
Shadow Financial Regulatory Committee Statements

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Outline

- What are Shadow Committees?
- Statement of International Meeting of Committees – Santiago, 17th August 2009
 - Securitization
- Statement of ANZSFRC, Melbourne, 22nd September 2009
 - Deposit and Wholesale Funding Guarantees



What are Shadow Committees

- Initially established in USA
 - Preceded by *Open Market Shadow Committee* (focusing on monetary policy)
 - US Shadow Financial Regulatory Committee
 - Established around start of 1980s
 - Academics and independent private sector (market oriented) experts (currently 13 members)
 - Discuss and issue statements on current problems, events and policy initiatives affecting the efficiency and safety of the financial sector and the public interest.
 - Hosted by American Enterprise Institute (but independent of it)
 - 278 statements to date
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International Committees

- U.S. SFRC (www.aei.org)
 - European SFRC (www.ceps.be)
 - Japanese SFRC
(www.econ.keio.ac.jp/staff/masaya/shadow/shadow.html)
 - Asian SFRC (www2.hawaii.edu/~fima)
 - Latin-American SFRC (www.claaf.org)
 - Australia-New Zealand
(www.melbournecentre.com.au)
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Joint Statement of International Committees, August, 2009

- *Making Securitization Work for Financial Stability and Economic Growth*
 - Background
 - Securitization had worked well and contributed to economic growth prior to the GFC
 - Flaws in sub-prime securitization included
 - Due diligence breakdowns throughout process
 - Compensation based on short-term outcomes
 - Inadequate regulation
 - US GSE demand for sub-prime securitizations
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Joint Statement

- Proposals/Solutions
 - Transparency: public availability of all information given by issuers to credit rating agencies
 - Disclosure of rating outcomes for all issues (to enable better evaluation of alternative ratings agencies), including issuers to reveal preliminary ratings
 - Fees to participants to be linked to gradual return of principal
 - Regulation: review Basel II, eliminate dependence of regulation on credit rating agencies
 - Discourage OTC derivatives
 - Improve regulation/supervision of monoline insurers
 - Standardization/simplicity of structure of securitized products
 - For emerging markets
 - Careful consideration of type of securitization model



ANZSFRC Statement, 22 Sept 2009

- *Is Credible Exit from Government Debt and Deposit Guarantee Programmes Possible?*
 - Background
 - Australia and NZ introduced schemes in Oct 2008
 - Deposit guarantees (as currently apply)
 - Until late/end 2011
 - NZ scheme permits broader range of institutions
 - Different level of coverage (AUD 1mill, NZ ½ mill)
 - Different fee arrangements
 - Wholesale Funding Guarantees (WFGs)
 - New borrowings, risk based fees
 - Until conditions “normalize”
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Aust/NZ Deposit/Debt Guarantees

- Some principles
 - Governments should generally avoid providing guarantees
 - Some explicit guarantees may be unavoidable. In such a 2nd best world distortions resulting from guarantees may justify other regulatory “distortions”
 - One size doesn’t fit all. Removal of guarantees over the stock of outstanding deposits can be different to that over flow of new borrowing
 - Guarantees should, if possible, be priced appropriately. If not, indirect/implicit charges may be justified
 - Rapid Access Matters. The future financial safety net structure should ensure rapid resolution when failures occur.



WFGs

- Pricing of fees for WFGs is linked to ratings, but is essentially arbitrary.
- WFGs create market distortions and contingent risks for governments
- Removing WFGs only affects marginal cost of bank funding (if at all given “normalization” of markets) and is credible signal that problem was market liquidity rather than bank solvency
- *the Australian and New Zealand governments should, with all due haste, identify a parsimonious set of conditions that define a return to “normal” conditions. As soon as these conditions are satisfied, the WFGs should cease operating, i.e., the governments should stop offering any new loan guarantees.*



WFGs

- WFGs were introduced because of market failure due to asymmetric information issues
 - 1st best solution is to eliminate information failure
 - But is an international problem
 - Potential to recur (even with coordinated international actions)
- Regretfully anticipate future where WFGs are occasionally used as a policy response
 - Risk of banks acting under assumption of a “funding guarantee call option”
 - *we recommend that governments develop a (i) transparent and (ii) credible set of conditions that explicitly spell out the circumstances that must exist before the temporary establishment of any future WFG schemes.*



Deposit Guarantees

- Introduced to preserve depositor confidence
 - Overall and in smaller v TBTF institutions
 - Also ensure retail investors have access to “risk-free” asset
- Impossible to credibly return to a claimed “no deposit insurance” *caveat emptor* world
 - Either implicit or explicit insurance now applies
 - Design of suitable scheme critical – many options possible



Deposit Guarantees

- Unlikely to have full risk-based pricing of guarantees
 - the DGS may need to be accompanied by various measures that mitigate excessive risk taking and support competition.*
 - Limited coverage (perhaps only transactions accounts), perhaps optional insurance for others
 - Some form of Prompt Corrective Action
 - Increased disclosure, director liability
- Provide alternative risk free (government bond) assets for retail investors



Deposit Guarantees

- *Whatever features are ultimately settled on, we recommend that the principles and characteristics of this replacement scheme be announced and introduced as soon as possible, subject to legislative constraints.*

