The Bankers’ New Clothes:
What’s Wrong with Banking and What to Do about It
(Plus: the broader context)

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May 8, 2024

Global Financial Crisis of 2007-2009

THE WALL STREET JOURNAL.

DOW JONES A NEWS CORPORATION COMPANY * * * * * TUESDAY, SEPTEMBER 16, 2008 - VOL. CCLII NO. 65 **** $2.00

DJIA 10917.51 ▼504.48 -4.4% NASDAQ 2179.91 ▼3.6% NIKKEI Closed (12214.76) DJ STOXX 50 2744.81 ▼4.0% 10-YR TREAS ▲2 3/32, yield 3.482% OIL $95.71 ▼$5.47 GOLD $783.10 ▲$22.00 EURO $1.4310 YEN 104.88

AIG, Lehman Shock Hits World Markets

Focus Moves to Fate of Giant Insurer After U.S. Allows Investment Bank to Fail; Barclays in Talks to Buy Core Lehman Unit

The convulsions in the U.S. financial system sent markets across the globe tumbling, as two of Wall Street's biggest firms looked set to exit the scene and insurance titan American International Group Inc. turned to the Federal Reserve and the state of New York for assistance.

By Susanne Craig, Jeffrey McCracken, Jon Hilsenrath and Deborah Solomon

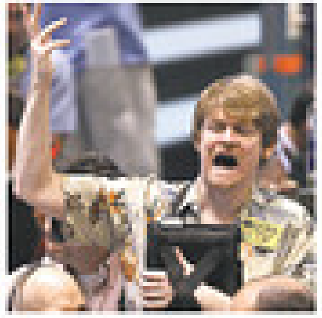
The U.S. stock market suffered its worst daily point plunge since the first day of trading after the Sept. 11, 2001, terrorist attacks. Financial markets were rattled by the rushed sale Sunday of Merrill Lynch & Co. and the bankruptcy-court filing of Lehman Brothers Holdings Inc., which scrambled Monday to sell its most-prized businesses before too many employees and customers walk out the door. (Please see related article on Page C1.)

All day Monday, top Lehman officials were huddled in Manhattan at their Seventh Avenue

ing. For much of the day, the major U.S. market indexes were down 2%, which, while a good-sized decline, was smaller than many had thought would be the case. But in the final hour of trading, a wave of selling hit, driven by concerns about the fate of AIG. The Dow Jones Industrial Average ended down 504.48 points on Monday, off 4.4%, at its daily low of 10917.51, down 18% on the year. Of the Dow industrials' 30 components, all but one—Coca-Cola Co.—fell, led by a 60.8% plunge in AIG.

In Europe, London's FTSE 100 index dropped 3.9%. Several Asian markets, including Japan and China, were closed Monday due to holiday. By Tuesday, Tokyo shares were down 5.1% in early trading, and Hong Kong's Hang Seng index was down 6.1%.

Monday's action was the latest fallout in a widening financial crisis that began a year ago with the fall of American housing prices and is now reordering the U.S. financial system. Steps unveiled by the Federal Reserve to expand its emergency lend-



AIG Faces Cash Crisis As Stock Dives 61%

By Matthew Karnitschnig, Liam Pleven And Serena Ng

American International Group Inc. was facing a severe cash crunch last night as ratings agencies cut the firm's credit ratings, forcing the giant insurer to raise $14.5 billion to cover its obligations.

With AIG now tottering, a crisis that began with falling home prices and went on to engulf Wall Street has reached one of the world's largest insurance companies, threatening to intensify the financial storm and greatly complicate the government's efforts

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DOW JONES A NEWS CORPORATION COMPANY ★★★★ WEDNESDAY, SEPTEMBER 17, 2008 - VOL. CCLII NO. 66 ★★★★ £2.50 PRINTED IN LONDON

DJIA 11059.02 ▲141.51 1.3% NASDAQ 2207.90 ▲1.3% NIKKEI 11609.72 ▼5.0% DJ STOXX 50 2658.77 ▼3.1% 10-YR TREAS ▼3/32, yield 3.409% OIL $91.15 ▼$4.56 GOLD $776.50 ▼$6.60 EURO $1.4143 YEN 105.92

U.S. to Take Over AIG in $85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up

Emergency Loan Effectively Gives Government Control of Insurer; Historic Move Would Cap 10 Days That Reshaped U.S. Finance

BY MATTHEW KARNITSCHNIG, DEBORAH SOLOMON AND LIAM PLEVEN

The U.S. government seized control of American International Group Inc.—one of the world's biggest insurers—in an $85 billion deal that signaled the intensity of its concerns about the danger a collapse could pose to the financial system.

The step marks a dramatic turnabout for the federal government, which had been strongly resisting overtures from AIG for an emergency loan or some intervention that would prevent the insurer from falling into bankruptcy. Just last weekend, the government essentially pulled the plug on Lehman Brothers Holdings Inc., allowing the big investment bank to go under instead of giving it financial support. This time, the government decided AIG truly was too big to fail...

...surance businesses, giving the Fed some protection even if markets continue to sink. And if AIG rebounds, taxpayers could reap a big profit through the government's equity stake.

"This loan will facilitate a process under which AIG will sell certain of its businesses in an orderly manner, with the least possible disruption to the overall economy," the Fed said in a statement.

It puts the government in control of a private insurer—a historic development, particularly considering that AIG isn't directly regulated by the federal government. The Fed took the highly unusual step using legal authority granted in the Federal Reserve Act, which allows it to lend to nonbanks under "unusual and exigent" circumstances, something it invoked when Bear Stearns Cos. was rescued in March.

As part of the deal, Treasury Secretary Henry Paulson in-...

...ance industries, while Wall Street has watched two of its last four big independent brokerage firms exit the scene.

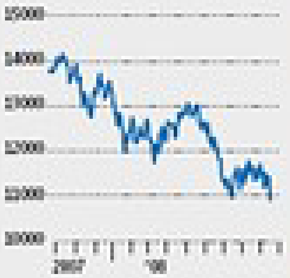
The U.S. on Sept. 6 took over mortgage-lending giants Fannie Mae and Freddie Mac as they teetered near collapse. This Sunday, the U.S. refused to bail out Wall Street pillar Lehman Brothers, which filed for bankruptcy-court protection and is now being sold off in pieces. That same day, another struggling Wall Street titan, Merrill Lynch & Co., agreed to sell itself to Bank of America Corp.

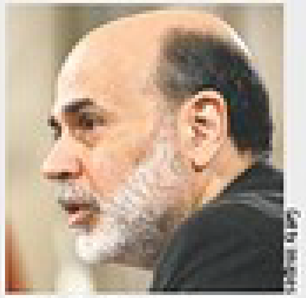
The AIG deal followed a day of high drama in Washington. The Treasury's Mr. Paulson and Federal Reserve Chairman Ben Bernanke convened in the early evening an unexpected meeting of top congressional leaders. Late in the trading day Tuesday, anticipation that the government might assist the insurer helped propel the Dow Jones In-...

Urgent Mission

Plunging shares, soaring credit costs push the government to step in.

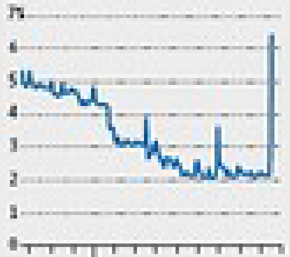
DJIA daily close





Fed chief Ben Bernanke

Overnight dollar Libor



Lending Among Banks Freezes

BY CARRICK MOLLENKAMP, MARK WHITEHOUSE AND NEIL SHAH

Banks abruptly stopped lending to each other or charged exorbitantly high rates Tuesday, threatening to spread the troubles of American International Group Inc. and Lehman Brothers Holdings Inc. to a broad range of financial institutions and the global economy.

The breakdown came despite efforts by central bankers to keep money flowing. Central banks in the U.S., Europe and...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NOTICE OF FORECLOSURE

… into a rabbit hole…

…and the toxic mix of confusion and politics

"[These events] present a challenge to standard economic theory…. policies to prevent future financial crises will depend on a deeper understanding of the processes at work.

Asymmetric information is key, precisely in the complex securities that [the standard theory] called for."

Kenneth Arrow (1921-2017)
"Risky business," *Guardian*, **October 15, 2008**

My daughter came home from school one day and said, ‘daddy, what’s a financial crisis?’
And without trying to be funny, I said, ‘it’s the type of thing that happens every five, seven, ten years.’

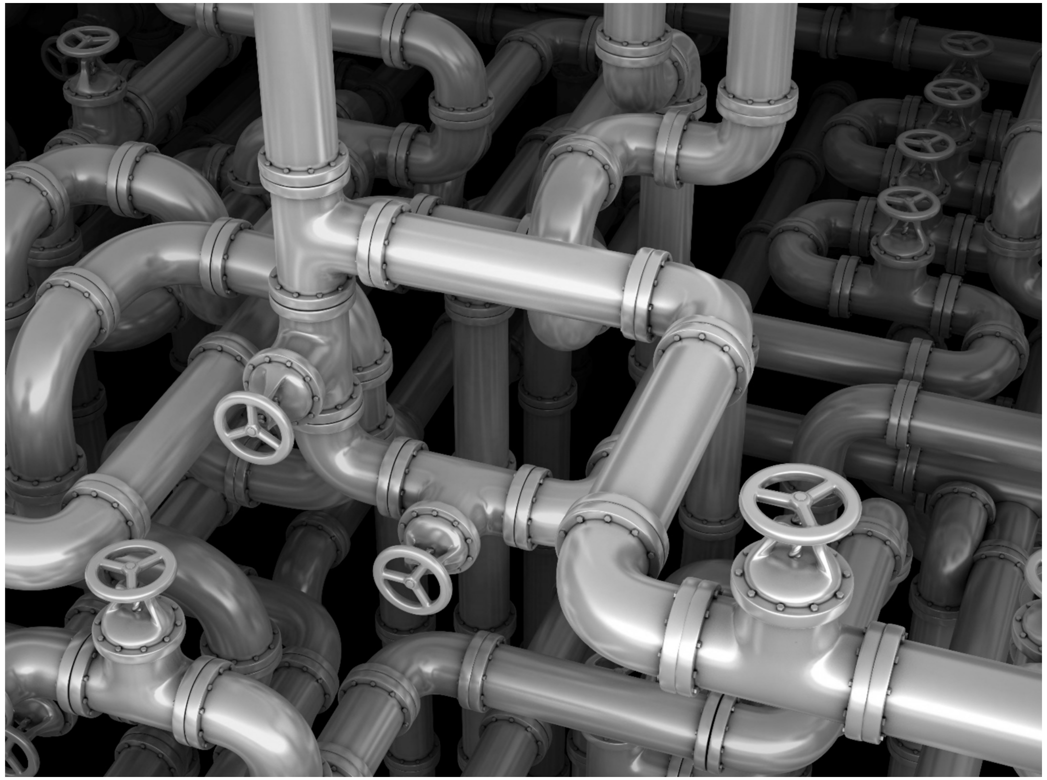
Jamie Dimon, January 2010
(to Financial Crisis Inquiry Commission)

Narratives Inform Policy

Was the 2007-2009 financial crisis like a natural disaster or a sudden shock?

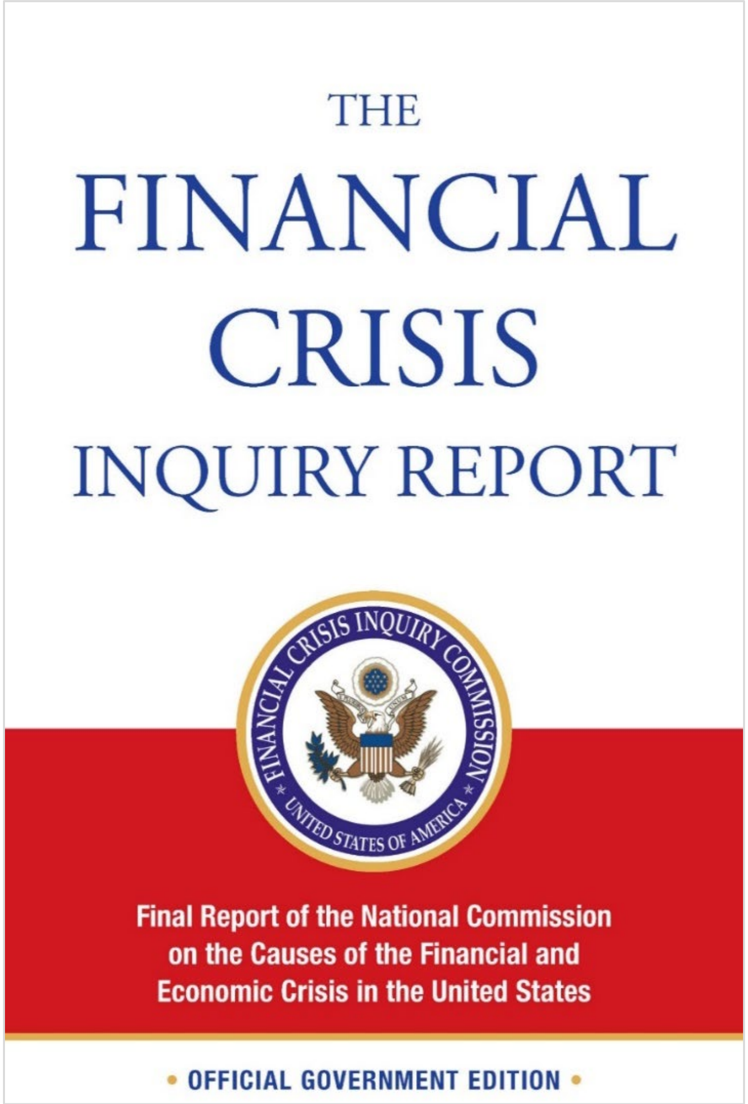
What about SVB, First Republic and Credit Suisse (spring 2023)?

The Perennial Narratives in Banking



A Liquidity Problem?

"A Classic Bank Run?"



Delivered January 27, 2011

The financial crisis was avoidable

Widespread failures in financial regulation

Breakdown in corporate governance

Explosive and excessive borrowing.

Lack of transparency

Widespread breaches in accountability at all levels.

The financial crisis reflected failures of rules and governance

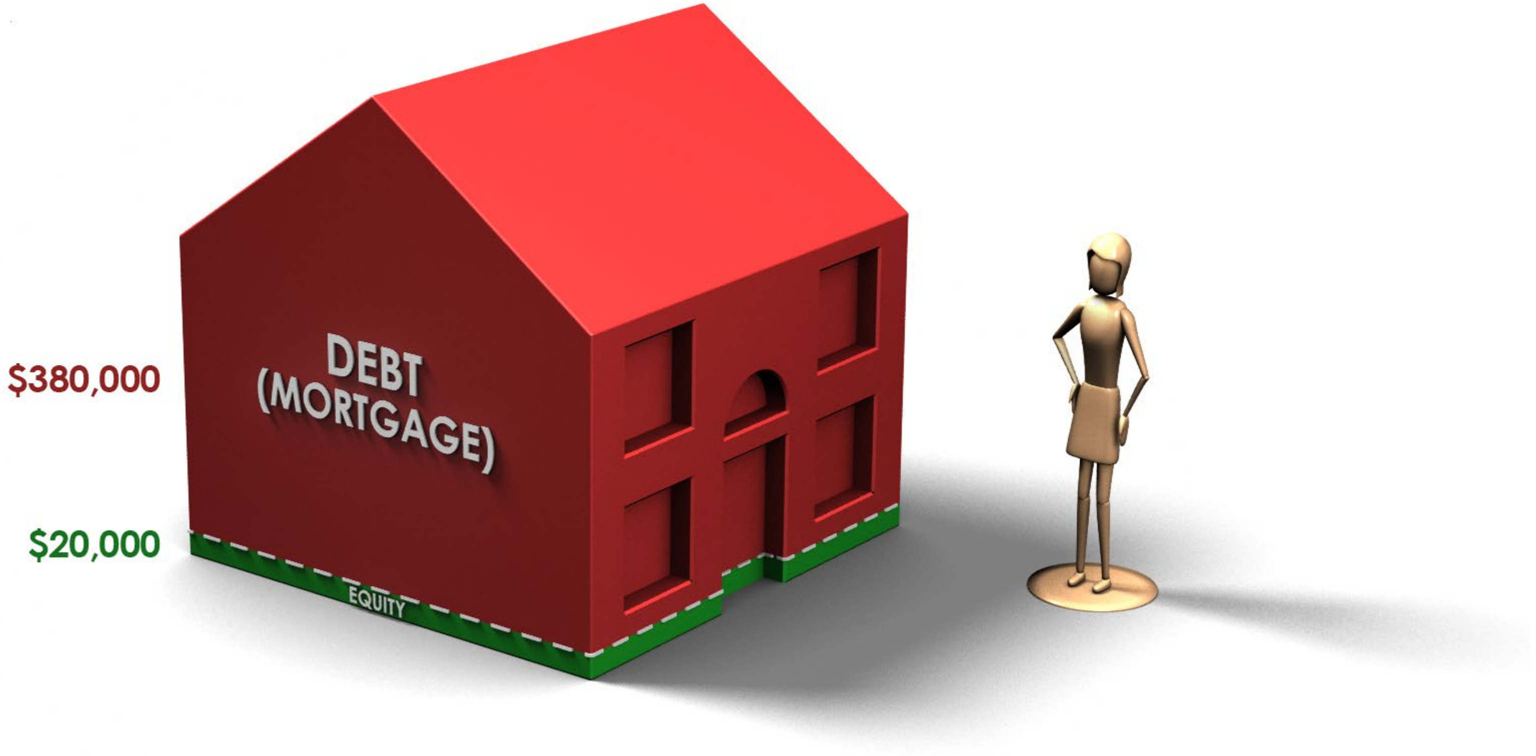
Key cause of fragility and distortions in the economy

