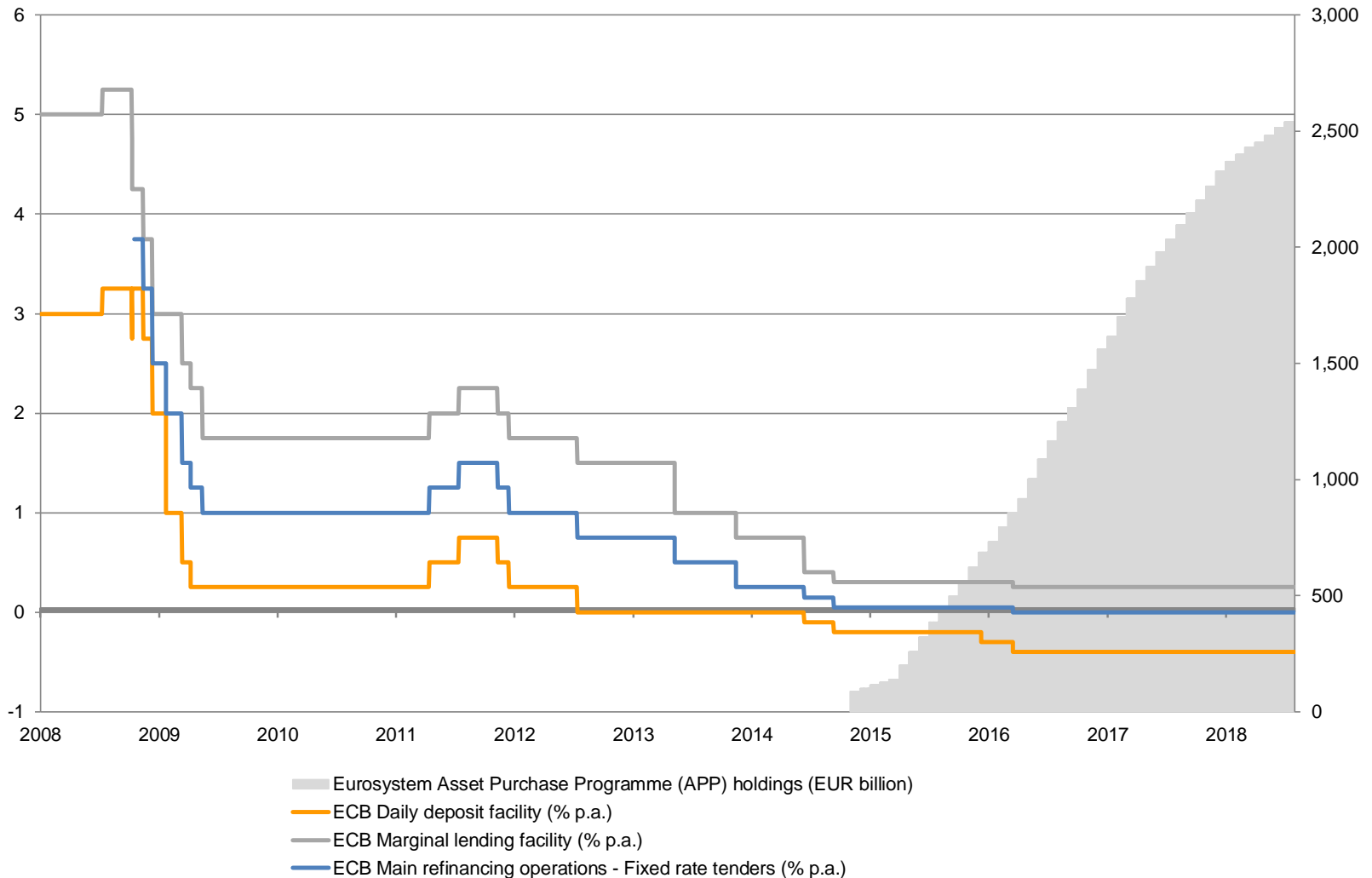
- ca. EUR 2 trillion in State Aid  
(ca. EUR 3.8 million per EU citizen)
- Massive increase in public-sector debt (e.g. IE, GR)  
➔ Loss of fiscal capacity to stabilise/stimulate economy

