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The ghost of Paul Volcker: is “too big to fail” returning to the centre stage?

Blog post by Adviser Leo Ringer, 22 February 2016

Global regulator the Financial Stability Board is at pains to cast banking reform in 2016 as an implementation exercise, not a policy-making one. But the ghost of Paul Volcker lives on in the US as the question of ending ‘too big to fail’ returns to the fore.

Mark Carney set out the Financial Stability Board’s agenda for 2016 in a letter to the G20 yesterday that confirms what had been suspected: the global regulator now sees the banking reform challenge as one of implementation, not of further policymaking. If anything, the FSB hints at the potential winding back of measures “where any material unintended impacts have been identified”, and in doing so follows the lead of the European Commission, which is conducting its own review of post-crisis financial regulation. So far so good: the industry has long awaited the transition from a period of intensive policy-making into one in which the regulatory dust is allowed to settle.

But reading the FSB letter in a broader context quickly puts paid to this optimism. In the US, we have just seen a leading regulator tug at a loose thread which could see the American consensus on banking reform unravel.

A fragmenting consensus?

Neel Kashkari, President of the Minneapolis Fed and architect of the TARP programme has delivered a set of hard-hitting remarks about too big to fail, arguing that further reform is needed. Kashkari’s comments are an important reminder of how vulnerable the ‘consensus’ on post-2008 bank reform is in the US: the Fed has long been a reluctant supporter of the Basel III overhaul and has sought to tighten it through leverage ratios and the “total loss absorbing capital” (TLAC) debate.

Carney’s letter to the G20 does not acknowledge this dissent and instead holds a firm line on the implementation focus, which echoes a recent speech in which he stated “in short, there will be no Basel IV”. Kashkari’s enthusiasm for going further is undoubtedly not shared at the top table of global financial regulation. But he went further than simply calling for tighter capital adequacy rules, by resurrecting the ghost of Paul Volcker and, in turn, questions of bank structure and size.

Risks to industry

The risks for industry here are material. First, the reinvigorated debate in the US has the potential to reverberate across the Atlantic and to awaken a dormant EU directive on bank structural reform, which industry hopes will be quietly removed from the legislative pipeline later this year.

Second is the risk that Kashkari's narrative is picked up by both Hilary Clinton and Donald Trump, neither of whom have been vocal defenders of Dodd Frank. In an increasingly febrile electoral atmosphere, both would be sorely tempted to collect the points on offer for running an anti-big-bank strand to their campaigns.

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