Excessive, inefficient, unnecessary use of private debt

The problem is particularly acute and harmful in banking

Kate takes a mortgage to buy a house

$400,000 - $380,000 = $20,000



$420,000 - $380,000 = $40,000

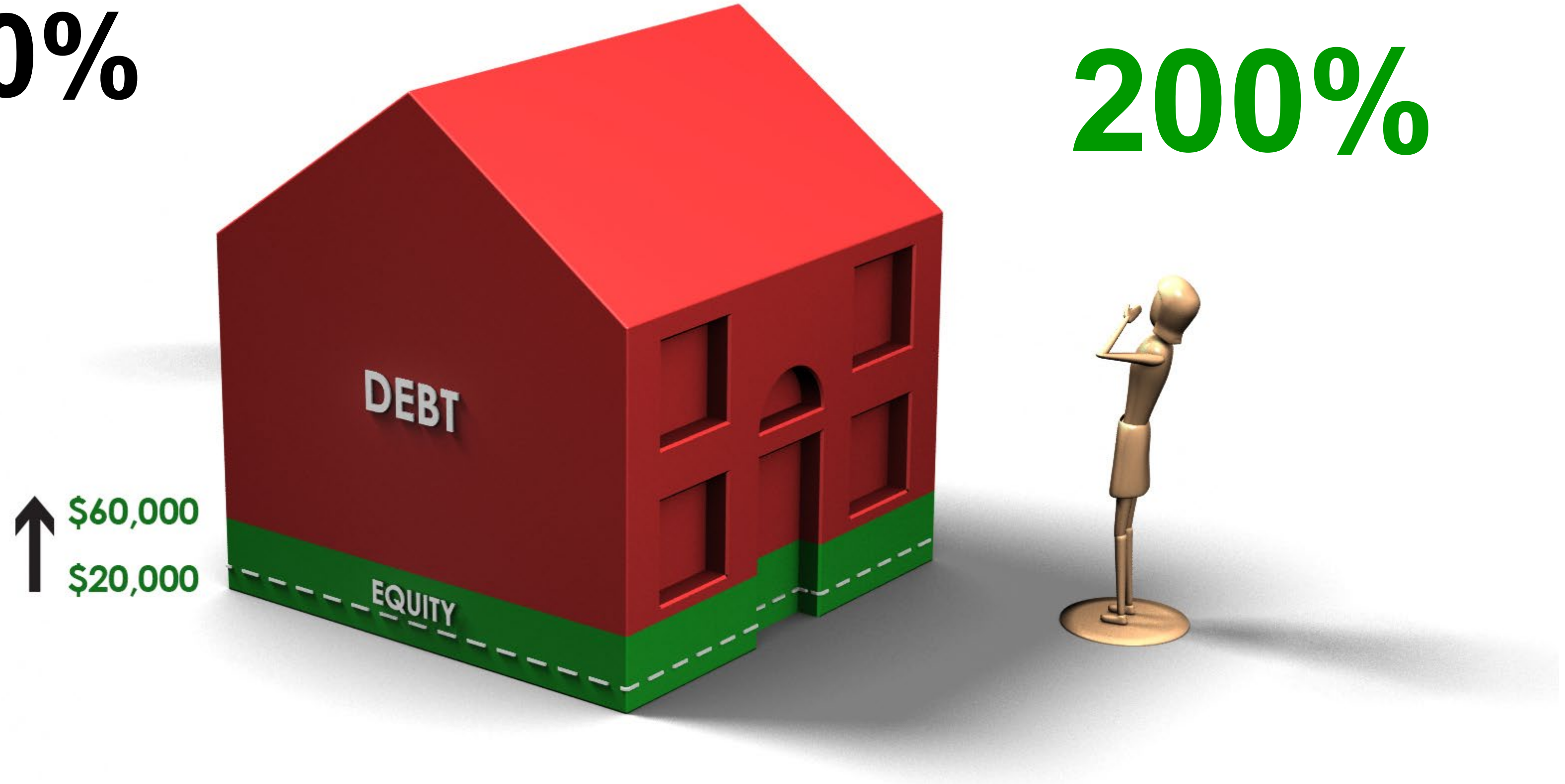
5%

100%

$440,000 - $380,000 = $60,000

10%

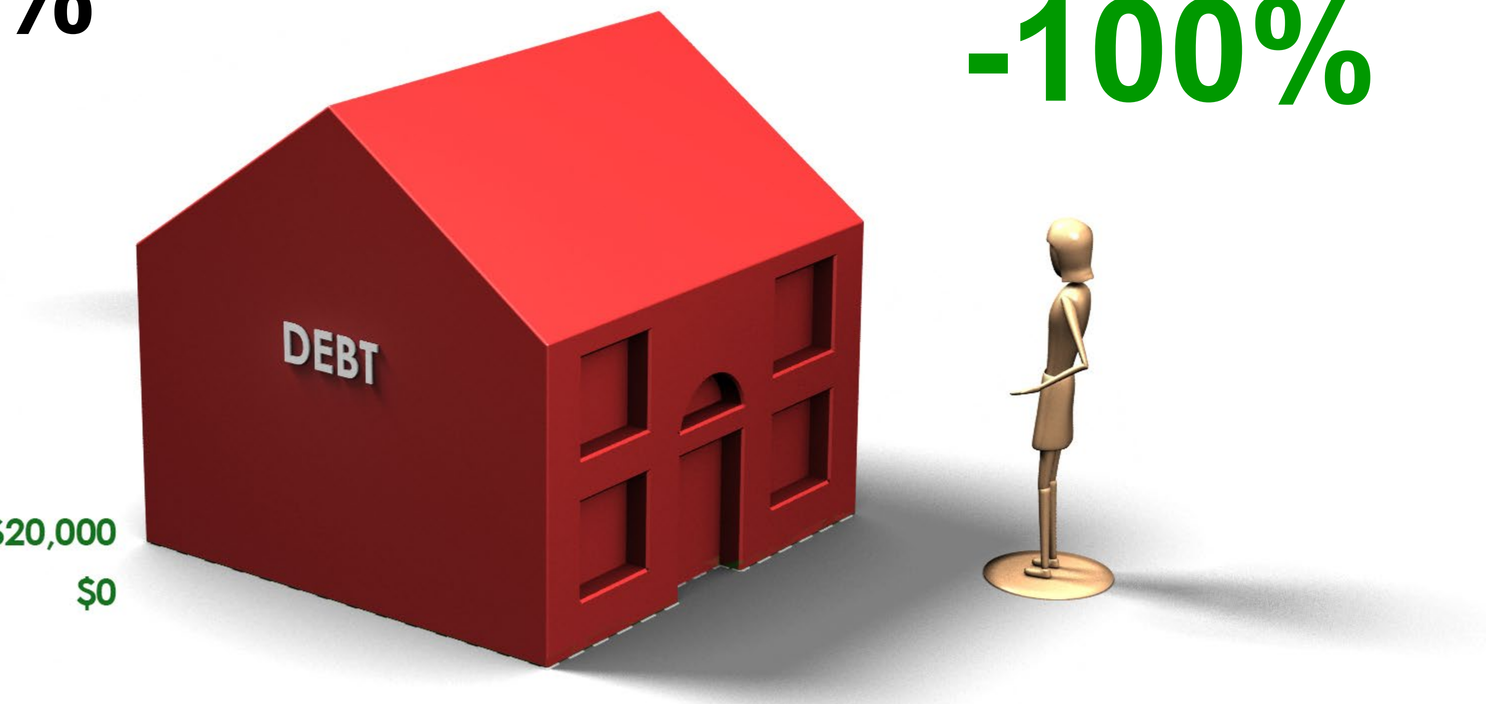
200%



$380,000 - $380,000 = $0

-5%

-100%



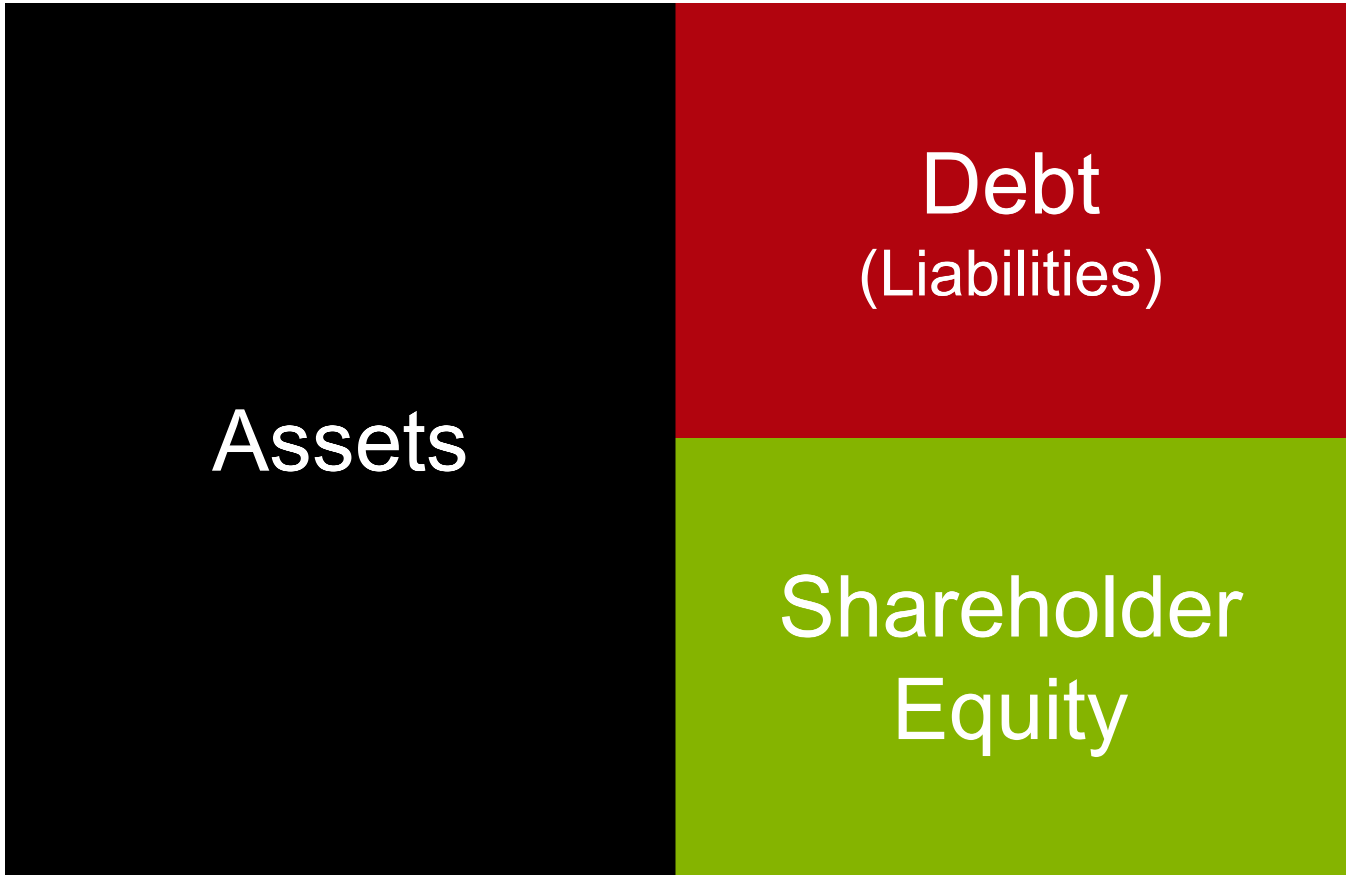
↓ $20,000

$0


-10%
DEBT
$20,000
-$20,000

Balance Sheet for a (Limited Liability) Business Corporation

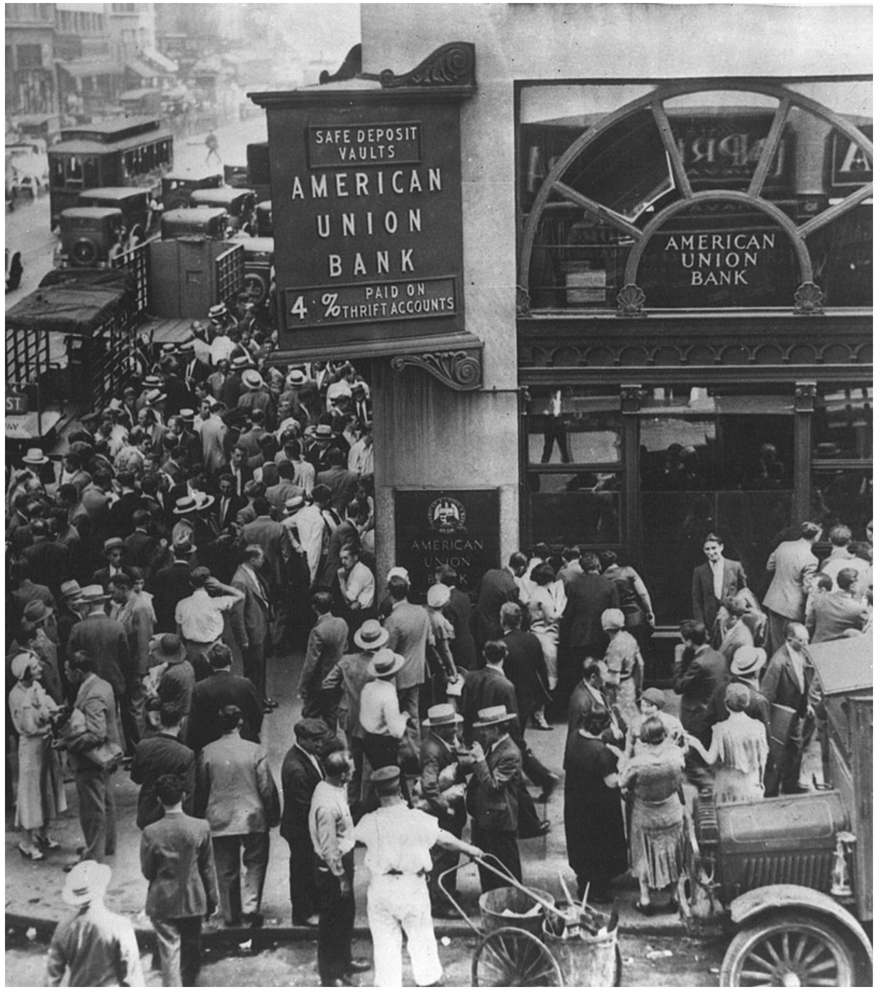
(Shareholders’ other assets are not exposed to risk from business)




Bank


B.I.G.
BANK
DEPOSITS
ATM

Bank runs: Extreme Case of “Liquidity Problems”



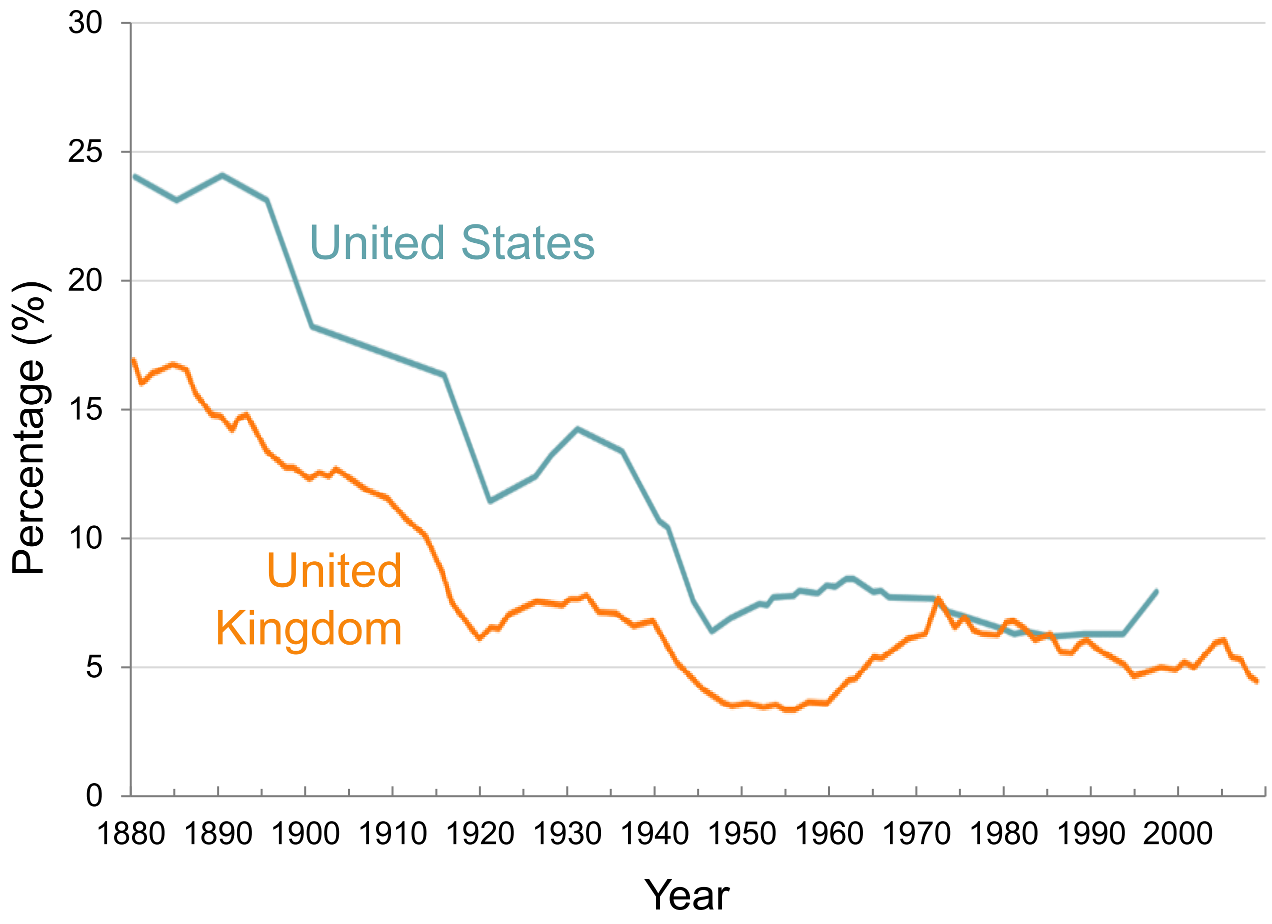
Runs can theoretically take down a healthy bank, but are rare without solvency concerns.