- Second-round effects

- Euro area 'sovereign debt crisis'
- Multi-year recession with slow, uneven recovery



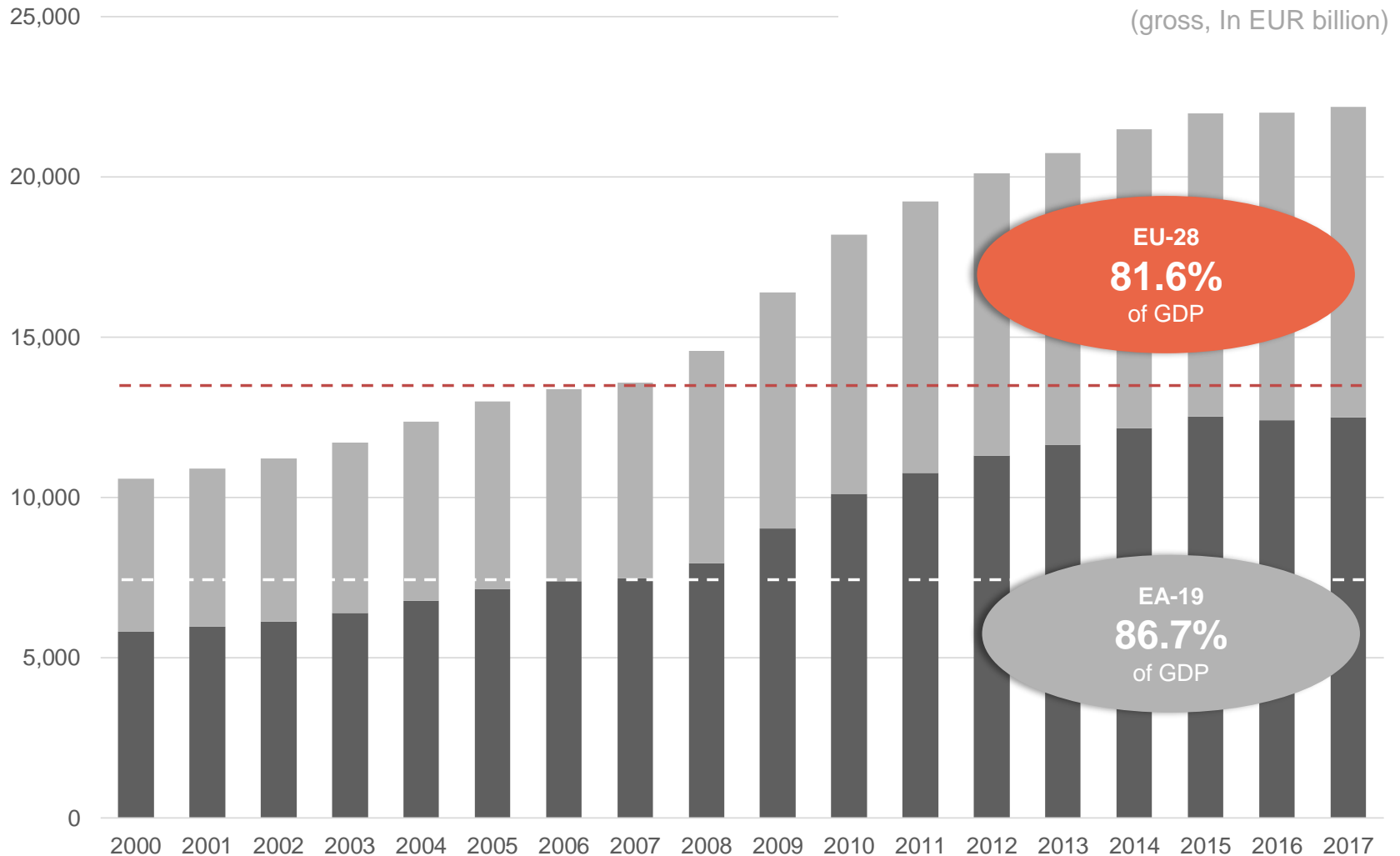
# Monetary policy



Source: ECB (Q1 2008 to Q2 2018)



