How to deal with SIFIs?

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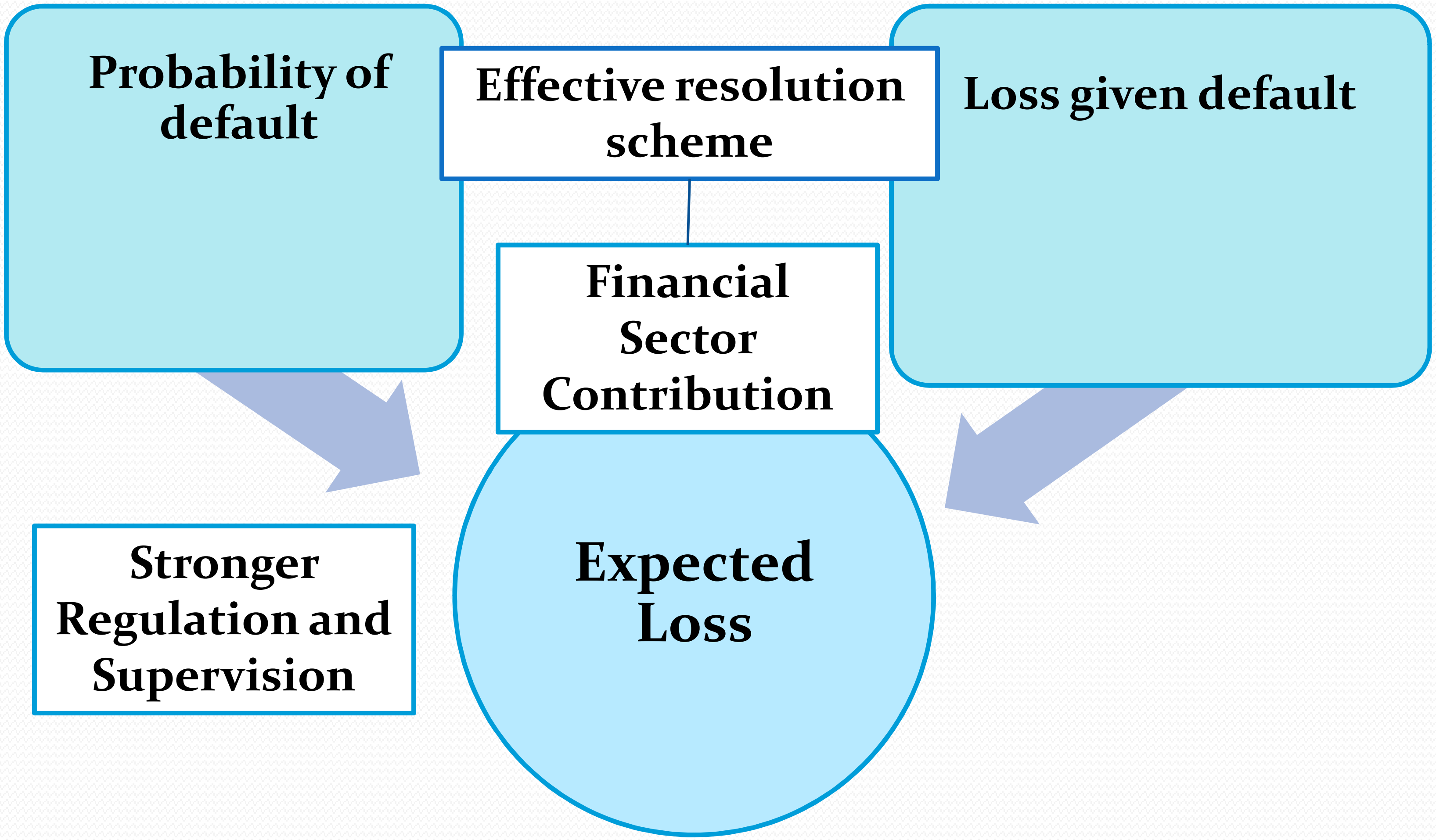
Financial Reform Conference
September 3, 2010