The opacity and low equity level of banks are key factors

Numerous disruptive bank runs in UK and US in 19th and early 20th centuries

Expansion of safety nets enabled distortive and dangerous recklessness without effective rules to control it

Historical Equity/Asset Ratios in US and UK



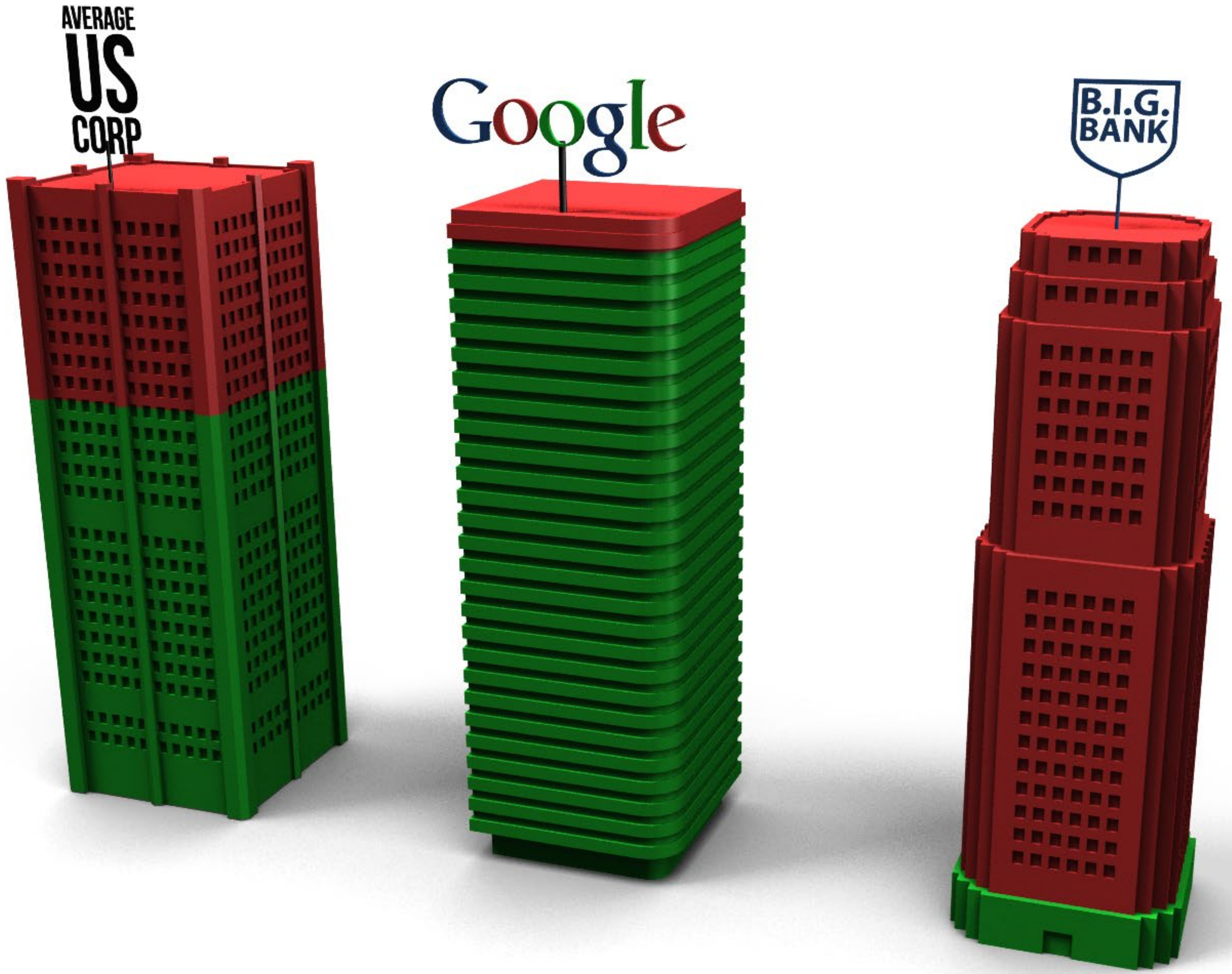
Mid 19th century: 50% equity, unlimited liability

After 1940s, limited liability everywhere in US

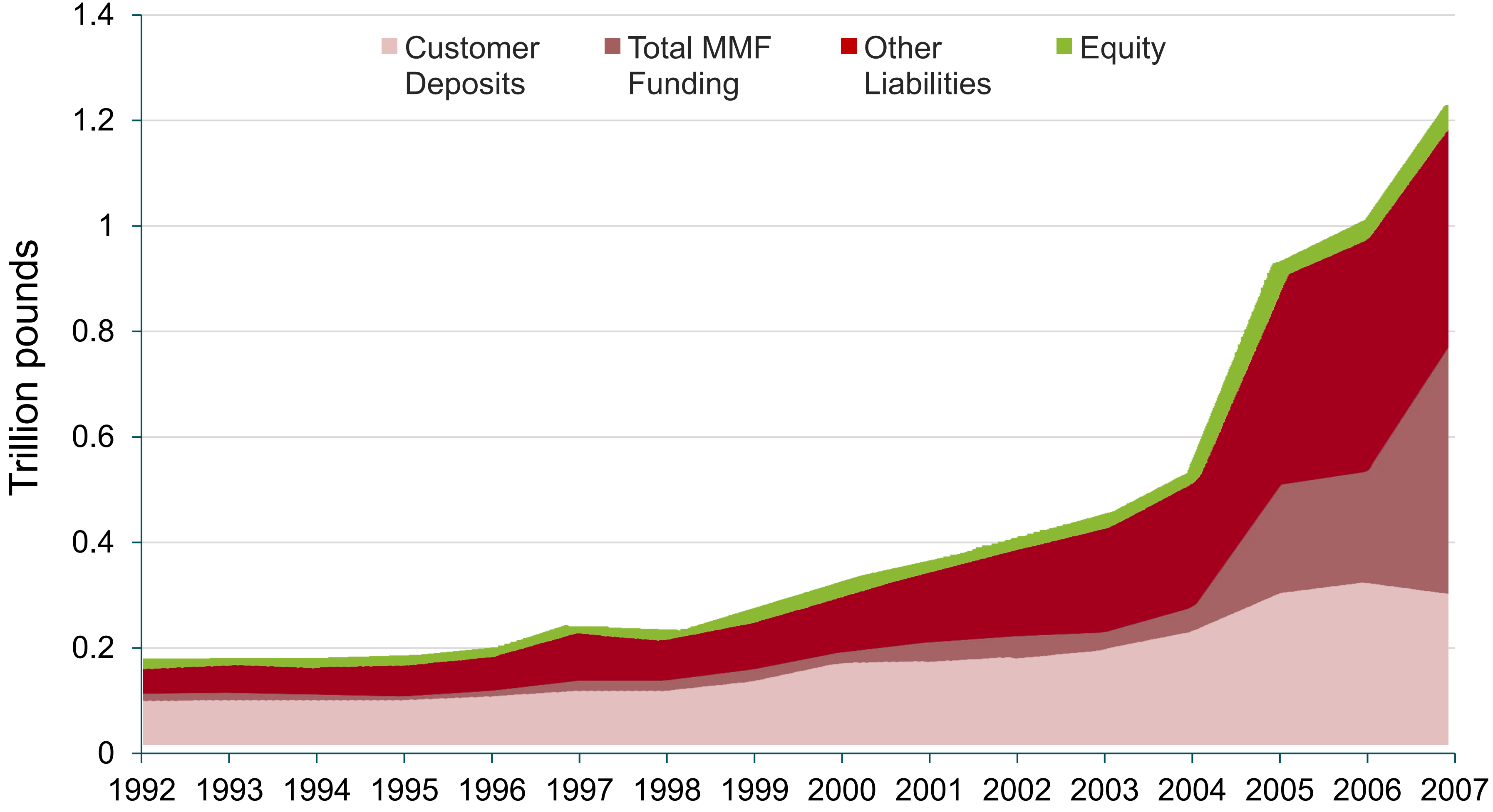
"Safety nets" expand

Equity ratios decline

“Banking on the State,” Alesandri and Haldane, 2009 https://www.bis.org/review/r091111e.pdf?frames=0


AVERAGE
US
CORP
Google
B.I.G.
BANK

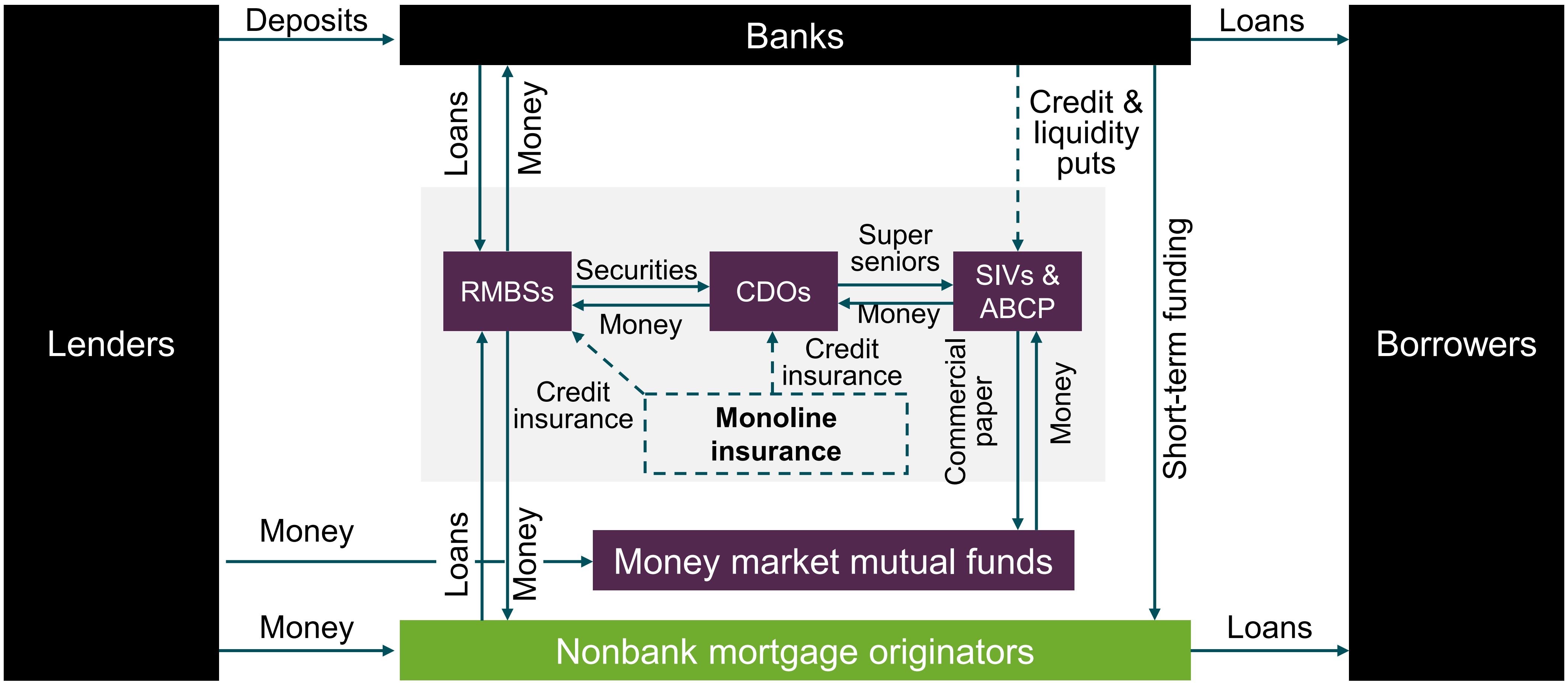
Recall: Total Liabilities and Equity of Barclays 1992-07



Hyun Song Shin, “Global Banking Glut and Loan Risk Premium,” IMF Annual Research Conference, November 10-11, 2011; Figure 22.

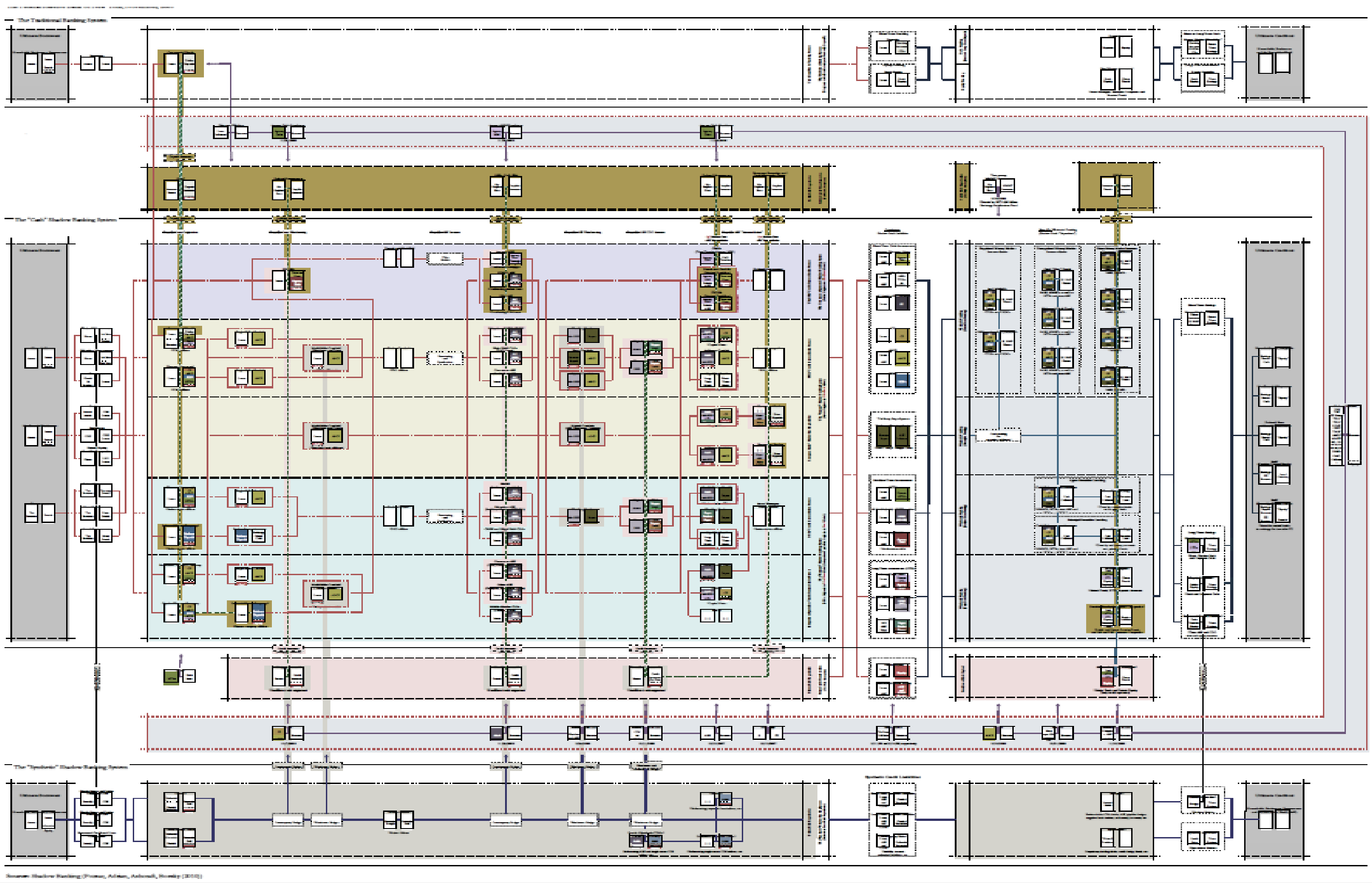
The Interconnected System

IMF Financial Stability Report 10/2014

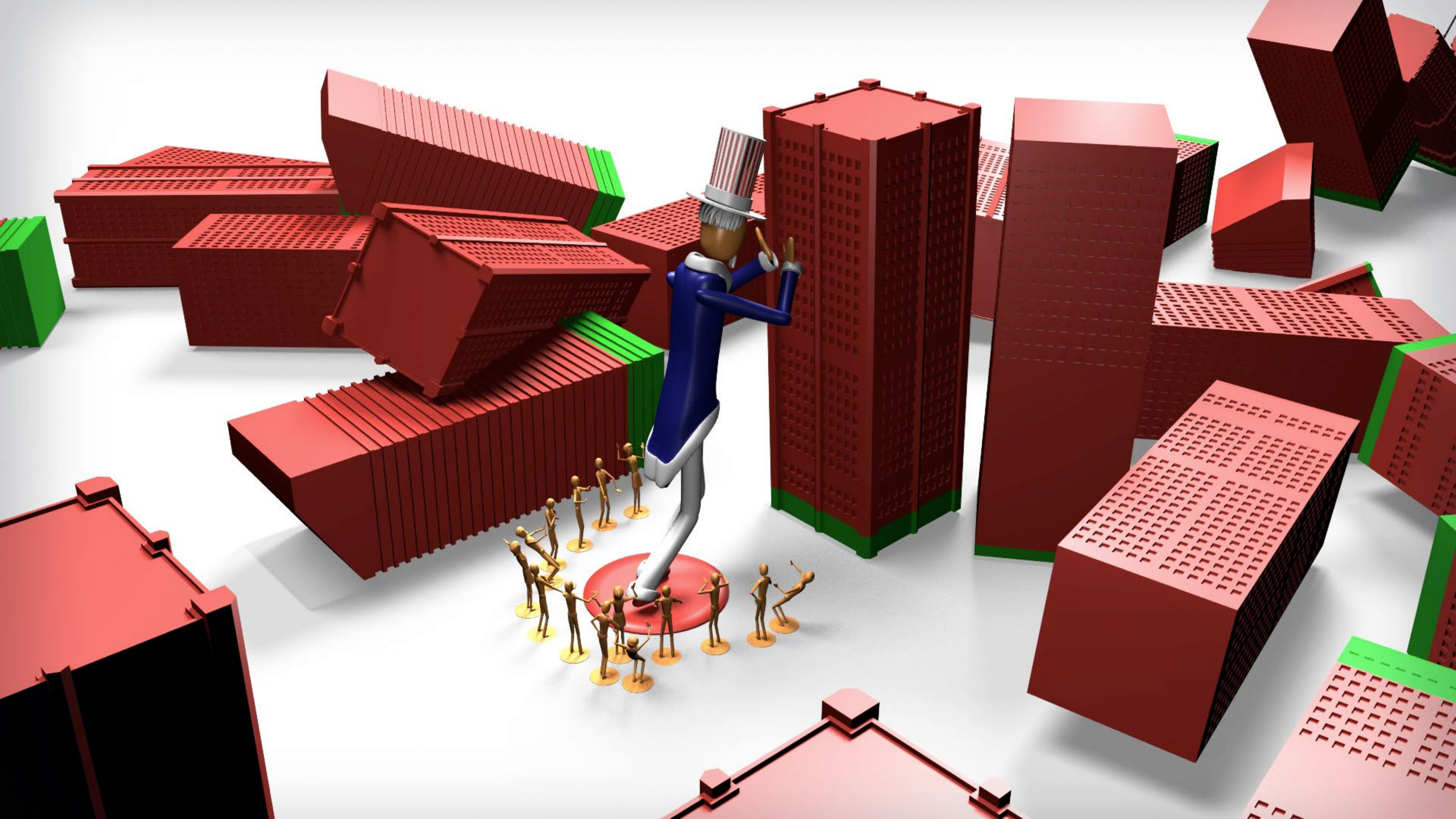


Complicated System with “Shadow Banks” (Partial Picture)

Pozsar, Adrian, Ashcraft and Boesky, New York Fed, 2010




B.I.G.
BANK



The Mantra in Banking: “Equity is Expensive”

“Expensive” to whom?

Why?

Are banks so special and different that nothing we know about the economics of corporate funding is relevant?

What if Wealthy Aunt Claire Ensures that Kate Never Defaults?

Cheap mortgage

No down payment (initial equity) required

Why not buy a huge mansion with no down payment? only upside!!

Equity is “expensive” for Kate!! Money machine with zero equity if possible.

The Banking System has "Uncle Sam" (in many interacting forms)

Deposit insurance

- Expanded scope in crisis
- Guarantees to non-deposit debts
- Loss sharing agreements in resolution

Treasury

- Direct investments to prevent default, e.g., Troubled Asset Relief Program, Greek gov't bailouts benefitting banks
- Takeover by government (Lloyds)
- Backstops of central banks

Central banks

- "Liquidity" facilities for banks, money market funds, others,
- Subsidized loans
- Asset purchases
- Low interest rates if system weakens

Government-Backed Institutions

- US Federal Home Loan Banks
- Fannie Mae and Freddie Mac

U.S. Program Lends a Hand to Banks, Quietly

April 14, 2009

The New York Times

The **FDIC program** enabled issuance of $28 billion for Goldman, over $40 billion each for Bank of America and JPMorgan Chase, $23 billion for Morgan Stanley $23 with the equivalent of AAA ratings. FDIC will cover the bonds if the banks fail.

The program does not come with the compensation and other regulatory conditions attached by Congress to the $700 billion bailout.