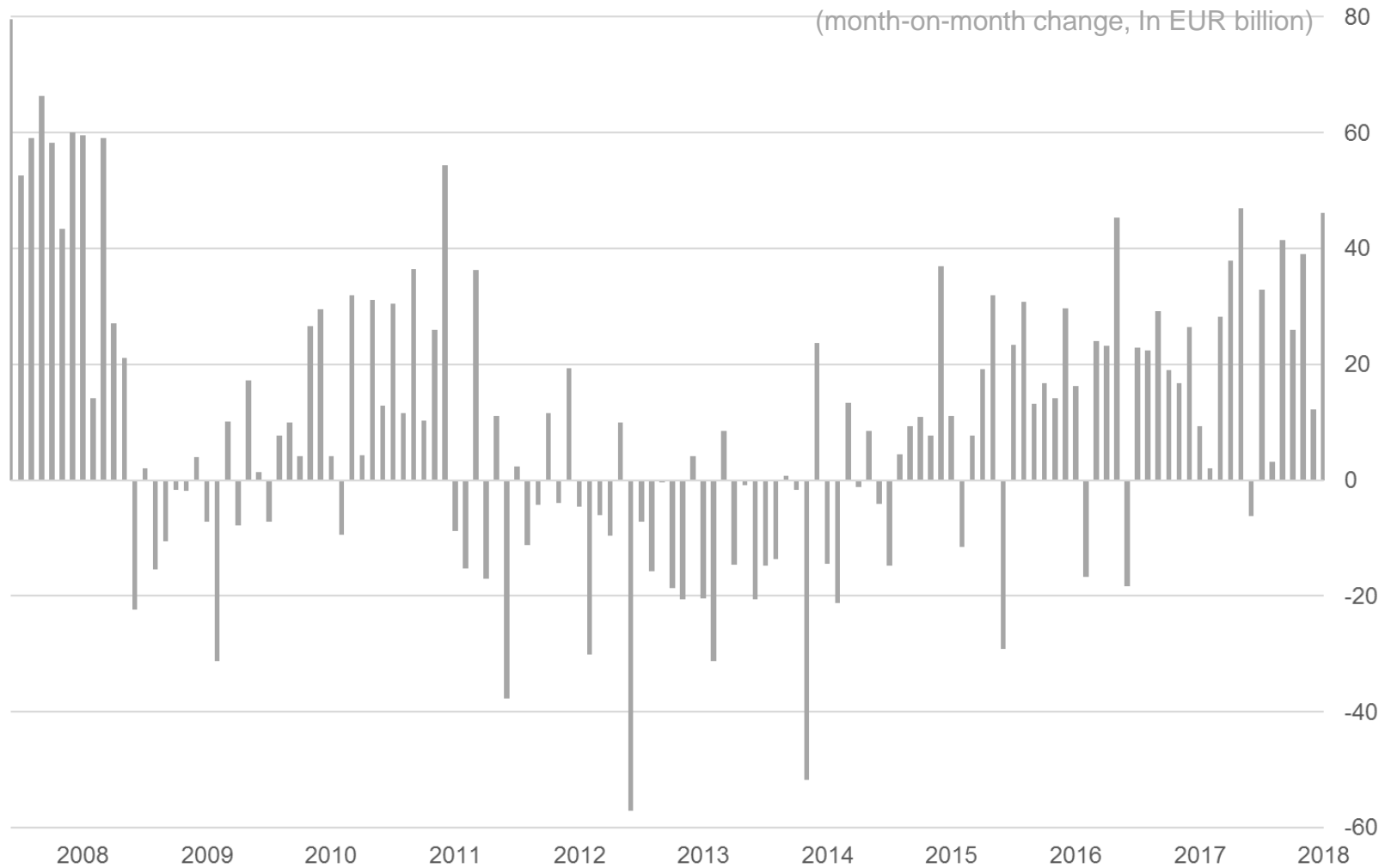
# Government debt (EU-28)



Source: Eurostat (2000-2017; as of 31 Dec 2017)