Cost of the current crisis

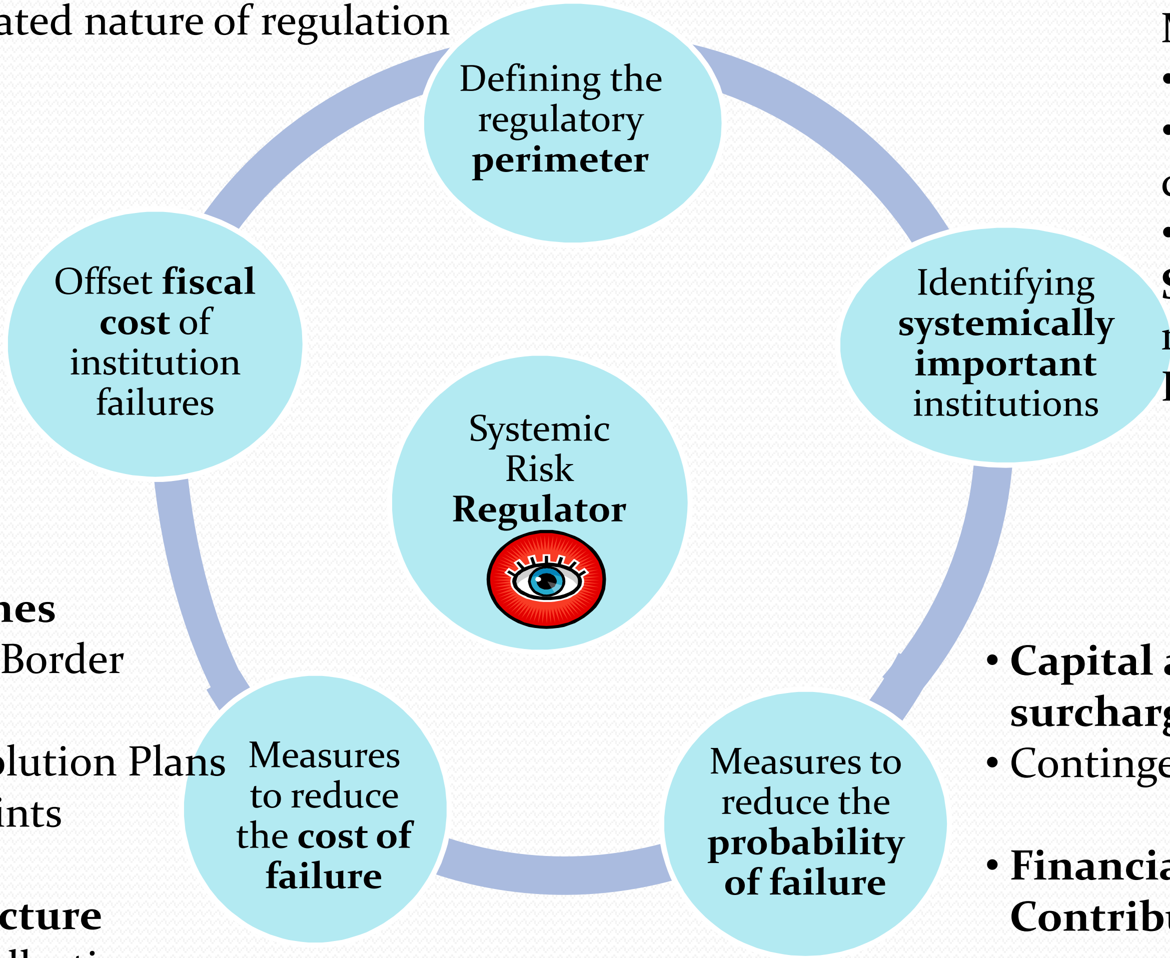
- Unprecedented public support in advanced G20
  - Amounts pledged: 25% of GDP
  - Gross support: 5% of GDP
  - Fiscal cost (net of recovery to end December 2009): 2.8% of GDP
    - UK: 5.4%, Germany 4.8%; US: 3.6%
  - Increase in public debt to GDP: almost 40%
  - Cumulative output loss in crisis G-20: 27% of GDP

Building blocks of a new system



Systemic Risks
Measure, Assess and Mitigate!

•Differentiated nature of regulation



Methodology
•Size
•Inter-connectedness
•Substitutability
Systemic liquidity risk?
Information Gaps

- **Taxes** on financial sector

- **Resolution regimes** National and Cross Border

- Recovery and Resolution Plans
- Structural constraints

- **Market infrastructure** CCPs, CRAs, data collection

- **Capital and liquidity surcharges**
- Contingent capital (?)

- **Financial Stability Contribution**

Financial Stability Contribution

- Levy on *all* financial institutions – linked to resolution
  - Base – balance sheet assets/liabilities, risk-weighted assets.
  - Rate – risk based
  - Perimeter – can apply to *all* SIFIs
  - Incidence – depends on supply/demand elasticities, some pass-through to customers.

- Link to systemic risk contribution of SIFIs
  - Accounting measures related to systemic risks
  - An increasing, risk-based rate

Capital Surcharges

- Systemic risk-based capital surcharges.
  - Solvency tool (mostly).
  - Relate (loss-bearing) capital to a measure of systemic risks.

- Measure of systemic insolvency risk is important.
  - Market based signals – e.g. CDS spreads, equity options – of joint/conditional probability of default – "CoVaR."
  - Actual exposure data to compute conditional probability of default.
  - Should avoid a procyclical measure.

- Incentives/disincentives can be complex.

GFSR Method

Constructs a capital surcharge related to systemic (solvency) risk – April 2010 GFSR

- Step 1: Track financial institutions' portfolios through the credit cycle.
- Step 2: Estimate each institutions spillover effects following a stress event, at each point in the cycle.
- Step 3: Compute capital surcharge as a function of an institution's systemic risk to others.

