

Deficiencies in the Legal Framework as a contributing Factor to the present Crisis

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Syllabus

A. Fundamentals

B. Analytical basis

C. Problem areas

A. Fundamentals

- I. Exacerbation of the crisis
- II. Global activities – national remedies
- III. The beneficial effects of the single European currency
- IV. Conclusion: overall failure

I. Exacerbation of the crisis

- Imminent bankruptcy of the banking system
- Nationalization of major banks or all banks
- Insufficiency and inefficiency of rescue programs
- Insolvency of sovereign states

I. Exacerbation of the crisis

Four essential illusions:

- Confinement to a limited segment of financial markets
- Immunization of the rest of the world
- Decoupling of the “real” economy
- Salvage by the emerging economies

II. Global Activities-National Remedies

- Financial institutions acting global as going concern
- Local legal entities when subject to administrative actions
- Recourse to sovereign states as savior

III. The beneficial effects of the single European currency

- Stability by sheer size
- Avoiding race for depreciation
- Enhancing discipline among sovereign states

IV. Conclusion: Overall Failure

- Malfunction of the legal system
- Failure of all other safeguards
- Consequence: strict scrutiny of all rules and procedures

B. Analytical Basis

- I. Precise Language
- II. Basic Distinctions

I. Precise Language

Legal system:

- Norms and their application
- Other administrative and judiciary actions

Vague language: “regulation” and “regulators” should be avoided.

II. Basic Distinctions

- Legal norms
- Non-legal norms
- Customs and other directing mechanisms
(e.g. “market forces”, “codices”, “memoranda of understanding”, “business judgment”)

II. Basic Distinctions

Origins of legal norms and actions:

- State
- Federal
- International and supranational (EU)

C. Problem Areas

- I. Securitization
- II. Monetary policy
- III. Rating agencies
- IV. Compensation schemes
- V. Supervision and control
- VI. Capital requirements
- VII. Accounting rules
- VIII. Deposit insurance and guarantee schemes
- IX. Nationalization and state banks

I. Securitization

- The “product”
- The sale

II. Monetary policy

- The emergence of the bubble
- Causes? (e.g. structural misperception of economic situation, steady decline of long term real interest rates)
- Effects? (e.g. persistent current account imbalances, persistent and growing trade surplus of emerging countries)

II. Monetary policy

Central bank policy:

- Focus on consumer price indices as gauge for “price stability” mandated by Art 105 para. 1 EU-Treaty
- Financial stability as task of the ECB, Art. 105 para. 5 EU-Treaty
- Asset prices as binding factor for monetary policy?

III. Rating agencies

- Structural flaws
- Lack of competition
- New neutral institution as public service

IV. Compensation Schemes

Management:

Short term orientation of compensation for management

Retail:

Fee driven sale of financial “products”

V. Supervision and Control

International organizations

- IOSCO
- BIS
- Basel Committee on Banking Supervision
- IMF

Multilateral treaties

V. Supervision and Control

European level:

- CESR
- Exchange of information
- New institution of the EU
- Extension of powers for the ECB

V. Supervision and Control

National level:

- Single supervisory agency (e.g. FSA)
- Central banks as banking supervisors
- Deposit protectors
- Dual/multiple systems

Key question: independency

VI. Capital Requirements

- Implementation of Basel II (pillar 1)
- Internal rating based approach (IRB-approach)
- Higher statutory capital requirements

VII. Accounting Rules

- Off-balance sheet instruments and guarantees
- Procyclicality of “fair value accounting”

VIII. Deposit insurance and state guarantees

- Implicit vs. explicit guarantees
- Deposit insurance vs. solvency guarantee for institutions
- Statutory obligation to protect bank deposits on a private basis

VIII. Deposit insurance and state guarantees

- Raising the minimum level of coverage to €100 000
- Maximum lapse of time for recovery
- Grant of legal entitlement to depositor

VIII. Deposit insurance and state guarantees

- Risk adjusted fee for protection
- Supervisory powers for the protection granting institution

IX. Nationalization and State Banks

Takeover of the business:

- Government orders to hand out loans
- Restructuring of institutions
- Developing new viable business models
- Government insurance for bank assets
- Creation of “bad banks”

IX. Nationalization and State Banks

Government sponsored “bad banks”

- Auction for lowest price of “toxic” assets
- Measure only after nationalization
(e.g. Resolution Trust Corporation in U.S.,
Sweden)

IX. Nationalization and State Banks

The stake of the general public:

- Effective control over the disposition of tax money
- Need for easy and transparent products
- Need for an absolutely safe “simple” bank?

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