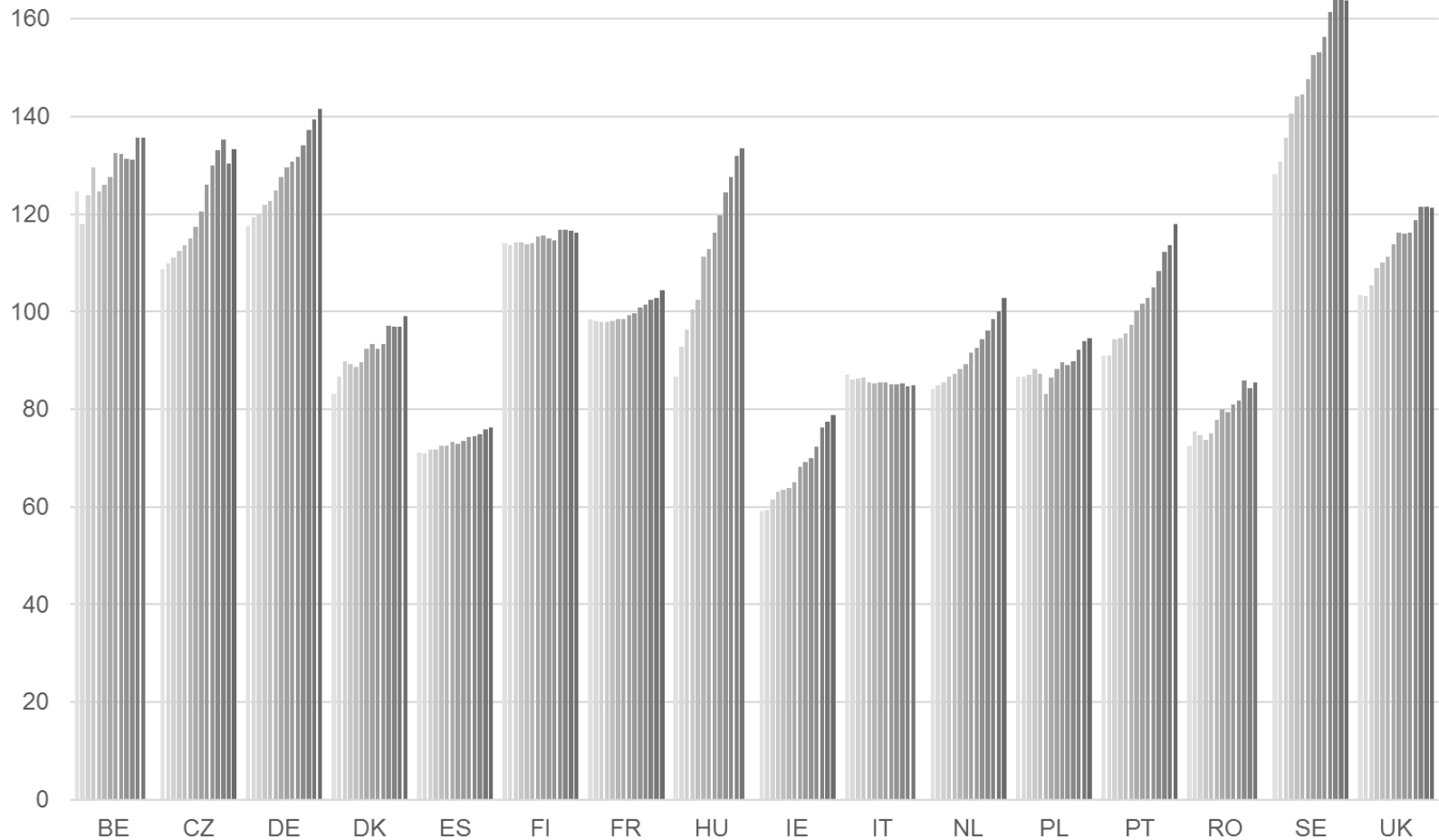
# Bank credit (HH and NFC)



Source: ECB (Q1 2008 to Q2 2018)

# Property prices

(indexed, 2007=100)



Source: EMF Hypostat (Q4 2014 to Q1 2018)