“I don’t know how you measure that subsidy,” said Mark Zandi, the chief economist at Moody’s Economy.com. “That’s why they say it’s invaluable. It’s an infinite subsidy.”

https://www.nytimes.com/2009/04/15/business/economy/15bank.html

Basel Committee on Banking Supervision

Committee of banking supervisory authorities: established 1974 by G-10

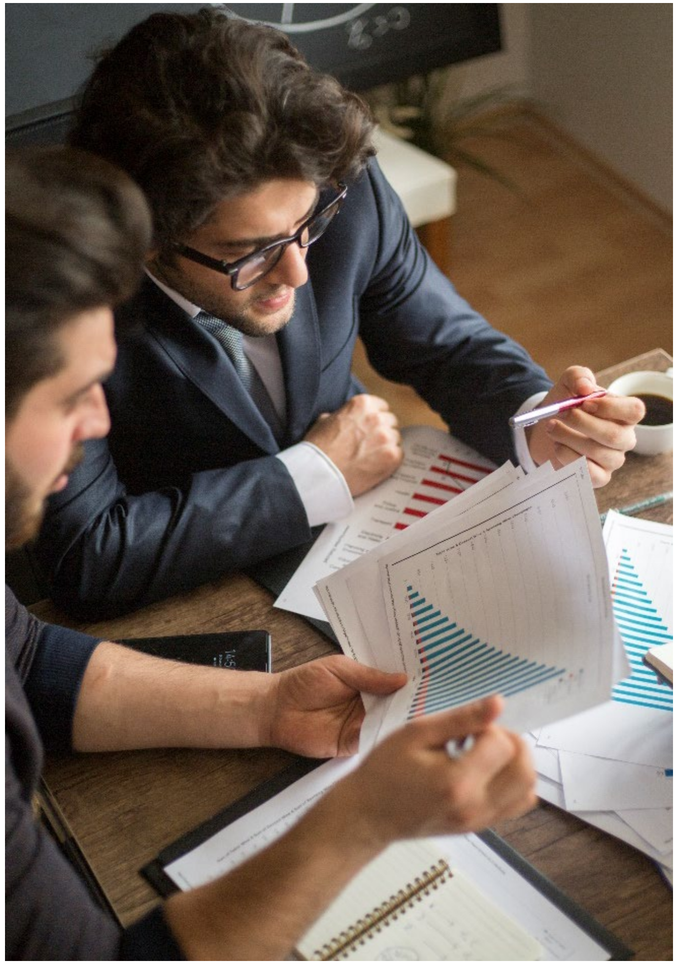
Goal: improve quality of banking supervision worldwide

Non-binding recommendations

Pillar I (Capital/liquidity minimal rules)

Pillar II (Supervisory practices)

Pillar III (Disclosure requirements)



Basel Accords

- **Basel I (1988)**
  Credit risk and risk-weighting of assets
- **Basel II (2004)**
  Allowing banks to take additional risks
- **Basel III (2010)**
  Response to 2008 financial crisis

Basel III revisions (2017)

“Final” Rules pending in many jurisdictions (“Basel III Endgame” in US)

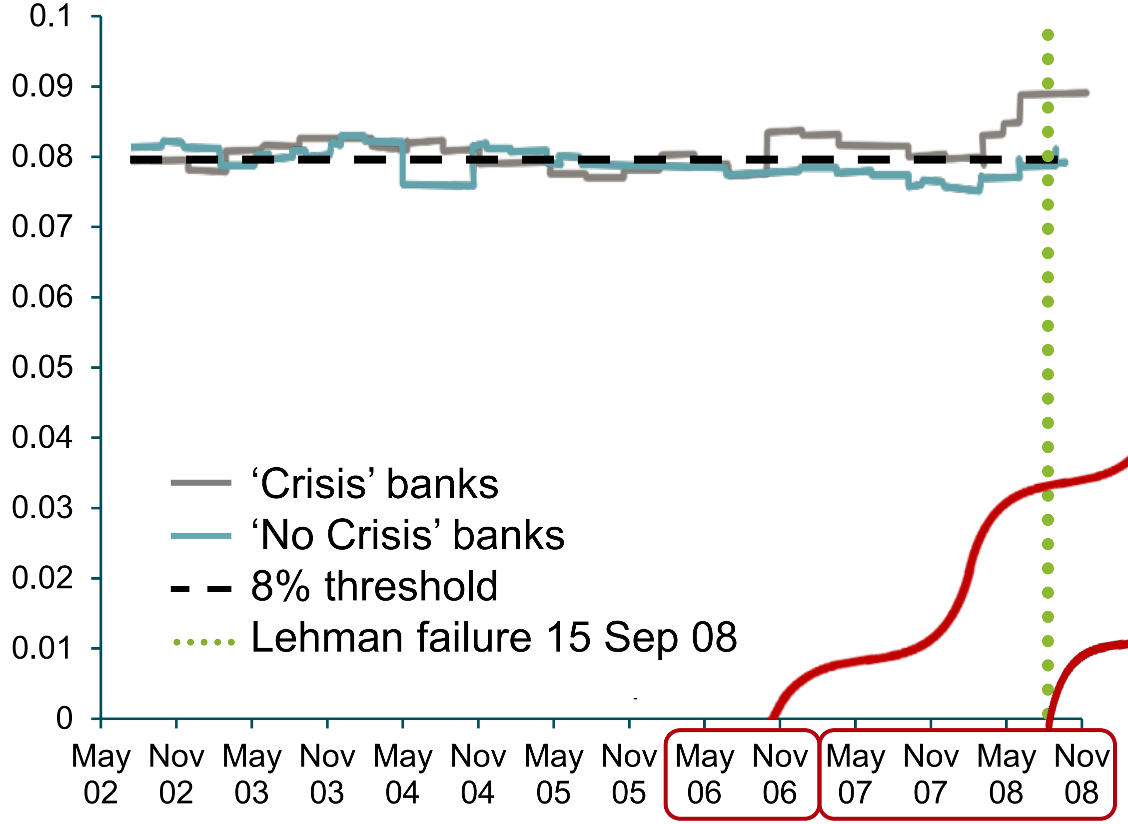
Basel II: A spectacular failure

Basel III: An inadequate tweak
("a well-intended illusion")

Regulatory Measures were Uninformative

(“Tier 1” capital ratios)

What crisis?

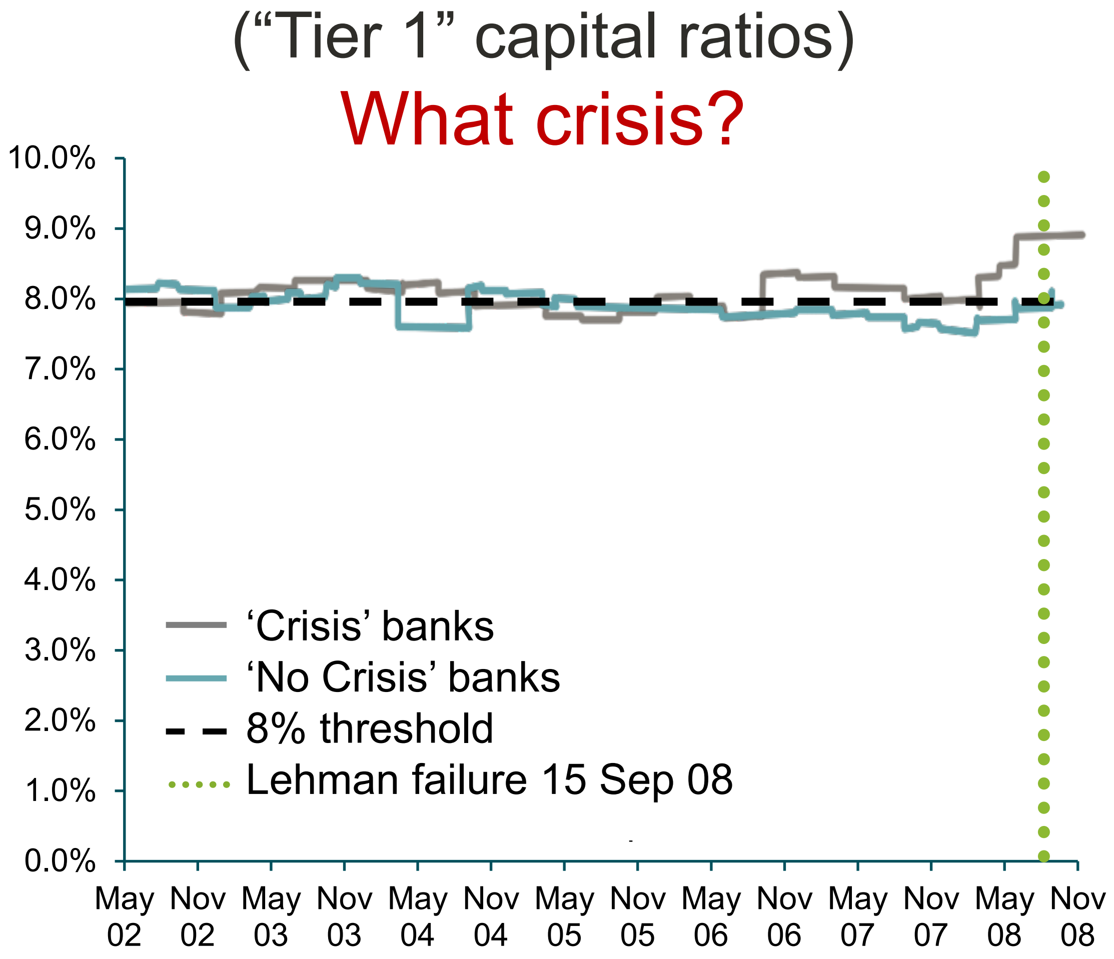


2006 was a great year in banking

Between summer 2007 and end of 2008, the largest 19 US institutions paid out nearly $80B to shareholders.

“Capital Discipline,” Andrew Haldane, January 2011 https://www.bankofengland.co.uk/speech/2011/capital-discipline-speech-by-andy-haldane

Regulatory Measures were Uninformative



Largest 19 institutions received ≈$160B under TARP (bailouts).

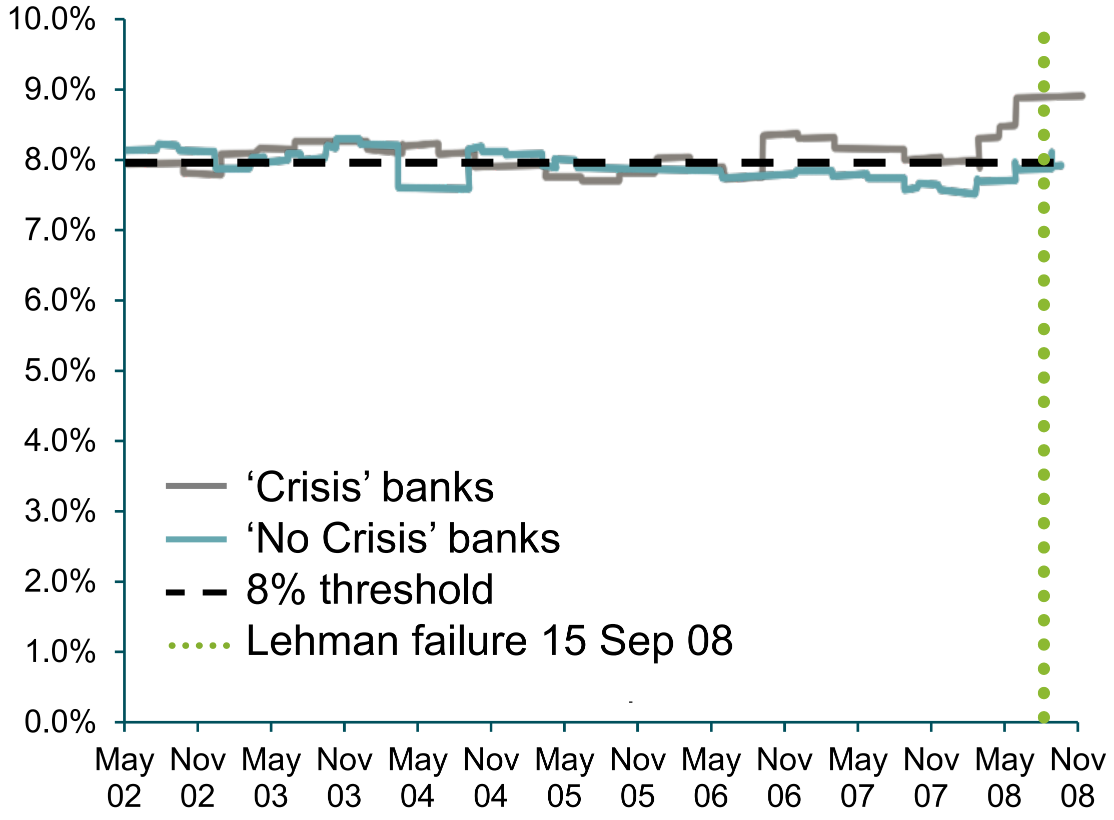
Fed committed $7.7 trillions in below-market loans to 407 banks.

"Tier 2 capital" proved useless to absorb losses (except Lehman).

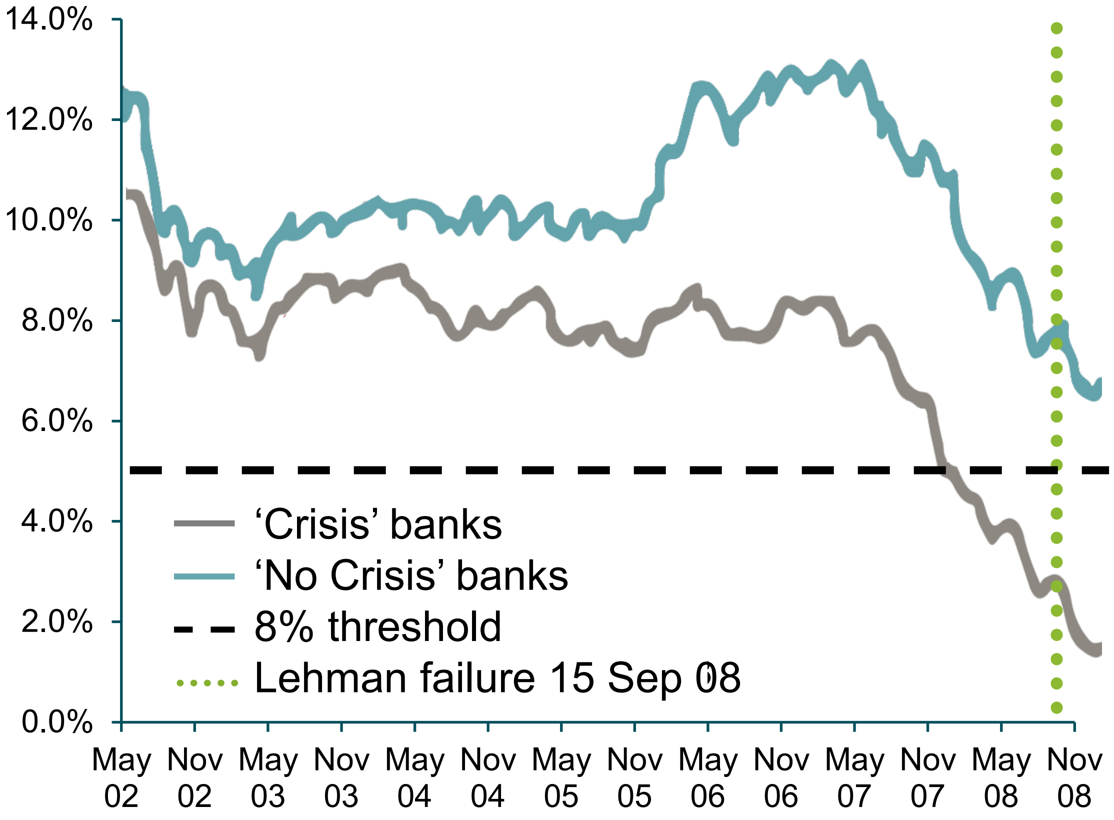
"Capital Discipline," Andrew Haldane, January 2011 https://www.bankofengland.co.uk/speech/2011/capital-discipline-speech-by-andy-haldane

The Stock Market Knew Better…

Regulatory measures



Market-based measures



"Capital Discipline," Andrew Haldane, January 2011 https://www.bankofengland.co.uk/speech/2011/capital-discipline-speech-by-andy-haldane

Basel Capital Regulation

(No Science, highly complex)

Basel II	Basel III
"Common equity Tier 1 capital" to **risk-weighted assets (RWA)**: 2%	"Common Equity Tier 1 Capital" to **risk-weighted assets (RWA): 4.5%** • Plus 2.5% conservation buffer • Plus 1.5% "Tier 1" to RWA Leverage Ratio: "Tier 1" to **total assets** • Basel III: **3%** • US: BHC: **5%**, insured banks: **6%**
"Tier 2" (loss-absorbing debt)	"Tier 2"/TLAC (loss-absorbing debt).

Sir, Basel III bank regulation proposals that Group of 20 leaders will discuss fail to eliminate key structural flaws in the current system.

If **at least 15%** of banks' total, not risk weighted assets were funded by equity, the social benefits would be substantial.
And the social costs would be minimal, if any.

Temporarily restricting bank dividends is an obvious place to start.

Anat R. Admati, Franklin Allen, Richard Brealey, Michael Brennan,
Markus K. Brunnermeier, Arnoud Boot, John H. Cochrane, Peter M. DeMarzo,
Eugene F. Fama, Michael Fishman, Charles Goodhart , Martin F. Hellwig,
Hayne Leland, Stewart C. Myers, Paul Pfleiderer, Jean Charles Rochet,
Stephen A. Ross, William F. Sharpe, Chester S. Spatt, Anjan Thakor

(Letter from 20 academics, *Financial Times*, November 9, 2010)
https://www.ft.com/content/63fa6b9e-eb8e-11df-bbb5-00144feab49a

https://www.gsb.stanford.edu/faculty-research/excessive-leverage/healthy-banking-system-goal

Risk Weights Can Undermine the Purpose of Regulation

“Regulatory capital” is calculated relative to “risk-weighted assets”

Complex; create illusion of “science”

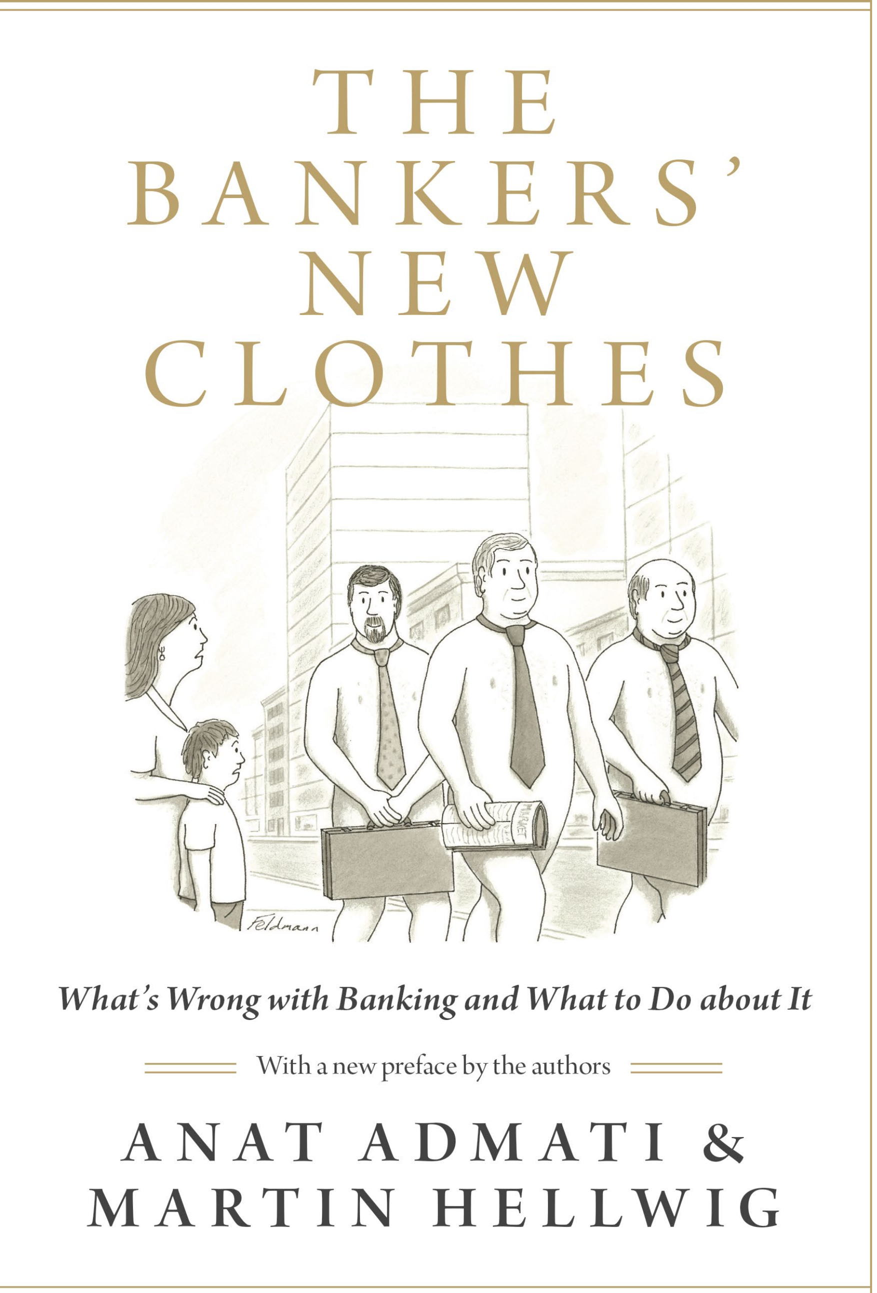
Focus on credit while ignoring interest rate risk, tail risk and correlations

Manipulable, distortive, political

Favor loans to governments and securities over business lending; allow manipulable models; get weaponized in muddled political discourse

Used to “economize” on equity in practice

Counter-productively, risk weights **exacerbate fragility and systemic risk**



February 2013

"…free of technical jargon and widely accessible to all…conveys a deep understanding and stands in opposition to the self-interested forces of obscurity."

