FINANCIAL STABILITY

Professeur(s) : Françoise DRUMETZ & Christian PFISTER
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COURSE SESSION

Session 1: General presentation of the course/Notions (beginning): definition of financial stability, financial fragility, leverage and liquidity, moral hazard and Too Big to Fail (TBTF)

- Is there a cost to financial stability?
- Is finance intrinsically instable?
- Market liquidity/Funding liquidity
- Why is moral hazard an issue for financial stability?
- If banks are TBTF, it is because they are too big to start with: Comment on that statement
- Is TBTF an issue for financial stability?

Required reading


Session 2: Notions (continuation)/ Financial crisis (beginning): bubbles and contagion; systemic risk; what is a financial crisis?

Exposés

- Rational bubbles
- Contagion: what does it mean?
• Can we eliminate systemic risk?
• Do we have a good theoretical explanation of financial crises?

**Required reading**


**Session 3: Crisis (continuation): what were the roots of the crisis?**

**Exposés**

• A historical perspective: is the last financial crisis different?
• A financial crisis or different crises?
• Should we be afraid of the shadow banking system?
• A modern version of “bank runs”?
• Leverage and procyclicality
• Global imbalances and the financial crisis
• International financial linkages and the financial crisis

**Required reading**


**Session 4: Incentivizing (beginning): motivation and modalities of a public intervention; innovation and financial stability; managing moral hazard in financial market infrastructures**

**Exposés**

• Incentives versus constraints: What are the trades-offs?
• Positive versus normative approach to financial regulation: What are the consequences for regulatory reform?
• Should financial innovation be patented?
• Do risk management measures in financial market infrastructures just move risk around? If it does, can it still be useful?

**Required reading**


**Session 5: Incentivizing (continuation): role of rating agencies; securitization; accounting standards; governance; reducing moral hazard (definition of financial contracts; resolution of institutions)**

**Exposés**

• Rating agencies; do we need them to implement financial stability policies?
• Is securitization detrimental to financial stability?
• Mark to market: Should we kill the messenger bringing bad news?
• What is “good governance” from a financial stability point of view?
• What are the best ways to reduce moral hazard in financial activities?
• What is an efficient resolution mechanism?

**Required reading**

Session 6: Incentivizing (continuation): taxing ; remunerating

Exposés

- In which sense can noise trading be dangerous for financial stability?
- Is the TFT useful from a financial stability point of view?
- Regulating the structure of remunerations versus regulating their level
- Are traders overpaid?

Required reading


Session 7: Constraining (beginning): institutions (deposit insurance, limitation of activities)

Exposés
• Do we need an insurance deposit scheme?
• Should banks activities be limited? If yes, to what extent and how?
• Vickers/Volcker/Liikanen: A comparison
• Should shadow banking be regulated? How?

Required reading

Session 8: Constraining (continuation)/Liquidity and solvency standards (beginning): financial markets (high frequency trading, short sales, use of market infrastructure, dark pools); costs of liquidity and solvency requirements

Exposés
• Is short selling destabilizing?
• Does HFT create risks for financial stability?
• OTC derivatives central clearing: a panacea
• Is bank capital costly? Does it matter?

Required reading:


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**Session 9: Liquidity and solvency standards (continuation): Basle I, Basle II, shadow banking system and pro-cyclicality; Basle III**

**Exposés**

- Why did banks behave pro-cyclically under Basle I/II?
- How does Basle III improve on Basle II?
- Leverage vs solvency ratios
- Does it make sense to impose liquidity ratios on banks?
- Liquidity ratios: State of play
- Can insurance companies create systemic risk?
- What is a “good” bank supervisor?

**Required reading**

Session 10: Macroprudential policies: objectives, indicators, instruments and implementation issues (communication, coordination, information needs), the Dodd Franck Act

Exposés
- Why do we need macroprudential policies?
- Is the credit/GDP ratio useful for macroprudential policies?
- Stress tests: Are improvements necessary?
- Are indicators of systemic risk useful?
- What instruments does the macroprudential authority have at its disposal?
- Should there be limits to the transparency of the macroprudential authority?
- Micro and macro surveillance of the financial system

Required reading

Session 11: Economic policies and financial stability: monetary policy (lender of last resort, role of financial stability considerations, fiscal dominance); fiscal policy; public (tax, competition, housing) policies

Exposés
- Lender of last resort: classic versus modern
- What is financial repression? Do we need it?
- Fiscal policy and inflation: a tale of two theories?
- Would financial stability be fostered by a pre-emptive strike of the central bank?
- Are inflation targeting strategies undermined by the financial crisis?
- Monetary and macroprudential policies: undesirable Interactions?
- The financial stability-fiscal policy nexus
- A trigger? Tax policy and the real estate bubble
- Are GSEs such as Fannie Mae etc. useful?
- Should bank competition be encouraged?
Required reading

- Bagehot, (1873), Lombard Street, H. S. King, London.

Session 12: Institutions: general, international and European aspects

Exposés

- What role should the central bank have in the institutional architecture of financial stability?
- Is it possible to avoid the capture of the financial regulator?
- Does the IMF have a role to play in the realm of financial stability at the global level?
- Is there a need for an international lender of last resort?
- Private sector involvement: who opposes it and why?
- Should risks be shared in the euro area? If yes, how?
- Are fiscal councils useful?
- Have the flaws in the SGP been corrected with the Treaty on Stability, Coordination and Governance (TSCG)?
- How can a euro area resolution mechanism be created?

Required reading