# Shadow banking

## Shadow banking

- Systemic risk
  - Interconnection with banking sector
  - Short-term funding (commercial paper, repo)
  - Loan fund markets
  - Return of structured credit (CDOs, CLOs, BTOs, ...)
- Regulatory initiatives
  - Insurers: G-SII framework under review (‘Metlife’ case)
  - Asset management: FSB initiative (G-SI-NBNI) on hold

# Derivatives markets

- Scale of the market:  
7 times world GDP
- FX derivatives alone:  
4 times global trade in  
goods and services
- Shift towards exchange-traded  
products, but ...
- OTC market still 94% of total
- OTC volume only 10% below 2007
- Central clearing: new challenges  
(systemic risk of CCPs)

All derivatives  
(OTC and exchange-traded)

**532**

USD trillion\*)



Global GDP

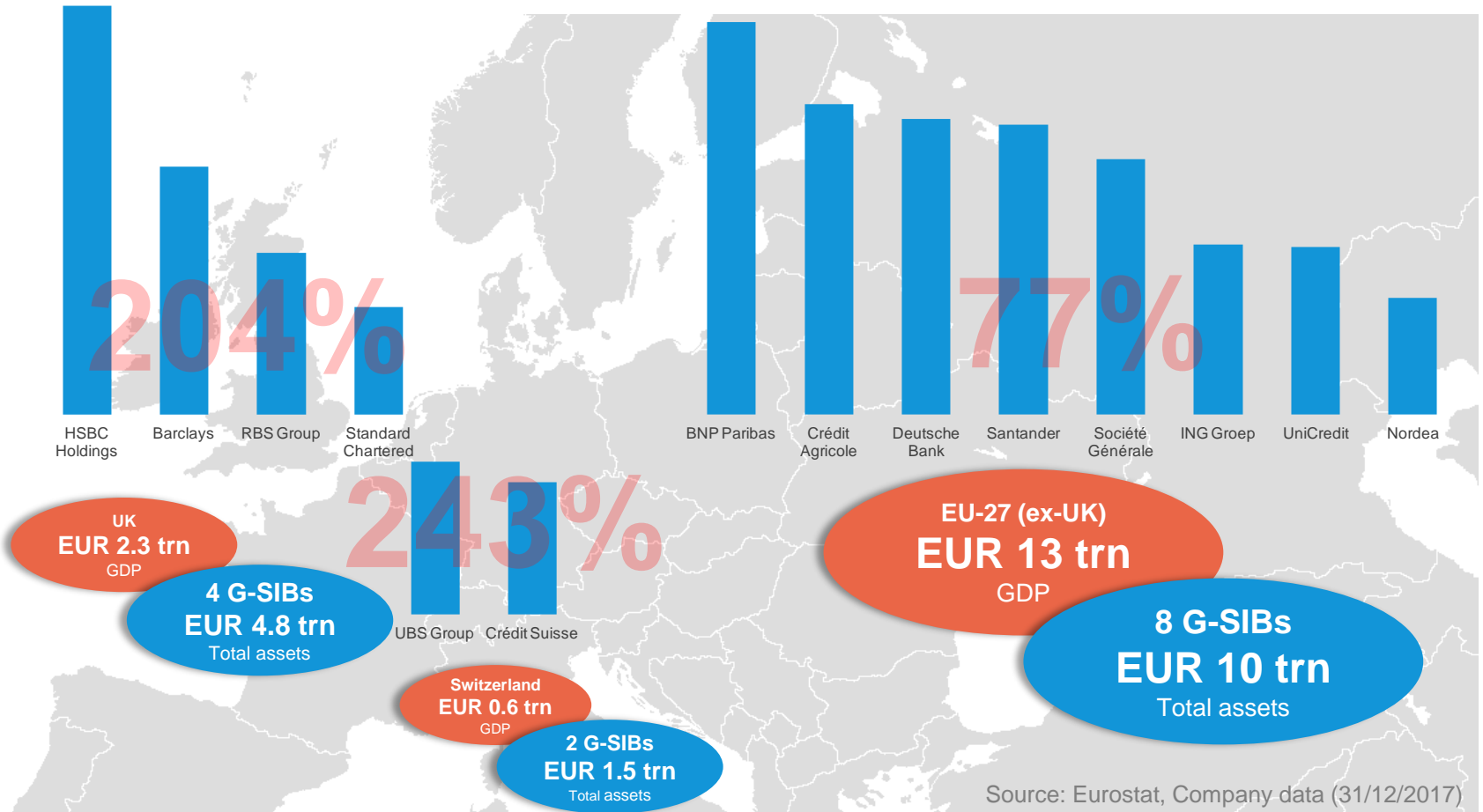
**80**

USD trillion

Source: IMF, BIS (2017)