- *Kenneth Arrow*

"…the most important book about banking in a very long time."

- *Ken Rogoff*

"With a knack for explaining complex concepts in a very straightforward fashion…Their brilliant book has much to offer everyone, from novices to experts."

- *Stephen Ross*

"… a must-read for concerned citizens… should be studied and memorized by lawmakers and regulators so they won't be duped by false claims in the future."

- *Eugene Fama*

“

Capital is a rainy-day fund.

“A Piece-by-Piece Guide to New Financial Overhaul Law,” *Associated Press*, 2010.
“Trying to Slam the Bailout Door, Gretchen Morgenson, *New York Times*, April 2013

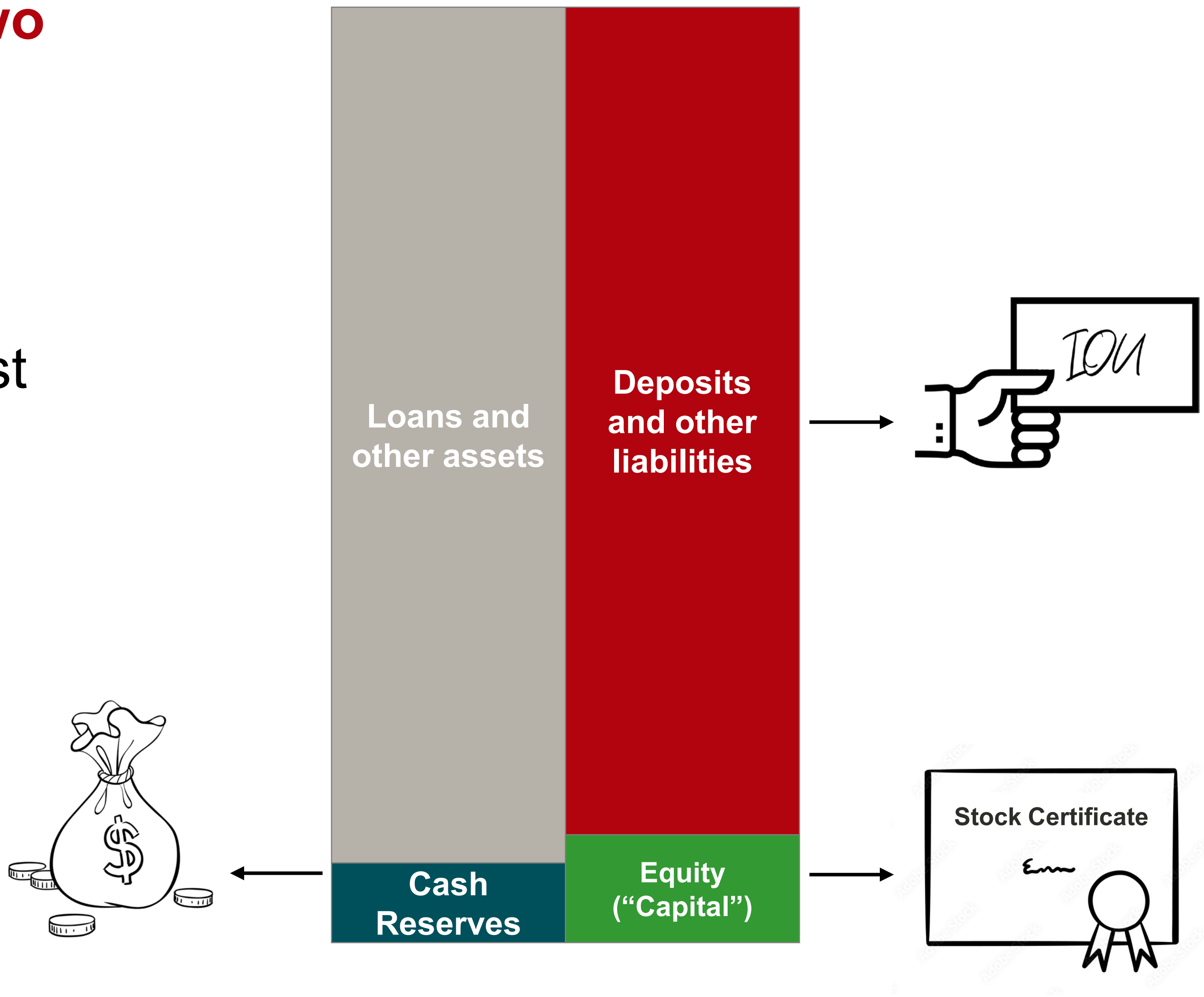
”

Capita … fund.

“A Piece-by-Piece Guid … aw,” *Associated Press*, 2010.
“Trying to Slam the Bail … n, *New York Times*, April 2013

Confusing Jargon mixes two sides of balance sheet!

The cash and central bank reserves banks hold are "on the sidelines," earning interest and not used for lending.




“Every dollar of capital is one
less dollar working in the economy.”
Steve Bartlett, Financial Services Roundtable,
September 2010


“Every one
less do conomy.”
NONSENSE
Steve B oundtable,


“This rule will keep billions out of the Economy.”
Tim Pawlenty, Financial Services Roundtable,
July, 2015

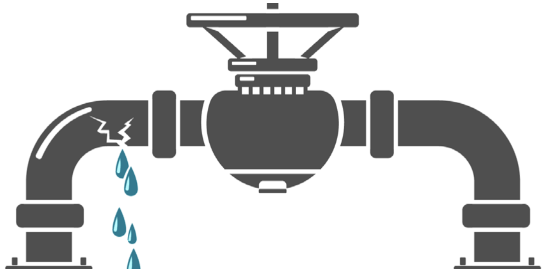

NONSENSE

"Just about whatever anyone proposes… the banks will claim that it will restrict credit and harm the economy….

It's all bullshit."

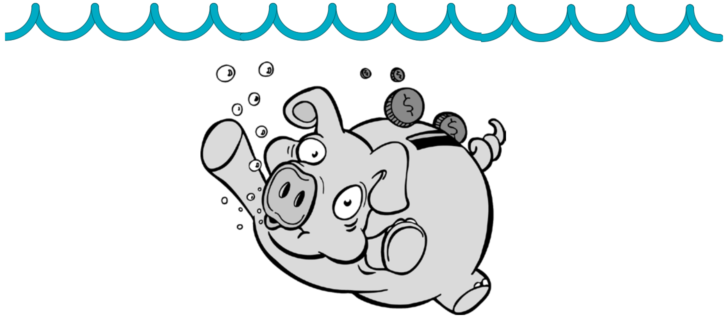
Paul Volcker (1927-2019),
January 2010
(From *The Payoff: Why Wall Street Always Wins*, Jeff Connaughton, 2012)

Possible Reasons for **Default (Non-Payment)**



Liquidity problems:

Borrower cannot convert assets to cash in a timely manner.



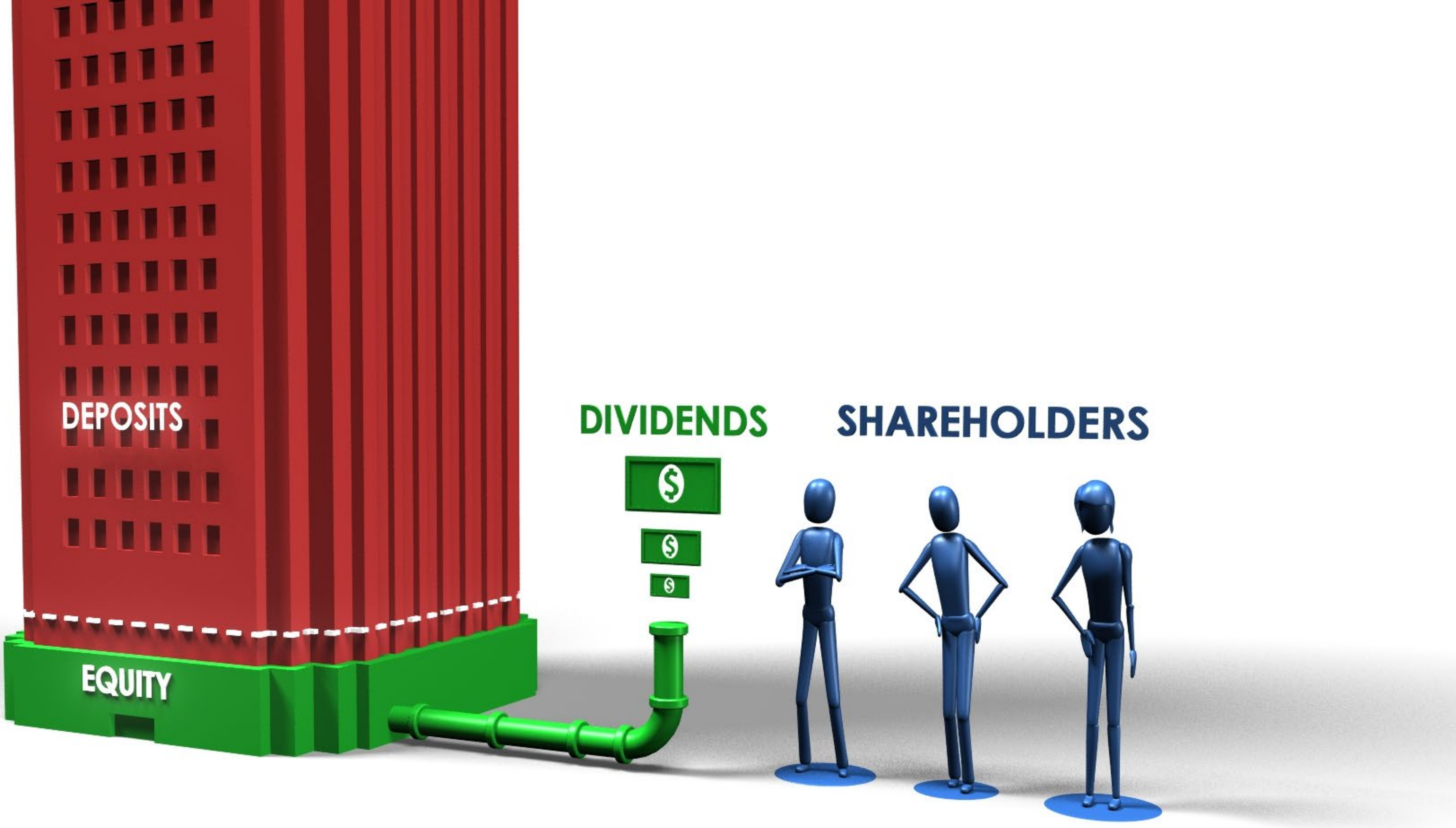
Solvency problems:

Borrower is likely ***unable*** to pay.

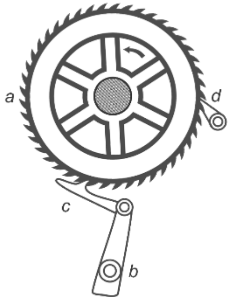
The source of potential default (and perceptions about it) matter greatly

Solvency problems are more challenging, cause more harm and distortions

Solvency concerns create liquidity problems, especially in banking!


DEPOSITS
EQUITY
DIVIDENDS
SHAREHOLDERS

The Leverage Ratchet Effect



***Journal of Finance,* 2018**

Anat Admati, Peter DeMarzo, Martin Hellwig and Paul Pfleiderer

Borrowing creats bias in favor of ever more borrowing and gets “addictive”

Debt overhang distorts decisions on both sides of a balance sheet

https://admati.people.stanford.edu/publications/leverage-ratchet-effect

Zombie (Insolvent) Borrowers: Opaque and Dysfunctional

Zombie (Insolvent) Borrowers: Opaque and Dysfunctional

Unable to raise equity

Lose trust of counterparties

"Gamble for resurrection"

Anxious to take cash out

Avoid equity, borrow if possible

Sell assets, even at fire-sale prices

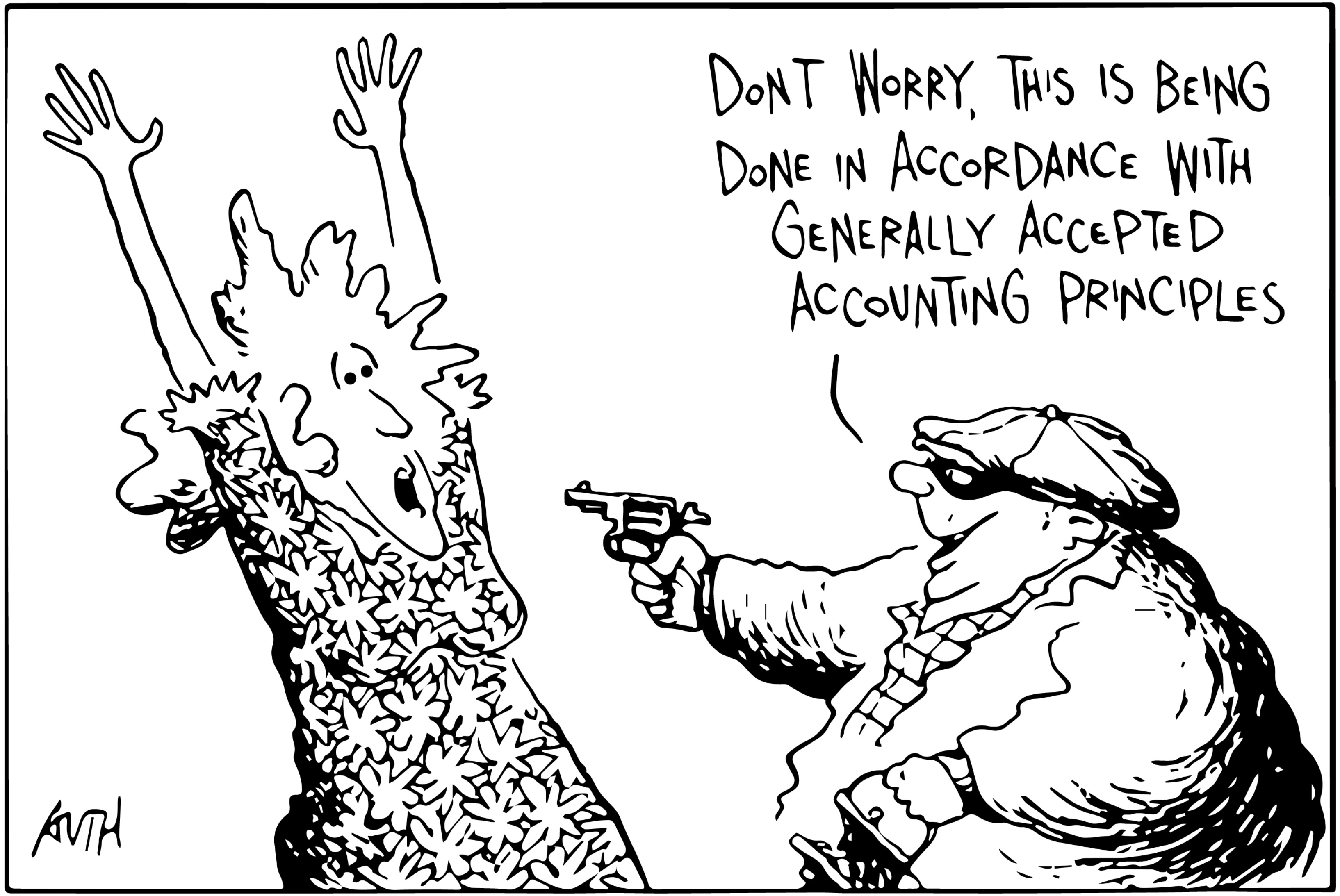
Underinvest in "boring" assets

Try to hide insolvency in disclosures

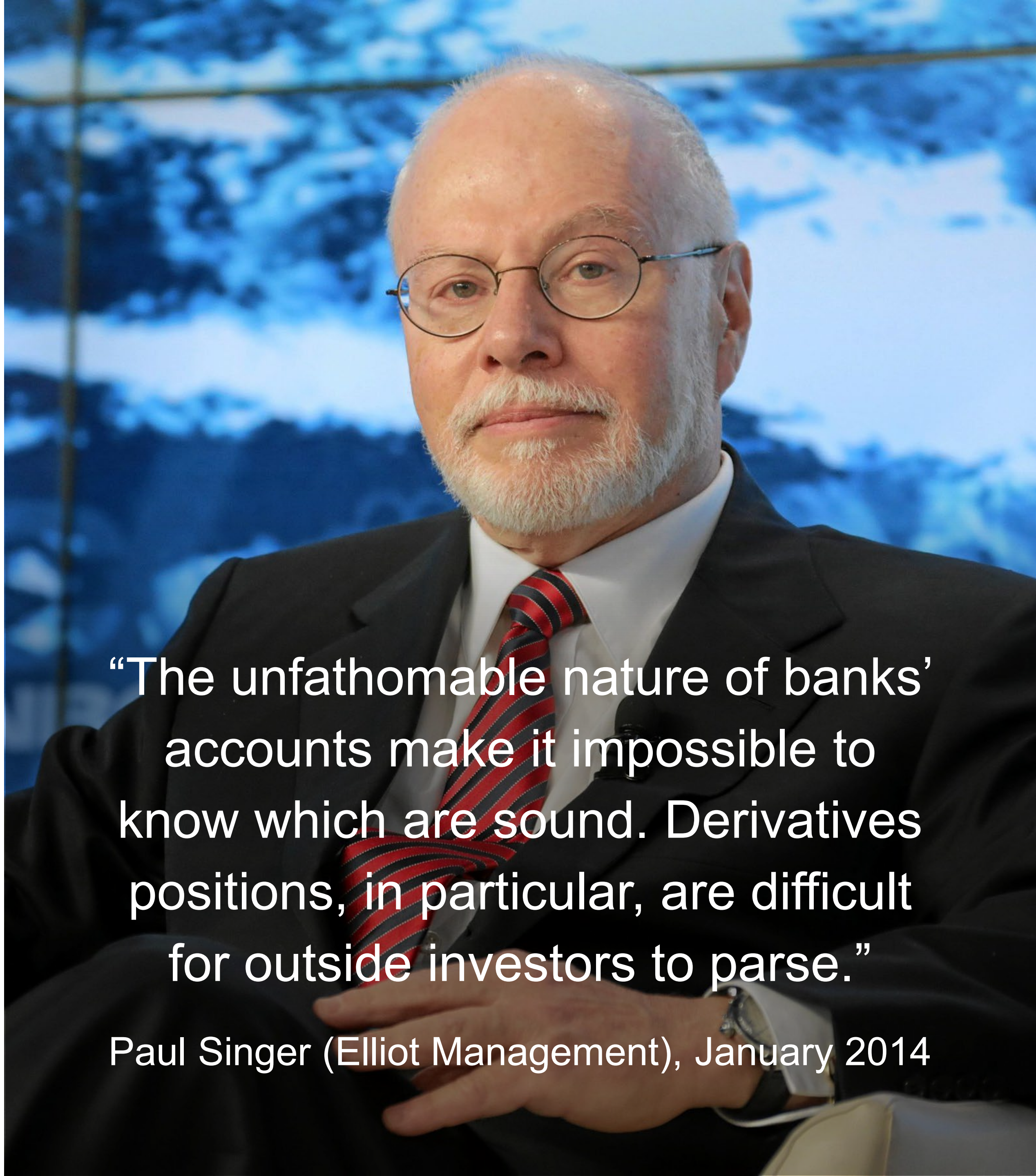
Claim it's "only a liquidity problem"

