SIFI Rules Are Recasting Global Banking

What Does SIFI Status Mean for Banks?

Knowledge@Wharton: So these are the biggest of the big banks. They are the usual suspects when you talk about the biggest banks in the world. What are the implications, from a bank point of view, to being designated a global SIFI?

Vangel: Most significantly would be enhanced prudential standards, the most prominent of which would be higher capital requirements. The Basel committee has a framework that would have these GSIBs hold more capital than other banks to account for their significance and to provide extra cushion against insolvency.

Knowledge@Wharton: Itay, from your point of view, what are some of the positive and negatives implications of all of this.

Itay Goldstein: From the regulator's point of view we have to ask, what is the role of having this designation before a crisis even started? I think they see the chaos that we saw in the recent financial crisis, where a few financial firms basically brought the financial system to its knees. And this led to very quick government reaction, injecting capital into banks in the form of TARP, etcetera. So what they want to do is avoid future financial crises by identifying these institutions ahead of time and regulating them, asking them to hold more capital so that, first of all, you reduce the probability that they're going to go into default; and second, if push comes to shove and there is a crisis, then the consequences will not be as severe. This is the logic behind being designating a SIFI for particular banks. But one thing that I think we should question is to what extent this is actually necessary. At the end of the day, we know which banks are big, which banks are interconnected, which banks are complex and which banks can bring the financial system to its knees. And should we really have this definition whereby if you hold more than $50 billion in capital, you have more than $50 billion in assets, you are designated a SIFI status and if you have below that you don't get this status?

I'm not sure, because I think this definition is going to create a lot of complexities. For example, some banks may find it worthwhile to stay just below the threshold and not be called a SIFI. And as a result they will change their business structure, change their policies so that they're not called a SIFI — officially. But then when there is a crisis and these banks do get into trouble, probably the regulators will face similar issues to what they did in the recent crisis. Even though these banks were not called SIFIs, they're still systemically important and then we will need to inject capital into those banks once a crisis erupts.

Knowledge@Wharton: The Financial Stability Board is charged with looking at this from a global point of view. But how does their regulation actually get transmitted down to the banks?

Schlich: This is where it gets interesting because clearly there needs to be a global understanding on how we're going to move forward and what the regulations should be. But then, when it gets implemented, it gets reviewed at a national level and that's where the issues come in. So, will all the countries apply the regulation the same way and will all of them look the same? That's where you begin to get concerned about regulatory overcharge and trying to take advantage of different regulators and the different ways in which it's been implemented.