\*) Notional amount outstanding (BIS, Dec 2017)

# 'Too-big-to-fail'

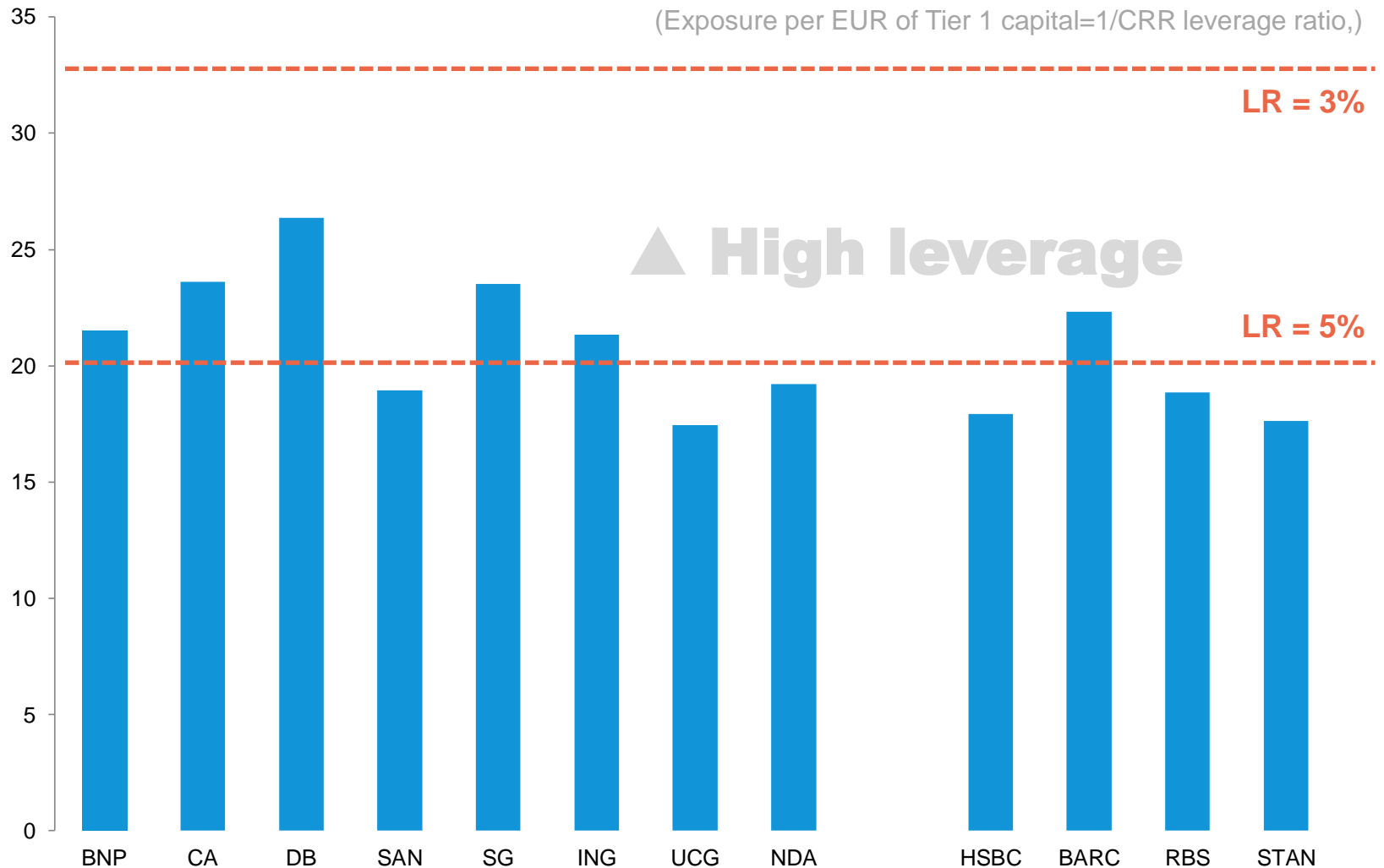


# Bank structural reform



- US: Volcker rule implemented but under review
- EU: EU-wide regulation (Liikanen) abandoned
- Vickers reform (UK) vs. Continental approach (DE, FR)

# Bank capitalisation

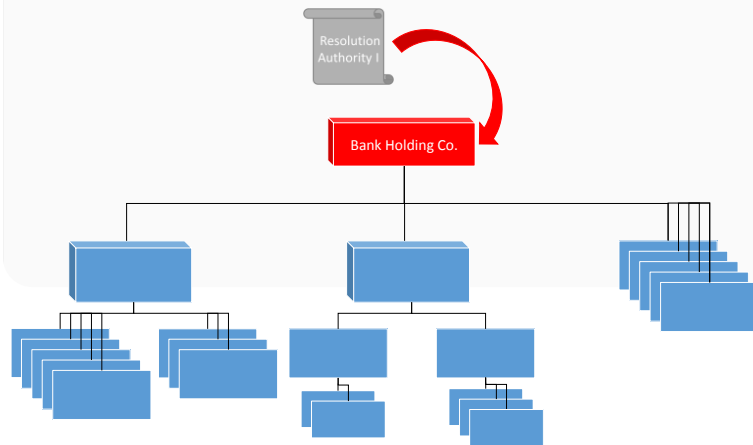


Source: Financial statements (as of 31 Dec 2017)

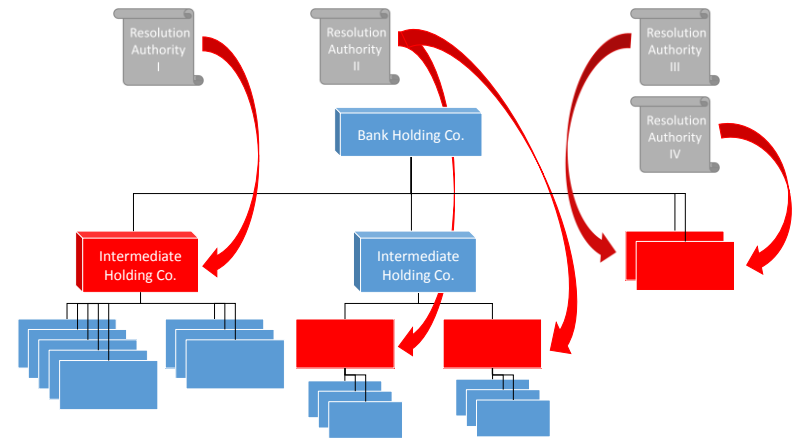


# Resolution

## Single point of entry



## Multiple points of entry



- Dependent upon political will, financial capacity (MREL)
- Success rate so far: 1 in 4 (Banco Popular)
- Legal certainty affected by divergent national practice
- Resolvability of G/D-SIBs unproven

# Summary

- **Progress since 2008**
  - “Too big to fail” problem recognised
  - Bank resolution regime introduced
  - Marginal capital improvements
  - Shadow banking risks recognised
- **Open issues**
  - “Too big to fail” problem unresolved
  - Bank structural reform failed
  - Bank resolution regime incomplete
  - Capital improvements insufficient
  - Shadow banking still unregulated

“There was a period of remorse and apology for banks. I think that period needs to be over.”

Robert (‘Bob’) Diamond  
ex-Chairman Barclays

(Treasury Committee Hearing on Competition and Choice in the Banking Sector, Januar 2011)

“It’s time for banks to be taken off the naughty step. This is about sending a signal that a chapter is over.”

Caroline Fairbairn  
Vorsitzende CBI

(Financial Times, 29. August 2016)



↑ **Next Crisis**

**Change Finance** →

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