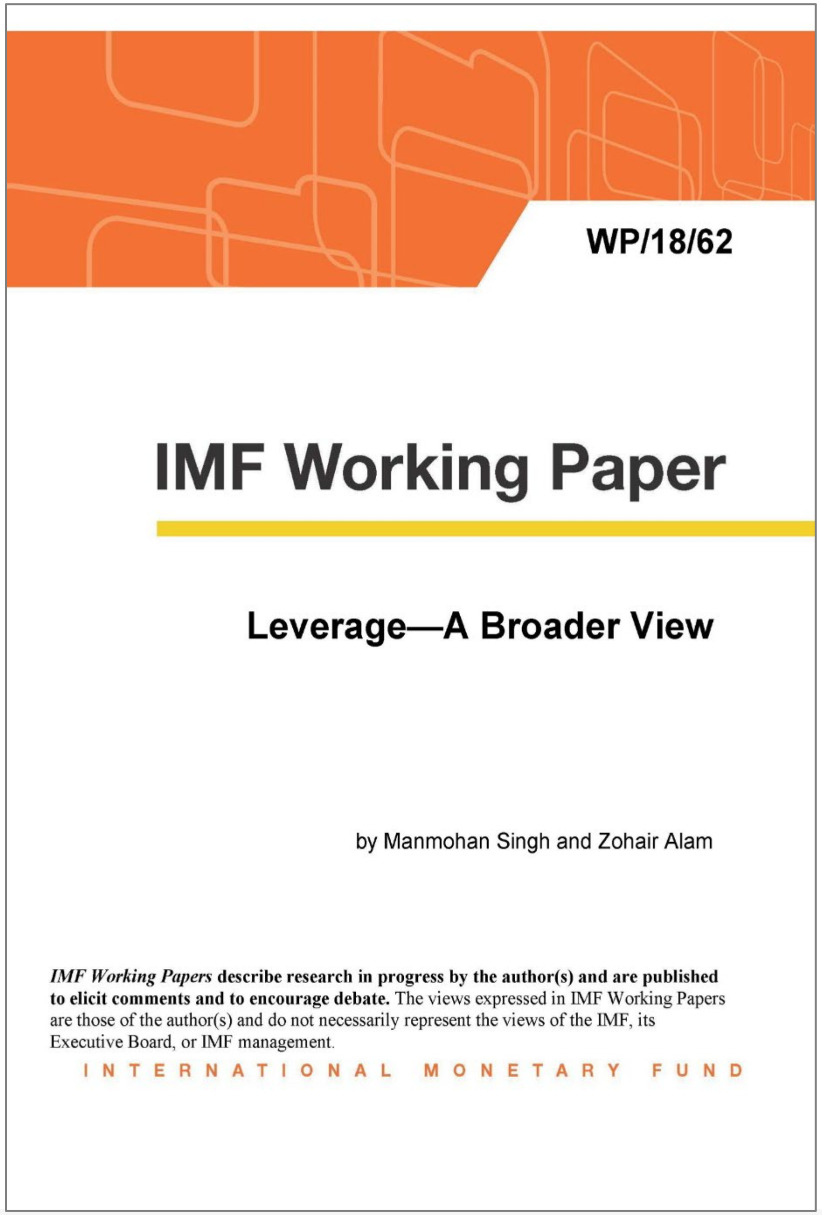
Avoid default with more cash reserves

Lobby for bailout to avoid default


DONT WORRY, THIS IS BEING DONE IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES


"Investors can't understand the nature and quality of the assets and liabilities... The disclosure obfuscates more than it informs."
Kevin Warsh, January 2013


"The unfathomable nature of banks' accounts make it impossible to know which are sound. Derivatives positions, in particular, are difficult for outside investors to parse."
Paul Singer (Elliot Management), January 2014



WP/18/62

IMF Working Paper

Leverage—A Broader View

by Manmohan Singh and Zohair Alam

IMF Working Papers **describe research in progress by the author(s) and are published to elicit comments and to encourage debate.** The views expressed in IMF Working Papers are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

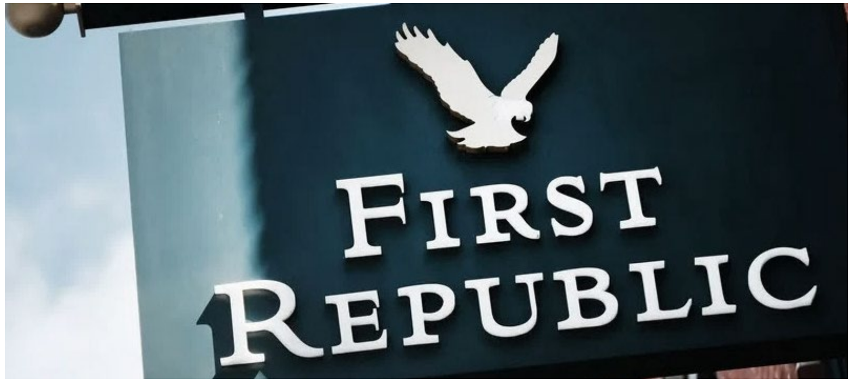
I N T E R N A T I O N A L   M O N E T A R Y   F U N D

"The omission of off-balance sheet items in the standard measures implies a substantial underestimation of bank leverage.

Off-balance sheet funding is higher now than in 2007."

– "Leverage, a Broader View," Singh and Alam, IMF, March 2018

US Banking Crisis since Spring 2023



The failure of Silicon Valley Bank (SVB) in March 2023 was **not a “modern-day run”** due to liquidity problems

SVB (and First Republic Bank) had long term treasury bonds or mortgages to the wealthy with **little or no credit risk** (of borrower default)**,** but **interest rate increases reduced the market value of their assets**

They became insolvent as their equity was insufficient to absorb losses. (Similar to the US Savings and Loan crisis in the 1980s).

Had they funded with 20% equity, shareholders would have absorbed the losses

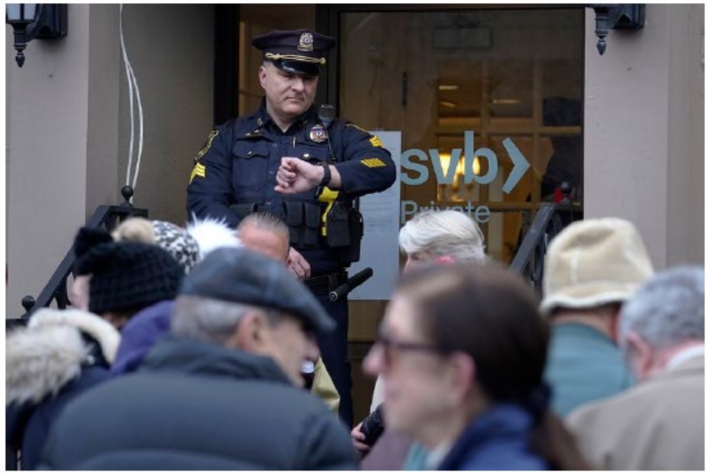
KPMG Gave SVB, Signature Bank Clean Bill of Health Weeks Before Collapse

Accounting firm faces scrutiny for audits of failed banks

By Jonathan Weil and Jean Eaglesham

Updated March 13, 2023, 12:21 pm ET

Silicon Valley Bank failed just 14 days after KPMG LLP gave the lender a clean bill of health. Signature Bank went down 11 days after the accounting firm signed off on its audit.



A Silicon Valley Bank branch in Wellesley, Mass., before opening on Monday morning.
PHOTO: STEVEN SENNE/ASSOCIATED PRESS

Joint Press Release

March 12, 2023

Joint Statement by Treasury, Federal Reserve, and FDIC

Department of the Treasury

Board of Governors of the Federal Reserve System

Federal Deposit Insurance Corporation

After receiving a recommendation from the boards of the FDIC and the Federal Reserve, and consulting with the President, Secretary Yellen approved actions enabling the FDIC to complete its resolution of Silicon Valley Bank, Santa Clara, California, in a manner that fully protects all depositors. Depositors will have access to all of their money starting Monday, March 13. No losses associated with the resolution of Silicon Valley Bank will be borne by the taxpayer.

We are also announcing a similar systemic risk exception for Signature Bank, New York, New York, which was closed today by its state chartering authority. All depositors of this institution will be made whole. As with the resolution of Silicon Valley Bank, no losses will be borne by the taxpayer.

Finally, the Federal Reserve Board on Sunday announced it will make available additional funding to eligible depository institutions to help assure banks have the ability to meet the needs of all their depositors.

No more bailouts???

THE FEDERAL RESERVE
Discount Window | Payment System Risk

Current Interest Rates

Primary Credit	Secondary Credit
5.50%	6.00%

Seasonal Credit	Fed Funds Target
5.35%	5.25 - 5.50%

Bank Term Funding Program

4.87%

January 11, 2024

Interest Rates on Reserve Balances for January 16, 2024 Last Updated: January 12, 2024 at 4:30 p.m., Eastern Time	Rates (percent)	Effective Date
Rate on Reserve Balances (IORB rate)	5.40	7/27/2023

MAY 1 2024

Interest earned by big UK high street banks on BoE reserves surges to £9.2bn

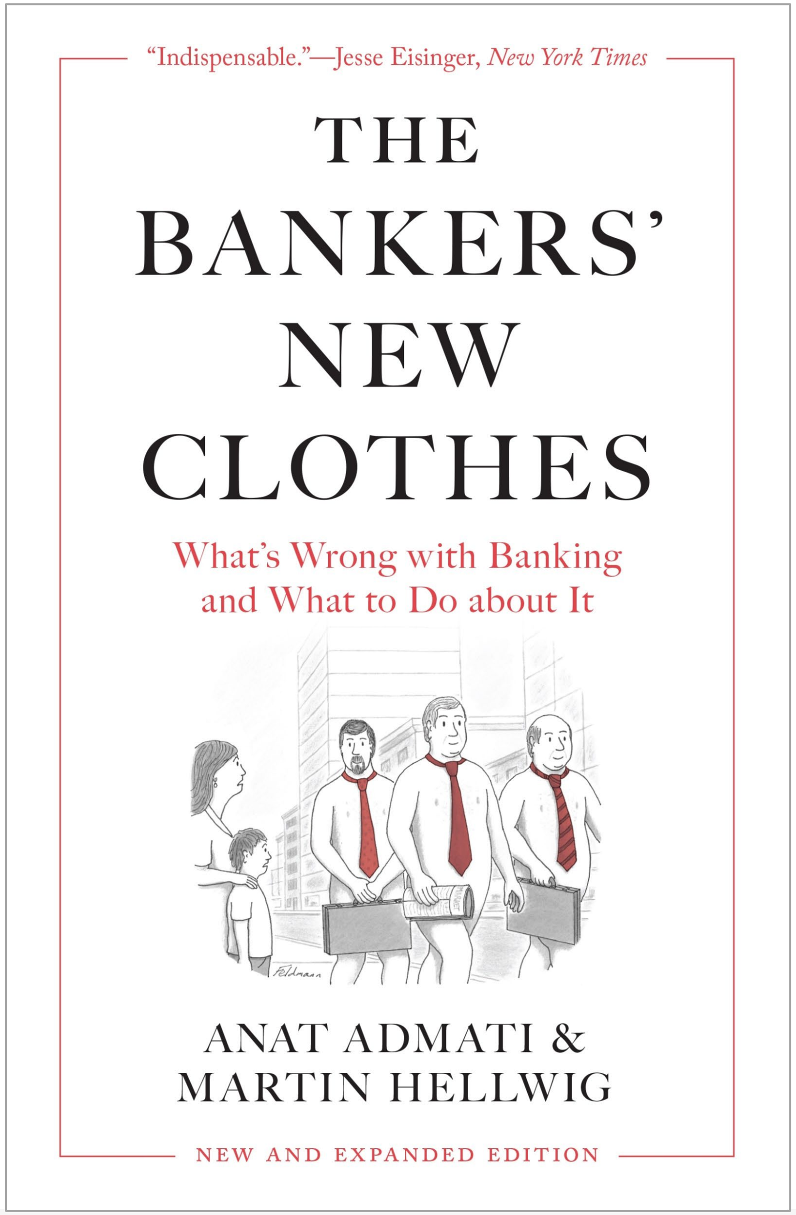
MP highlights scale of lenders' 'unanticipated income' in 2023, but acknowledges some progress towards better savings rates for consumers

The interest the BoE paid on commercial banks' reserves, which is ultimately covered by the Treasury, has risen sharply in recent years as the central bank lifted its key rate to 5.25 per cent in an effort to bring inflation back under control.

Dame Harriett Baldwin, chair of the [Treasury select] committee, said the data showed "the staggering scale of unanticipated income high street banks are bringing in, with no work required, as a result of increased interest rates."

The letters [from the banks] said the banks had worked towards giving customers a fairer deal.

https://www.ft.com/content/9d954577-38c8-480f-ac9a-e9b5aa8263bf

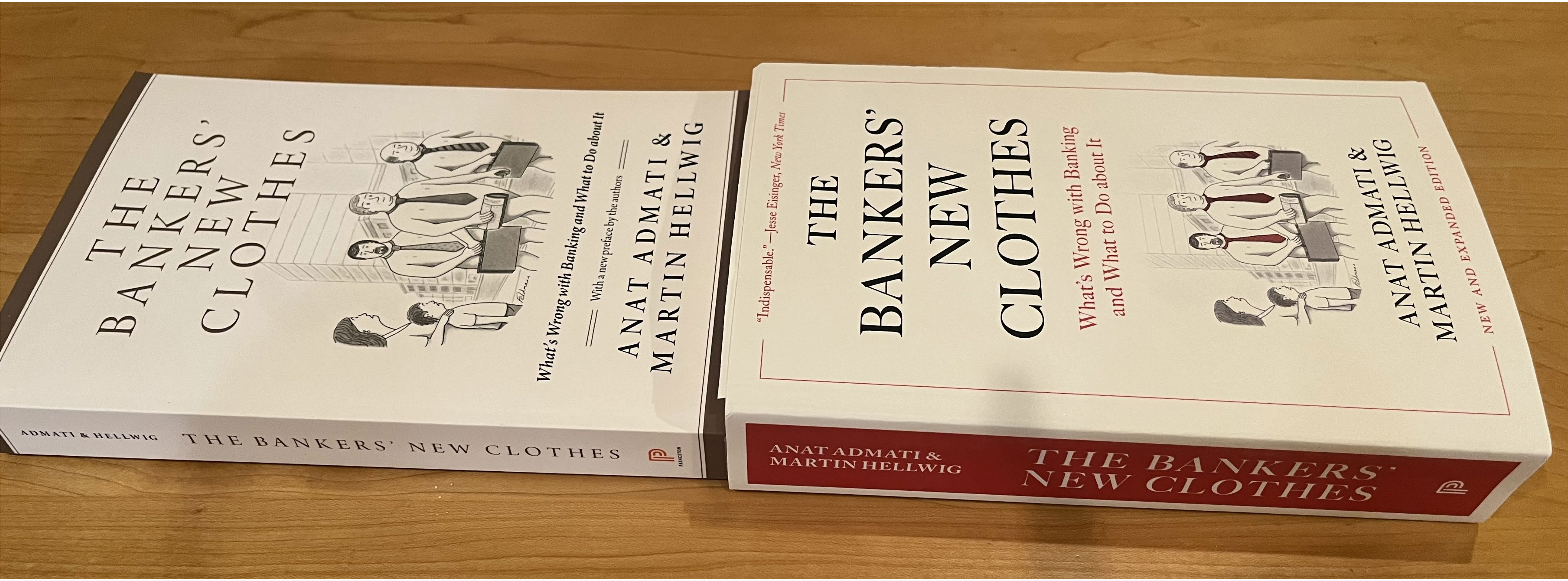


CONTENTS

https://press.princeton.edu/books/paperback/9780691251707/the-bankers-new-clothes

2014 vs 2024

200 additional pages



FOURTEEN

Too Fragile Still

Without reform of the financial system, . . . , another crisis is certain, . . .

Mervyn King, Former Governor of the Bank of England, The End of Alchemy *(2016)*[1]

FIFTEEN

Bailouts and Central Banks

It was not quite a Lehman moment. But it got close.

London Banker, September 2022[1]

SIXTEEN

Bailouts Forever

[A] globally active systemically important bank cannot simply be wound up according to the "too-big-to-fail" plan.

Karin Keller-Sutter, Head of the Swiss Finance Department, March 25, 2023[1]

SEVENTEEN

Above the Law?

[Power struggles in the economy] are not fought by people who are infinitely progress-minded, but by people who have developed sophisticated and brutal techniques of fighting for power.

Walter Eucken, German economist (1891–1950)[1]

The Parade of Bankers New Clothes Continues…

44 Flawed Claims Debunked (latest version April 8 2024)

https://gsb-faculty.stanford.edu/anat-r-admati/publications/the-parade-of-bankers-new-clothes-continues/

Flawed Claims Grouped

1. Basics about Bank Capital and Bank Funding
2. "Banks are Special"
3. Economic Effects of Higher Bank Equity Requirements
4. "Bank Regulation and Supervision are Already Tough"
5. "No More Bailouts!"
6. More radical approaches?
7. Politics of Bank Regulation and Global "Competitiveness"

https://gsb-faculty.stanford.edu/anat-r-admati/publications/the-parade-of-bankers-new-clothes-continues/

Nonsense and Politics Persist: Public Theater, Weaponized Details

"Let's translate [Basel III Endgame] for the average American... It is simply requiring more capital on the sidelines, which then means fewer dollars to lend to small businesses, first-time homebuyers, car loans… to Americans who need desperately to be engaged in the process of achieving the American Dream."

Ranking Member Tim Scott (R-SC)
Senate Banking Committee Hearing, Dec 6, 2023

“Let's tran … dgame] for the
average A … uiring more
capital … n means
fewer … sses, first-
time … o Americans
who … gaged in the
process o … erican Dream.”