FSC versus Capital Surcharges

- Both are attempting to “price” the externality, *ex ante*.
  - More economically efficient than quantity (activity) constraints
  - If designed properly should be able to mitigate systemic risks

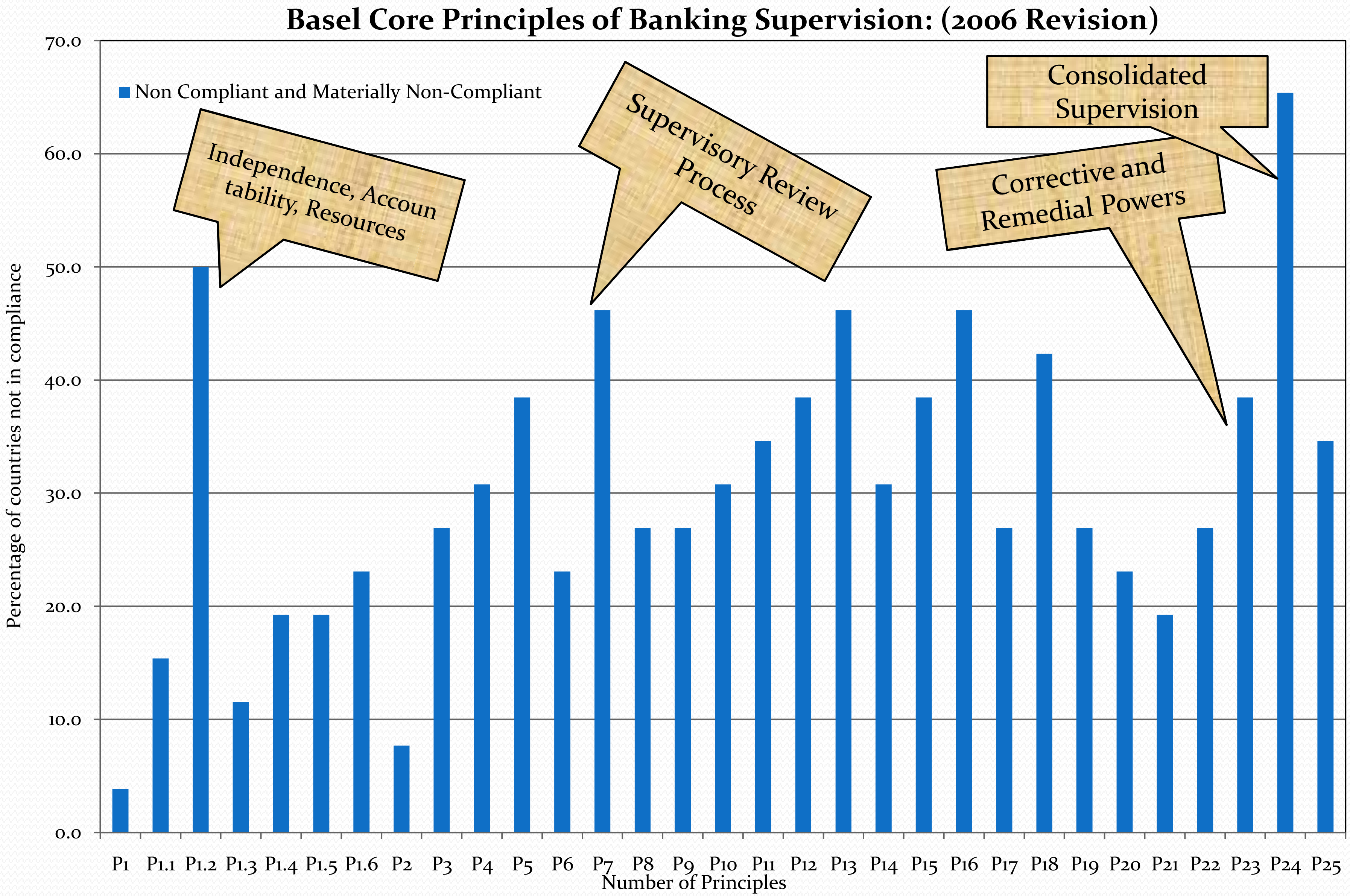
- FSC
  - Easy to implement; can apply to *all* SIFIs; intertemporal
  - But coordination needed; not a buffer for individual institution

- Systemic risk-based capital surcharge
  - Methods are extensions of existing risk capital charges.
  - But may be sensitive to market conditions and/or procyclicality.
  - Capital held by firms may not mitigate other systemic risks.

Cross Border Resolution Framework for Enhanced Coordination

- Amendments to domestic legislation to allow cooperation
- Core coordination standards on supervisory and insolvency frameworks
- Criteria and parameters guiding burden-sharing process
- Procedures for coordinating resolution measures across borders

Supervision is also critical…



Thank you