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Bull by the Horns – Persistent dilemmas of the banking system and the tightness of reins*

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Sheila Bair:
Bull by the Horns – Fighting to Save Main Street from
Wall Street and Wall Street from Itself
New York: Free Press, 2012, p. 415
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Hundreds of books have addressed the history of the financial crisis that started in 2007. Nearly all stakeholders have drawn conclusions, from influential economists through politicians and consumer protection activists to famous or infamous bank executives. The highly autobiographical publications by key protagonists of crisis management form a separate subcategory, giving readers a behind-the-scenes look at the events. Tim Geithner, former president of the New York Fed and United States Secretary of the Treasury between 2009 and 2013 (*Geithner 2013*), Ben Bernanke, who headed the Fed between 2006 and 2014 (*Bernanke 2015*), and Henry Paulson, who served as United States Secretary of the Treasury between 2006 and 2009 (*Paulson 2010*) have all authored their own memoirs of the crisis.

These three figures are also key protagonists in the memoir written by Sheila Bair, entitled *Bull by the Horns*, which has not yet been published in Hungary. Bair is less of a household name in Hungary, but is widely known in the US for her emblematic role in crisis management, having served as the chair of the Federal Deposit Insurance Corporation, the US banking supervision and resolution authority between 2006 and 2011, the most turbulent period of the crisis. She had a key responsibility in addressing the hundreds of bank failures, took part in negotiations for creating the global regulatory response referred to as Basel III, and played an active role in rethinking the US financial supervisory framework. She recounts these events in depth through her accessible, yet professionally objective writing.

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At the same time, one may ask: can a book published in 2013 still offer something in 2016 as a myriad other publications have since covered the same topic?

The value of *Bull by the Horns* lies mainly in the the fact that its questions, dilemmas and recommendations remain relevant today. The core conceptual dilemma that permeates the entire book is how tight the rein needs to be kept on financial institutions. Bair is relentlessly rigorous in this regard. In her view, moral hazard is encoded into bank operation: credit institutions have a tendency to take on excessive risk that exceeds the socially optimal level. For one, because deposits are insured by deposit insurance funds, even risky, poorly run banks are able to easily collect funds at a low cost. In addition, institutions can count on being bailed out by the state, which does not allow them to become insolvent. Thus, neither their shareholders or professional creditors need to fear losing their capital or loan-type investments in banks. These two factors may foster reckless operation, and Bair deems that this was a major factor in the emergence and escalation of the crisis, which climaxed with the bailouts of banks and investment firms, costing taxpayers billions of dollars. (The book presents the history of these bailouts and the related internal debates from the front lines— perhaps the most valuable parts of the publication.) Moreover, the role of the state as a regulator is also ambivalent in light of the foregoing, because as long as banks are driving the economy, it also has an interest in growth, as presented by Bair in her chapter on the banking system's golden years.

Accordingly, the main dilemma and challenge for regulators remains the same even today, three years after the book's publication. In the meantime, many things that were recommended also in the book have been implemented. International capital requirement standards have been raised. Many countries (including Hungary) have introduced a resolution framework, also prompted by Bair. Financial market supervision has been reinforced: by establishing macroprudential powers on the one hand, and with the integration of formerly fragmented — and thus weak and at times inconsistent when faced with market players — authority structure on the other hand. (The latter was only partially achieved in the US, but implemented for the most part in the euro area by vesting the ECB with a supervisory function.)

At the same time, many members of the G20 are still struggling to relaunch economic growth, and more specifically, to stimulate lending. There is an ongoing debate on whether financial regulation has become excessive and on the leeway that should be given to banks in defining their capital requirements. Furthermore, relaunching securitisation, which was considered as one of the root causes of the crisis a few years ago, also became an objective. Regulations were introduced to govern the entities of the shadow banking system, which are not or only barely covered by financial supervision and regulation (and which also contributed to the emergence of the crisis), while various fintech companies, crowdfunding platforms or virtual currencies – all of them falling outside the supervisory radar – are seeing a rapid rise.

In her book, Bair vigorously presses for passing the cost of the bailouts of large financial institutions (Bear Stearns, AIG, Citigroup, etc.) using taxpayer funds on to shareholders and large institutional creditors. In the period that has since elapsed, we have seen precedents for this, i.e. the approach of the authorities has been tightened in this regard, in line with the author's recommendation. At the same time, the case of Portugal's Novo Banco in early 2016 – where losses were passed on to bondholders rather than taxpayers – prompted strong objections from professional investors (*Financial Times 2016*). The debate on the tightness of reins remains as relevant as ever.

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