FALSE!!

Ranking Member Tim Scott (R-SC)
Senate Banking Committee Hearing, Dec 6, 2023

Capital is cash-like assets

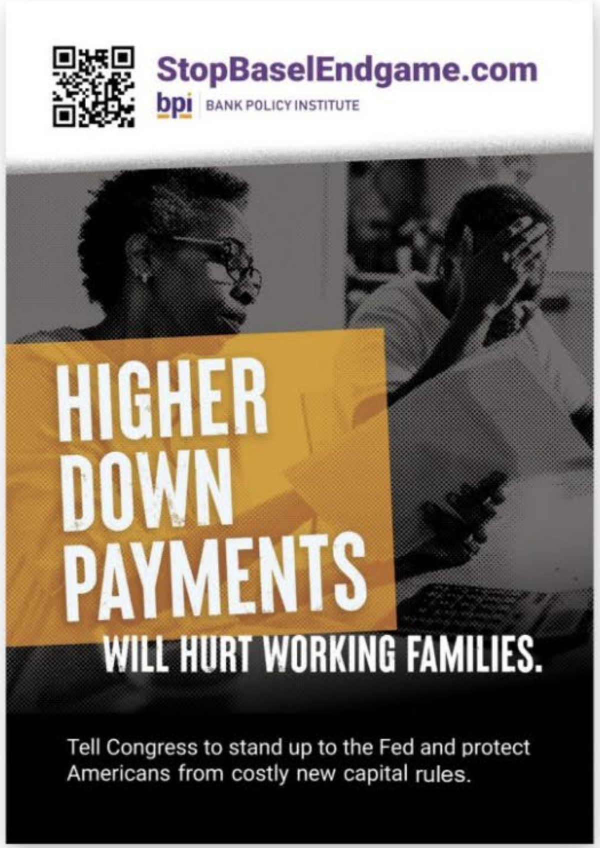
“Why Big Banks (and Some Odd Allies) Oppose a Plan to Protect Banks,“
Emily Flitter, *New York Times*, January 18, 2024

Capita … ssets

“Why Big Banks (a … Plan to Protect Banks,“

Emily … ary 18, 2024

To learn more, please visit *StopBaselEndgame.com*.



“Credit will Suffer” Claims Debunked

Excessive Borrowing and Bad Rules Distort Credit Market

01 Too much or too little credit; boom, bust, and crises

02 Wasteful investments in boom

03 Credit crunch exacerbates recessions

04 Zombie banks lend to and maintain zombie businesses

05 Risk weights and liquidity rules distort lending decisions

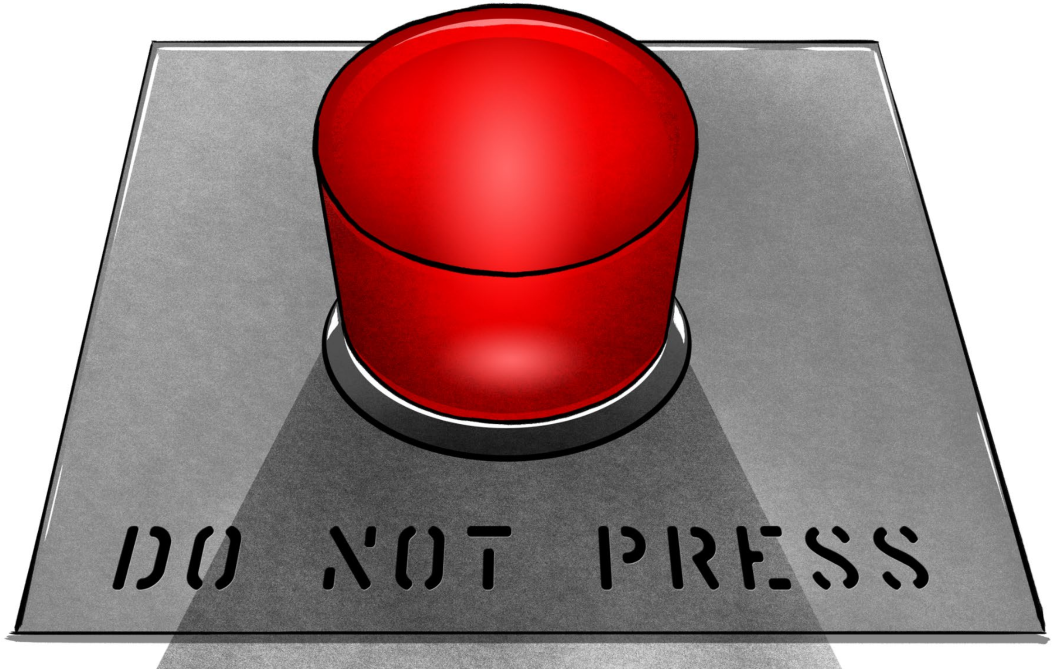
Mark Carney hails new deal for ‘too big to fail’ banks

Bank of England governor unveils new set of rules about the capital that 30 ‘globally systemically important’ banks must hold to avoid further bailouts

November 10, 2014

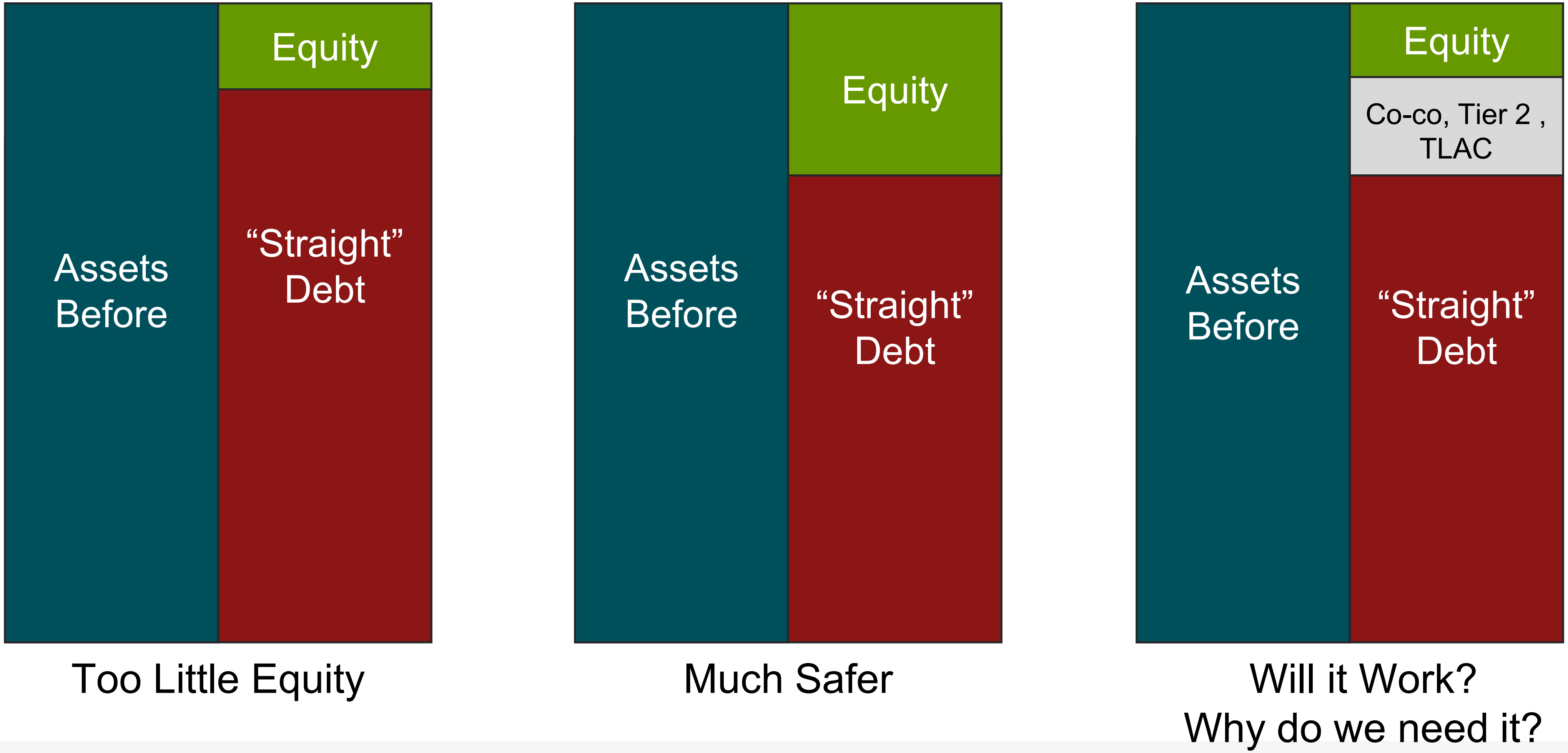
Loss-Absorbing Debt (“Bail-in,” “AT1,” “TLAC”): Clever or Fool’s Gold?

Equity Dominates Debt for Loss Absorption in Every Relevant Way!

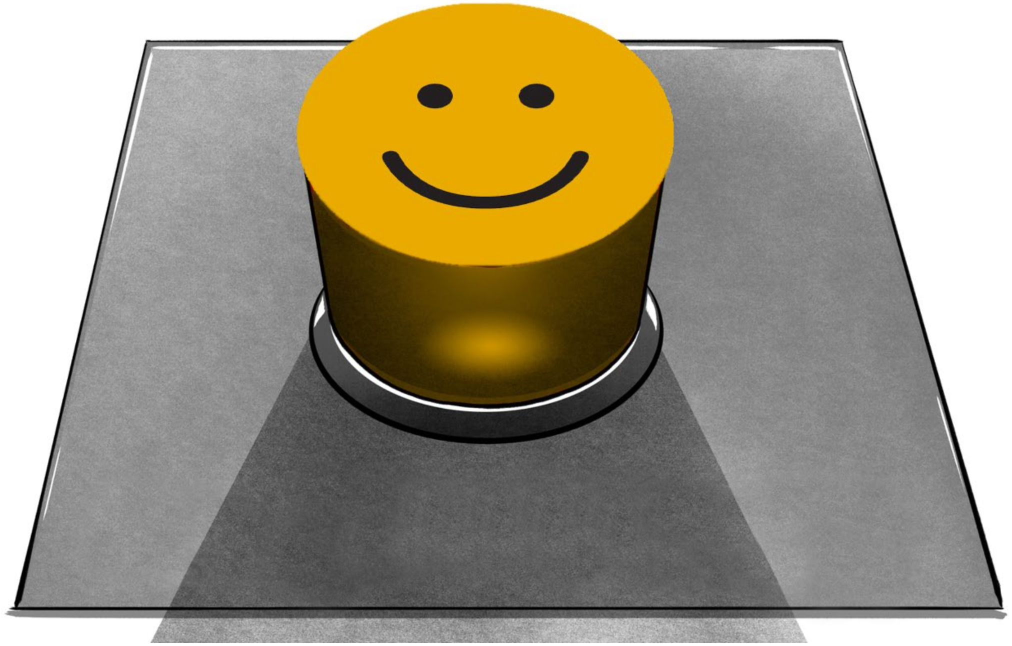


“Anything but Equity” Why?

“Loss absorbing debt” (TLAC) investors rarely if ever absorb losses!



“Heroic Savior” Button Instead?



Wednesday, 5 April 2023 14:50

How Credit Suisse Became a Dead Bank Walking

«Zombie» is an apt moniker for Credit Suisse, now that it's crystal clear that without intervention, the bank would have been history last fall. Outflows were even greater than the bank admitted.

And Now, a Credit Suisse Bailout

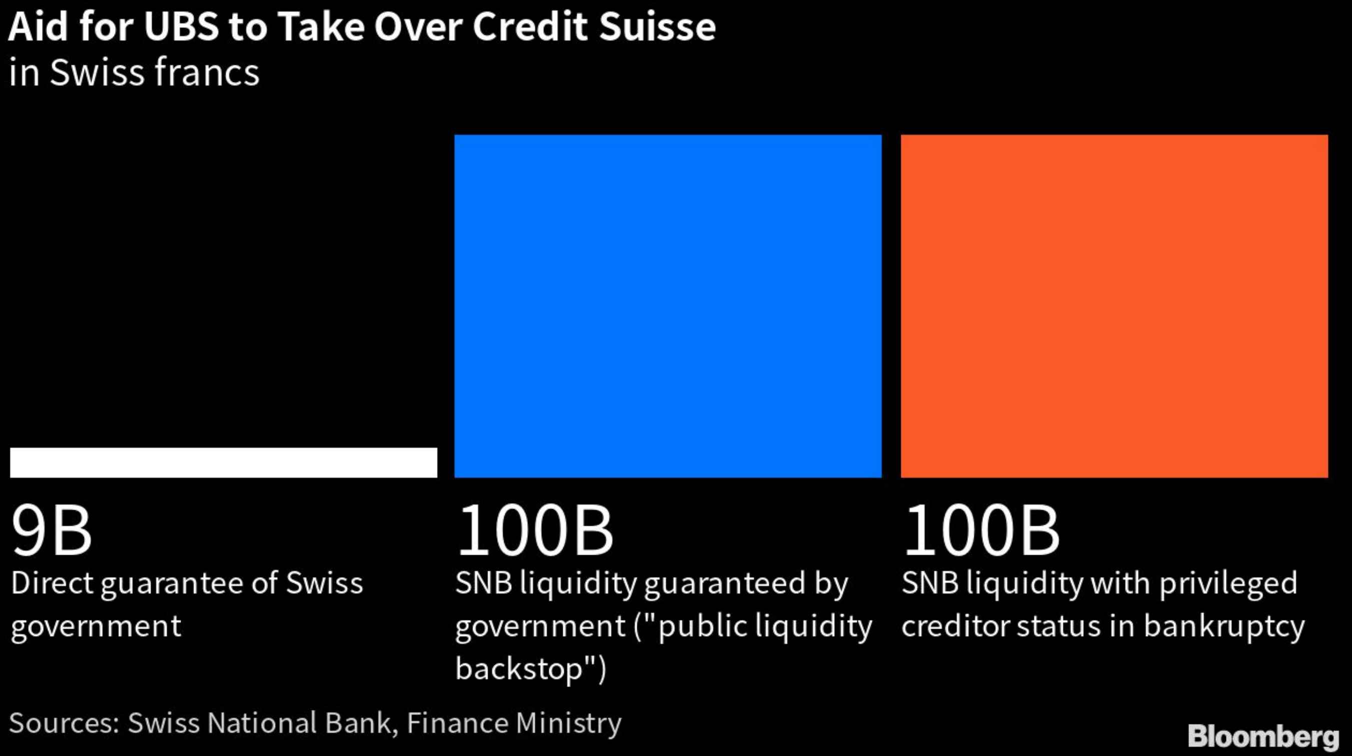
The weekend shotgun marriage with UBS shows how post-2008 regulation failed again.

By The Editorial Board WSJ | OPINION

March 19, 2023 5:10 pm ET

https://www.wsj.com/articles/and-now-a-credit-suisse-bailout-ubs-switzerland-regulators-svb-shareholders-bankruptcy-europe-management-default-2bdf3aa

Swiss Are On the Hook for $13,500 Each on Credit Suisse Bailout



The combined sum of 209 billion francs is equivalent to about a quarter of Switzerland's gross domestic product and exceeds total European defense spending in 2021.

The price tag for Switzerland's largest ever corporate rescue could add up to more than three times the 60 billion-franc bailout of UBS in 2008.

Swiss financial regulator calls for tougher powers after Credit Suisse collapse

Finma report says it 'exhausted its options' in regulating scandal-plagued bank

DECEMBER 19 2023

Switzerland's financial regulatory system has long been criticised internationally for lacking the authority of its global peers.

Finma said that to improve its oversight of the finance sector, it would need to be able to fine companies. It also called for the introduction of a senior managers' regime

Legal authority for financial regulators is necessary, but so is the political will that the use authority in the public interest! (See U.S.)

The “Level Playing Field” Mantra
(Chapter 12: “Politics of Banking”)

Is fairness in sports a proper analogy for rules of economic “game”? **NO!**

Should taxpayers subsidize sectors or corporations to win cross-jurisdictional “competition” as “national champions” while causing harm? **NO!**

Race to the bottom dynamics

Recall Icelandic and Irish banks

"Banks are still the most powerful lobby on Capitol Hill. And they frankly own the place."

Senator Richard Durbin (D-Ill), 2009

"Banks are not special, except for what they are allowed to get away with…. The model is intellectually bankrupt. The reason that this is not more widely accepted is that bankers are so influential, and the economics are so widely misunderstood.

"Why Bankers are Intellectually Naked," Martin Wolf, *Financial Times*, March 17, 2013

Politics of Banking: Are we Hostages?

