Financial Regulatory Reform

After the Crisis: An Assessment

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The Core Elements of Post-Crisis Reform

1. Making financial institutions more resilient.

2. Ending “too-big-to-fail.”


4. Transforming shadow banking.

5. Improving trade competition.

The first four are the “core elements” of the FSB 2015 Progress Report.
Making financial institutions more resilient

Example: Improving CET1 capital ratios of EU banks

Data source: European Banking Authority

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Making financial institutions more resilient

What is the impact of regulating dealer-bank capital structure on market making?
More equity to fund more assets

- Assets
  - Debt
  - Equity
- Old assets
  - Debt
  - Equity
  - New assets
  - New equity
Higher capitalization implies a value transfer from legacy shareholders to creditors.
For shareholders to break even, the new assets must be purchased at a profit that exceeds the value transfer to creditors.
Impact of supplementary leverage ratio rule on repo markets

Debt overhang dampens repo intermediation incentives, widening bid-offer spreads

The modeled impact on repo bid-ask spread is $2 \times \text{SLR} \times \text{credit spread}$. 
Estimated impact of SLR on USD repo-rate bid-ask spread

Average within-quarter difference between overnight GCF and Tri-party repo rates.
Data sources: Bloomberg and BONY Mellon
Decline in GCF repo net lending volume

Source: Martin (2016)
Total repo volumes in Europe

ICMA semi-annual repo market survey
(outstanding amounts)

Source: ECB, from ICMA repo market survey 8 December 2015
Making Derivatives Markets Safer

Example: Clearing of swaps in central counterparties
Making Derivatives Markets Safer

Significant progress with reducing swap exposures, especially from compression trading

Data source: Bank for International Settlements
Improving Trade Competition

Legacy bilateral OTC markets were inherently uncompetitive
Improving Trade Competition

Example objective: Migration of active products to all-to-all trade platforms
Typical response of market design

Buy-side firms request quotes at multilateral trading platforms
But with excessive fragmentation across platforms
Reducing fragmentation improves competition

\[ c_1 \rightarrow \text{MTP} \rightarrow d_1, d_2, d_3 \]
At corporate bond platforms
Dealer competition lowers buy-side trade costs

Source: Hendershott and Madhavan (2014)
Fragmented two-tiered OTC markets