Summary of the Discussion of the Paper by CHARLES A.E. GOODHART

TILO KAUFMANN

In replying to BALTENSPERGER’s comment, GOODHART noted that from his point of view many regulations and laws (e.g. investor protection) were imposed as much for political reasons as for economic reasons (i.e. systemic risk). As a case in point, he cited the Financial Services Act (FSA) in the UK. In fact, the FSA was enacted principally to prevent the misuse of client money by fund management. Systemic risk hardly played a role. Along the same lines, GOODHART observed that the Securities and Investment Board had mainly dealt with the mis-selling of pensions in recent years. Finally, he remarked that the loss of a significant amount of money by insufficiently informed investors was definitely a political issue but maybe not an economic one.

Discussing further BALTENSPERGER’s comment, GOODHART observed that the economically most interesting aspect of regulation concerned the question of whether sanctions on management should be linked to the causes of default (idiosyncratic vs. market-imposed). In his opinion the present structure of management incentives already introduced a quite sufficient and satisfactory penalty on the individual manager of an individual bank which operated less well than the competition. According to GOODHART, one is bound to reinforce the herd instinct, which tends to cause systemic problems, by adding aggregate regulatory differentials.

In replying to HELLWIG’s question of whether external controls play any role in his framework, besides guaranteeing that the internal control mechanisms work properly, GOODHART argued that Capital Adequacy Rules (CAR) were needed to ensure that the managers would not act too risk-loving. The latter could occur despite the most sophisticated internal controls.

In respect to the desired simplicity that CAR should ensure ZUBERBÜHLER expressed doubt that the Amendment to the Capital Accord of the Basle Committee (1996) met this requirement. GOODHART accepted ZUBERBÜHLER’s point but added that the assessment of banks’ risks position could not be simple. That is why internal control mechanisms are needed. However, it has to be assured that the managers and owners have enough at risk themselves to prevent them from taking on excessive risks. In short, internal and external regulation ought to become much more sophisticated according to GOODHART.

Taking up on ZUBERBÜHLER’s remark that the composition of the New Zealand banking industry – mainly subsidiaries of top-rated foreign banks – was too special to be regarded as a valuable example, GOODHART admitted that New Zealand’s policy could indeed not be generalised. Notwithstanding these qualifications, he felt nevertheless that the New Zealand approach could serve as a suitable guide for other countries.
MANZ questioned the need for external regulators and suggested that they should be replaced by rating agencies. GOODHART was prepared to concede in principle that a world even without any external regulation might, in the long run, be not worse off than a world with external regulation. However, he pointed out that at the very first crisis, one was bound to reimpose external regulation for political reasons.

GOODHART was convinced that the issue pertaining to the appropriate incentive structure raised by CROCKETT was a crucial one. In fact, he found a conflict to exist between the objectives of supervision transparency and bank confidentiality. Particularly, the time horizon needed to be analysed thoroughly in order to overcome this conflict of objectives.

At the end of the discussion, BOOT remarked that the lack of transparency was likely to protect the top management’s interests, since it prevented its reputation from being worsened by financial crisis. Therefore, he suggested doing away with the intransparency regarding the resolution of financial crisis. In contrast to BOOT, GOODHART was not sure about the priority of transparency over confidentiality. He admitted, however, that this was a point worth discussing.