Symbiotic relations cause harm when issues are misunderstood

“Banks are where the money is”

Guarantees appear free; their social cost is invisible

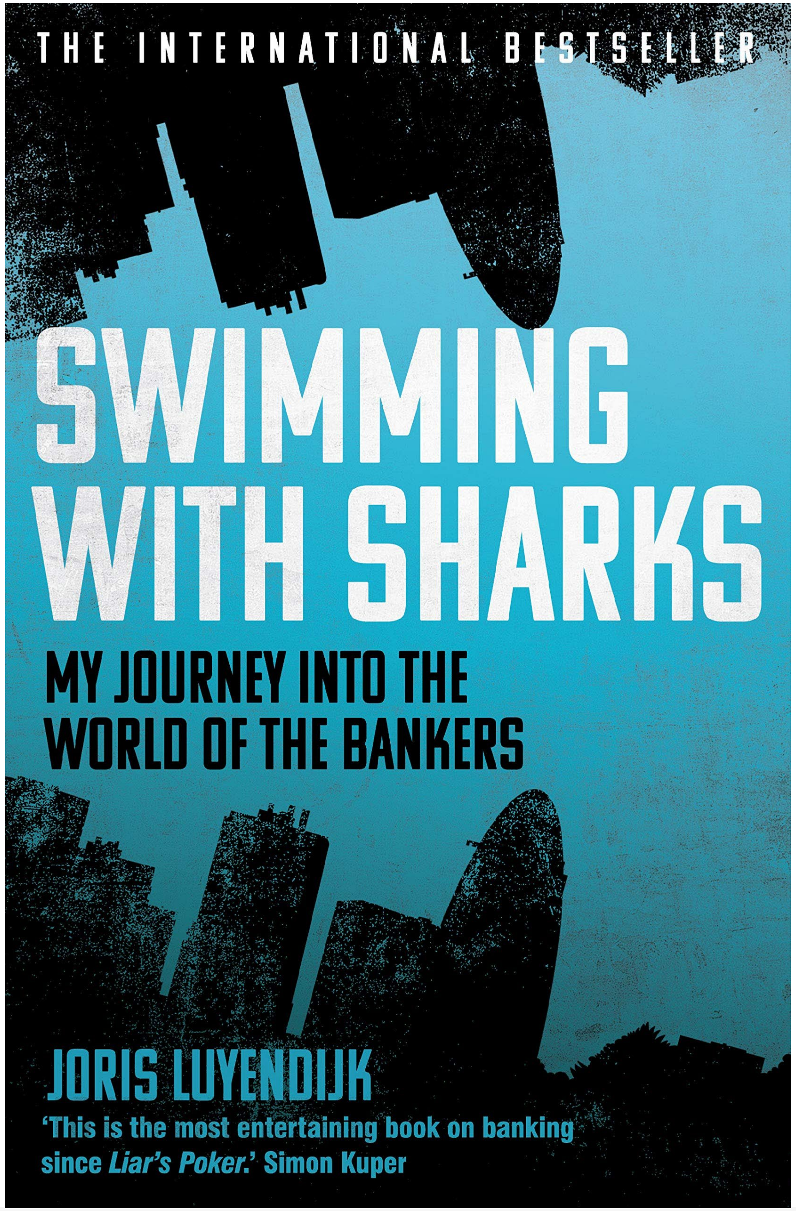
Banks seem sources of funding, not risk

“National champions” (dressed in “level playing field” narratives)

Central banks bail out banks and governments

Willful ignorance or confusion

Without political will to set and enforce proper rules, bank(er)s undermine democracy, get away with recklessness and deception



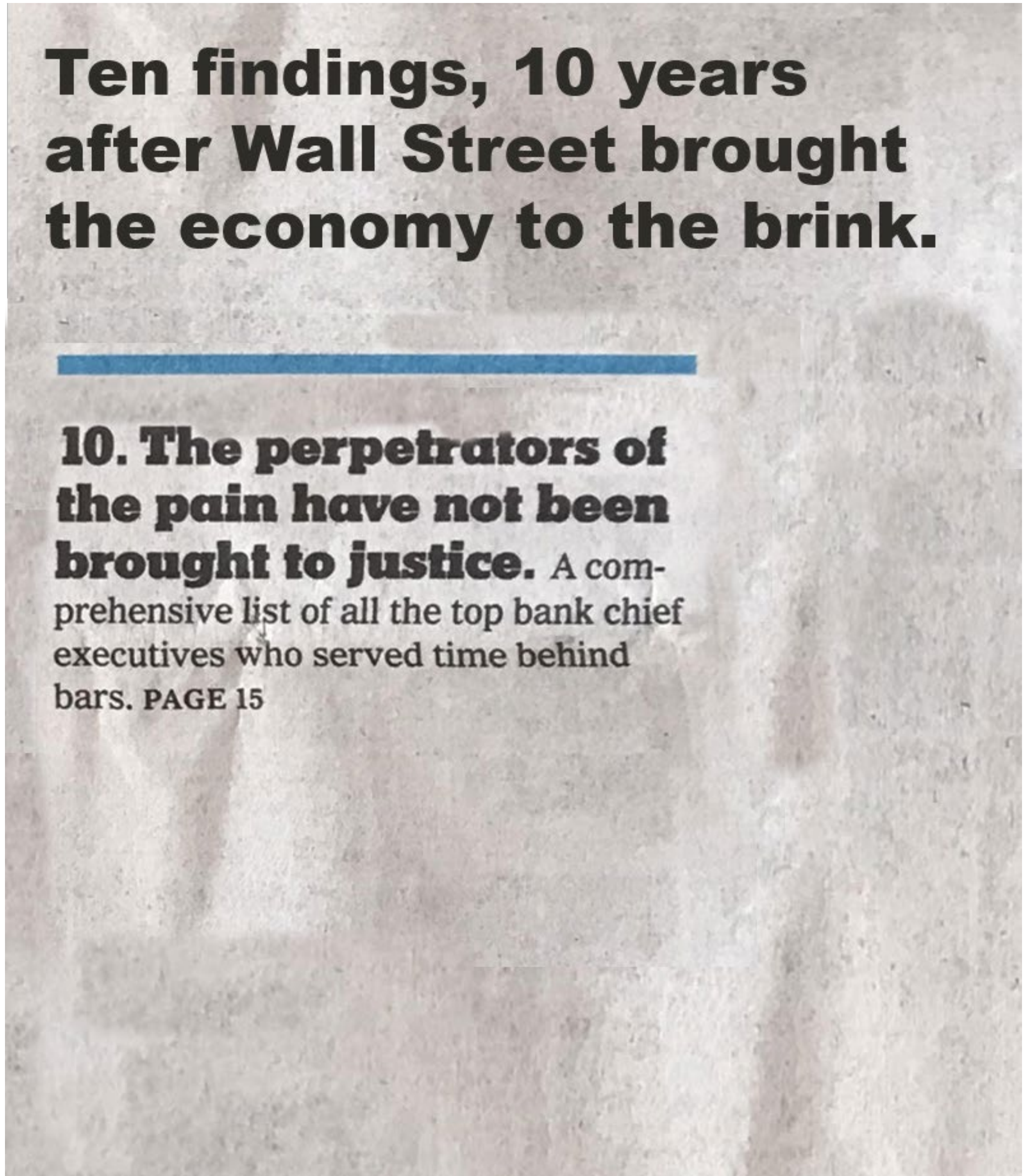
How the Banks ignored the lessons of the crash

September 30, 2015

Seven years after the collapse of Lehman Brothers, it is often said that nothing was learned from the crash. This is too optimistic. The big banks have surely drawn a lesson from the crash and its aftermath: that in the end there is very little they will not get away with.

Sunday Business Section, *New York Times*

Sep. 16, 2018, Ten years after Lehman Brother’s bankruptcy)



Ten findings, 10 years after Wall Street brought the economy to the brink.

10. The perpetrators of the pain have not been brought to justice. A comprehensive list of all the top bank chief executives who served time behind bars. PAGE 15

THE NEW YORK TIMES, SUNDAY, SEPTEMBER 16, 2018 15

OCT. 17 OIL PRICE DROPS, AIDING ECONOMY AND CONSUMERS OCT. 18 FEDERAL LEAP INTO BANKING HAS ITS PERILS OCT. 19 F.B.I. STRUGGLING TO HANDLE WAVE OF FINANCE CASES

10. The C.E.O.s Of Wall Street Sent to Jail

page intentionally left blank.

Banks have paid $321 billion in fines since the crisis (but they've made almost $1 trillion) | CNBC, March 17, **2017**

JPM Chase Rap Sheet

GOOD JOBS FIRST VIOLATION TRACKER

Violation Tracker Current Parent Company Summary

Current Parent Company Name: JPMorgan Chase
Ownership Structure: publicly traded (ticker symbol NYSE: JPM)
Headquartered in: New York
Major Industry: financial services
Specific Industry: banking & securities
Penalty total since 2000: **$38,995,648,319**
Number of records: 267

TOP 5 OFFENSE GROUPS (GROUPS DEFINED)	PENALTY TOTAL	NUMBER OF RECORDS
financial offenses	$26,626,159,167	115
consumer-protection-related offenses	$8,619,119,178	63
competition-related offenses	$2,458,674,791	27
government-contracting-related offenses	$614,000,000	1
employment-related offenses	$522,408,672	46

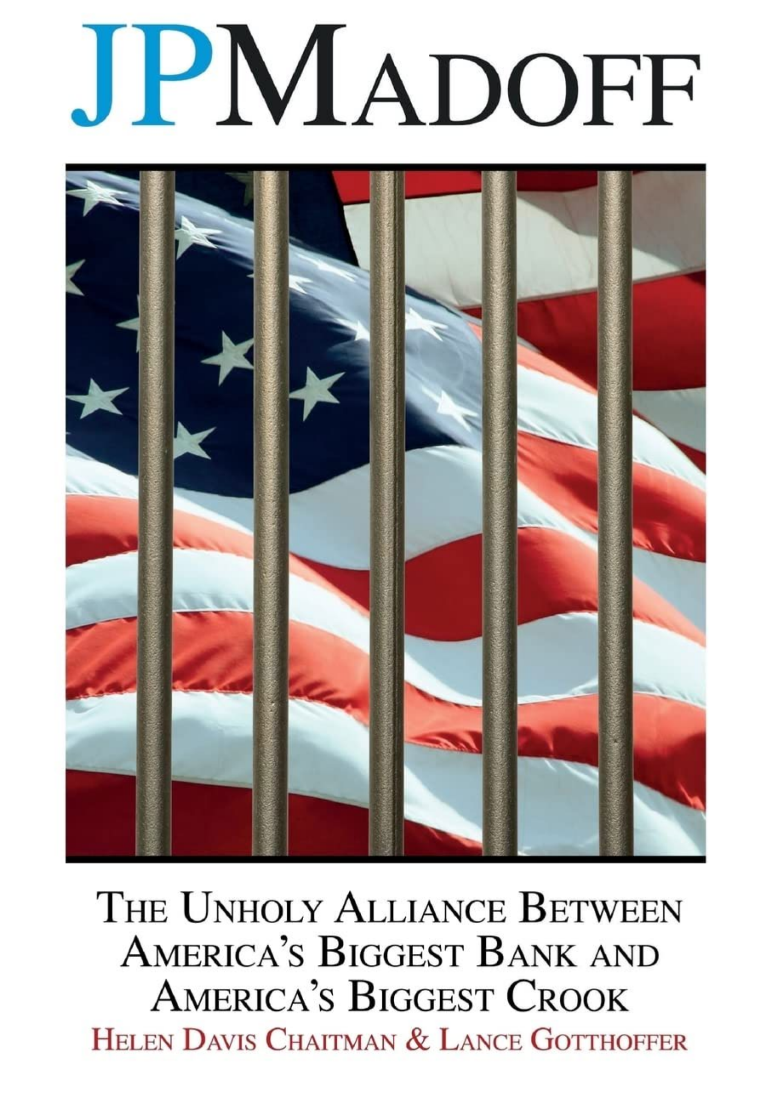
https://violationtracker.goodjobsfirst.org/parent/jpmorgan-chase

JPMorgan Chase Will Pay $13 Billion In Record Settlement

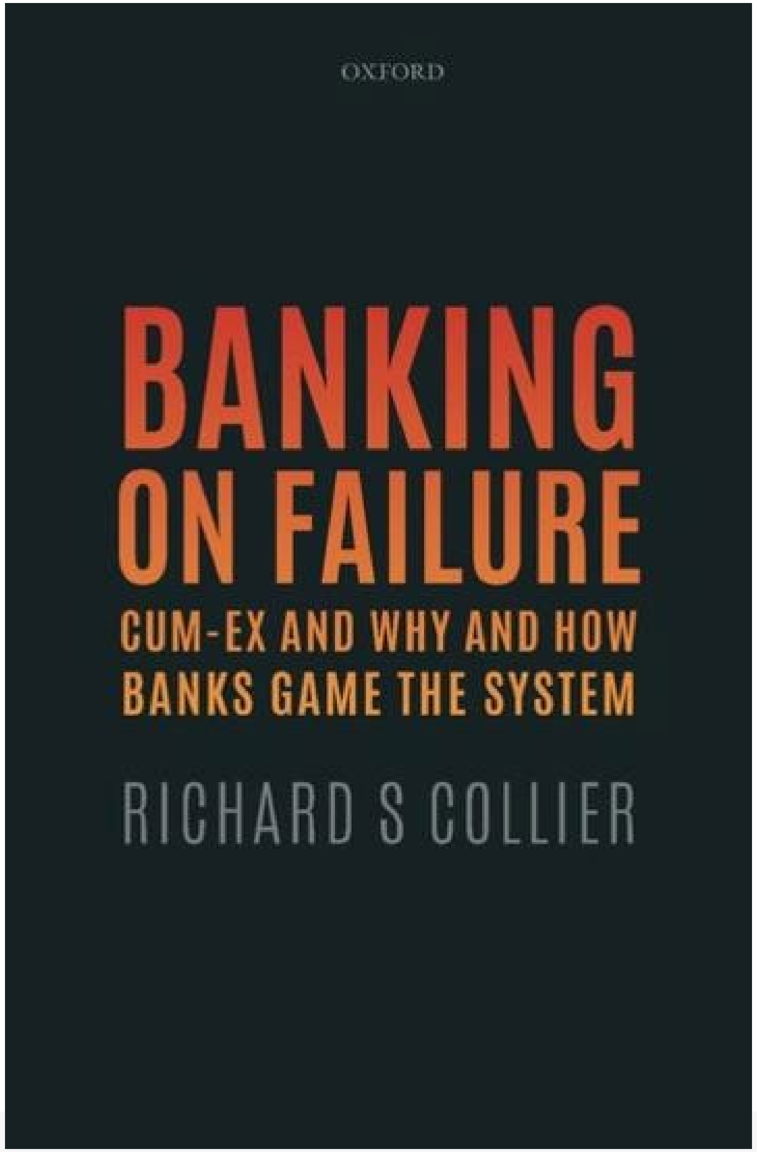
November 19, 2013 · 3:03 PM ET

By Bill Chappell

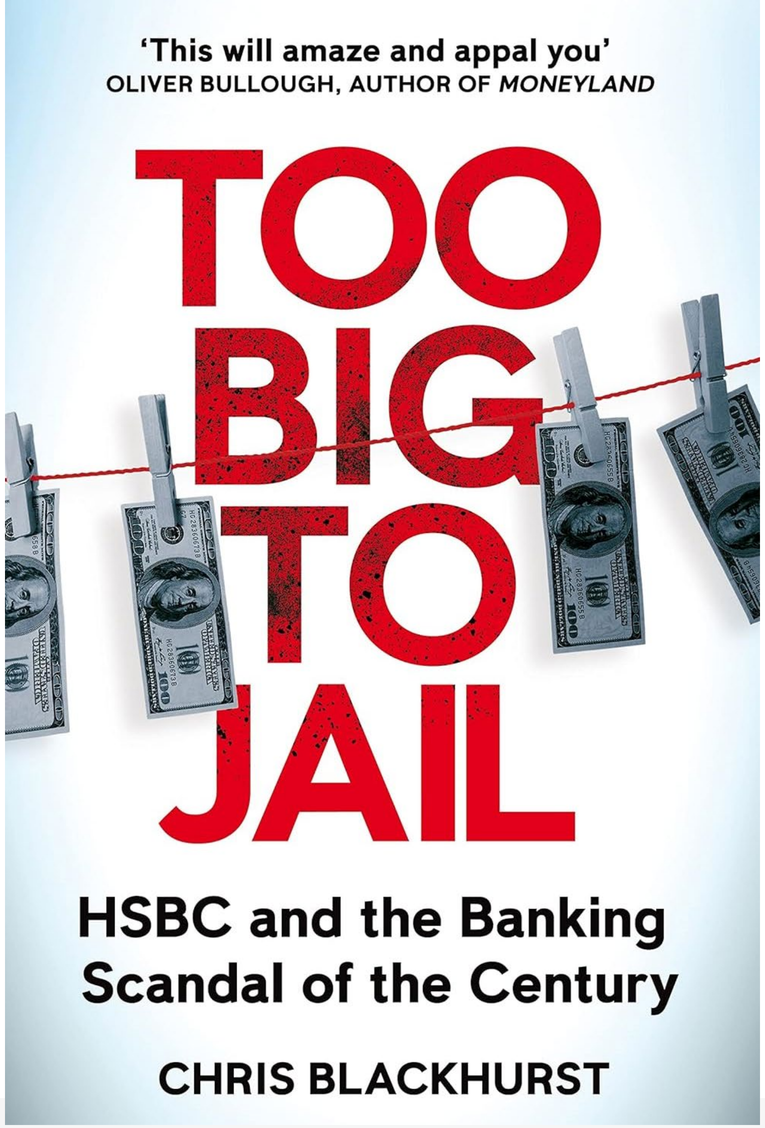
Not cited in our book but relevant…



2016



2020



2023

It Takes a Village to Maintain a Dangerous System

Many enablers

Bankers and other financial sector employees

Institutional investors

Executives and boards of financial firms

Auditors and rating agencies

Lawyers and Consultants

Supervisors and regulators

Central bankers

The media

Politicians

Courts

Academics

https://admati.people.stanford.edu/publications/it-takes-village-maintain-dangerous-financial-system

“

With such friends [as academics], who needs lobbyists?

Risk manager in a major systemic institution, 2016

”

Comments due January 16, 2024

Capital rules: 132,776 words of proposed new rules; 176 questions

July 27, 2023

Agencies request comment on proposed rules to strengthen capital requirements for large banks

Board of Governors of the Federal Reserve System

Federal Deposit Insurance Corporation

Office of the Comptroller of the Currency

of all risks to which the banking organization is exposed,[15] to have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital,[16] and, where applicable, to conduct internal stress tests.[17] Also, holding companies subject to the Board's capital plan rule would continue to be subject to a stress capital buffer requirement that is based on a supervisory stress test of the holding company's exposures.[18] Although the proposal would remove use of internal models for calculating capital requirements for credit and operational risk, internal models can provide valuable information to a banking organization's internal stress testing, capital planning, and risk management functions. Large banking organizations should employ internal modeling

organizations with total assets of $100 billion or more and their subsidiary depository institutions.[19] These banking organizations are large and exhibit heightened complexity. Application of the expanded risk-based approach to large banking organizations would provide granular, generally standardized requirements that result in robust risk capture and appropriate risk sensitivity. By strengthening the requirements that apply to large banking organizations, the proposal would enhance their resilience and reduce risks to U.S. financial stability and costs they may pose to the Federal Deposit Insurance Fund in case of material distress or failure. Relative to smaller, less complex banking organizations, these banking organizations have greater operational capacity to apply more sophisticated requirements.

Previously, the agencies determined

August 29, 2023

Agencies request comment on proposed rule to require large banks to maintain long-term debt to improve financial stability and resolution

Board of Governors of the Federal Reserve System

Federal Deposit Insurance Corporation

Office of the Comptroller of the Currency

https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm

Who submits public comments?

GRADUATE SCHOOL OF BUSINESS
STANFORD UNIVERSITY
KNIGHT MANAGEMENT CENTER
STANFORD CA 94305-7298

ANAT R. ADMATI
THE GEORGE G.C. PARKER PROFESSOR OF FINANCE AND ECONOMICS
GRADUATE SCHOOL OF BUSINESS

January 16, 2024

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R-1813, RIN 7100-AG64

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-AF29

Mr. Benjamin McDonough
Chief Counsel
Office of the Comptroller of the Currency
400 7th Street, NW
Suite 3E-218
Washington, DC 20219
Docket ID OCC-2023-0008

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity

GRADUATE SCHOOL OF BUSINESS
STANFORD UNIVERSITY
KNIGHT MANAGEMENT CENTER
STANFORD CA 94305-7298

ANAT R. ADMATI
THE GEORGE G.C. PARKER PROFESSOR OF FINANCE AND ECONOMICS
GRADUATE SCHOOL OF BUSINESS

January 16, 2024

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R–1815 and RIN 7100–AG66

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064–AF86

Mr. Benjamin McDonough
Chief Counsel
Office of the Comptroller of the Currency
400 7th Street, NW
Suite 3E-218
Washington, DC 20219
Docket ID OCC–2023–0011

Re: Long-term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions

https://gsb-faculty.stanford.edu/anat-r-admati/presentations-and-policy-papers/

English

Economics

3

Nonsense and Bad Rules Persist in Banking

Apr 8, 2024 | **ANAT R. ADMATI**

False Choices, Muddled Debate

"Free market Capitalism"

"Big government Socialism"

OXFORD REVIEW OF ECONOMIC POLICY

CAPITALISM

VOLUME 37 NUMBER 4 WINTER 2021

("What has gone wrong with capitalism, what needs to change and how to fix it" in 5,000 words)

Capitalism, Laws, and the Need for Trustworthy Institutions

Anat R Admati

In recent decades, the forces of 'free-market capitalism' have undermined and overwhelmed democratic institutions, leading to intertwined crises in both capitalism and democracy. Deception and the manipulation of beliefs often distort both markets and political systems.

https://academic.oup.com/oxrep/article-abstract/37/4/678/6423479?redirectedFrom=fulltext