

# Financial Regulation before and after the GFC

# Course Outline

- 1/ Why regulate?
- 2/ The phases of financial regulation before the global financial crisis: from Bretton Woods regulation to neoliberal deregulation and financial globalisation
- 3/ “The System Worked” and how the authorities and the G20 re-regulated after the GFC



# The flaws of “free banking” (ChatGPT, 9 October 2025)

- 1/ Lack of a uniform and reliable currency
- 2/ Poor quality of collateral (state bonds not very reliable)
- 3/ Bank failures and “wildcat banking”
- 4/ Absences of a lender-of-last resort
- 5/ Geographic fragmentation (in contrast to the US tariff-free market)
- 6/ Recurring “panics”

**What is today’s equivalent?**

## Key objectives of regulation (based on DeepSeek, 9 October 2025)

1/ to ensure systemic stability and prevent financial crises

2/ to protect consumers and investors

3/ to promote market integrity and efficiency

4/ to prevent financial crime

5/ to enhance macroeconomic stability

to ensure functioning of the payments system ([Sketch Jasper Carrot: “a large-scale nuclear attack \[...\] would completely disrupt the banking system...”](#))

# The Inherent Trade-Offs (ibid)

- Compliance costs
- Reduced innovation (after the GFC, Paul Volcker: “the only thing useful banks have invented in 20 years is the ATM”)
- Moral Hazard – when institutions believe they will be “bailed out”
- Adair Turner: the fundamental trade-off is that growth needs credit, but debt finance always becomes risky.

# The Great Crash and Great Depression

- The Stock Market crash spilled over into the wider economy, via bank failures (with knock-on effects in Europe – contributing to the rise of fascism and Nazism – and ultimately World War II)

Post-crash regulation ([A Brief History of Financial Regulation in the USA, SideDrawer, April 10, 2025](#)):

- 1/ [Glass-Steagall Act 1933](#): separated commercial & investment banking; and created created the Federal Deposit Insurance Corporation (FDIC);
- 2/ Securities Act of 1933: information – “truth in securities”
- 3/ Securities Exchange Act of 1934: to oversee the exchanges

# The Post-World War II World of Monetary and Financial Stability

Building on the 1930s:

- 1/ Credit allocation, credit controls, interest rate setting (Regulation Q):  
reserve requirements
- 2/ Limited capital mobility as most countries had capital controls
- 3/ Exchange rates were fixed (though adjustable)

# 1970s - Stagflation and Deregulation

The breakdown of “Fordism”, the end of Bretton Woods (1971) and the first oil-shock (1973-4) led to stagflation in the 1970s, which in turn provoked a progressive paradigm shift in policies towards neoliberalism

- > monetary policy to control inflation
- > tax cuts
- > deregulation of economic activities, including banking as of 1980s
- > “market discipline”

# Self-regulation / “light-touch” regulation

Alan Greenspan



13th Chairman of the Federal Reserve

In office

August 11, 1987 – January 31, 2006

President

Ronald Reagan

George H. W. Bush

Bill Clinton

George W. Bush

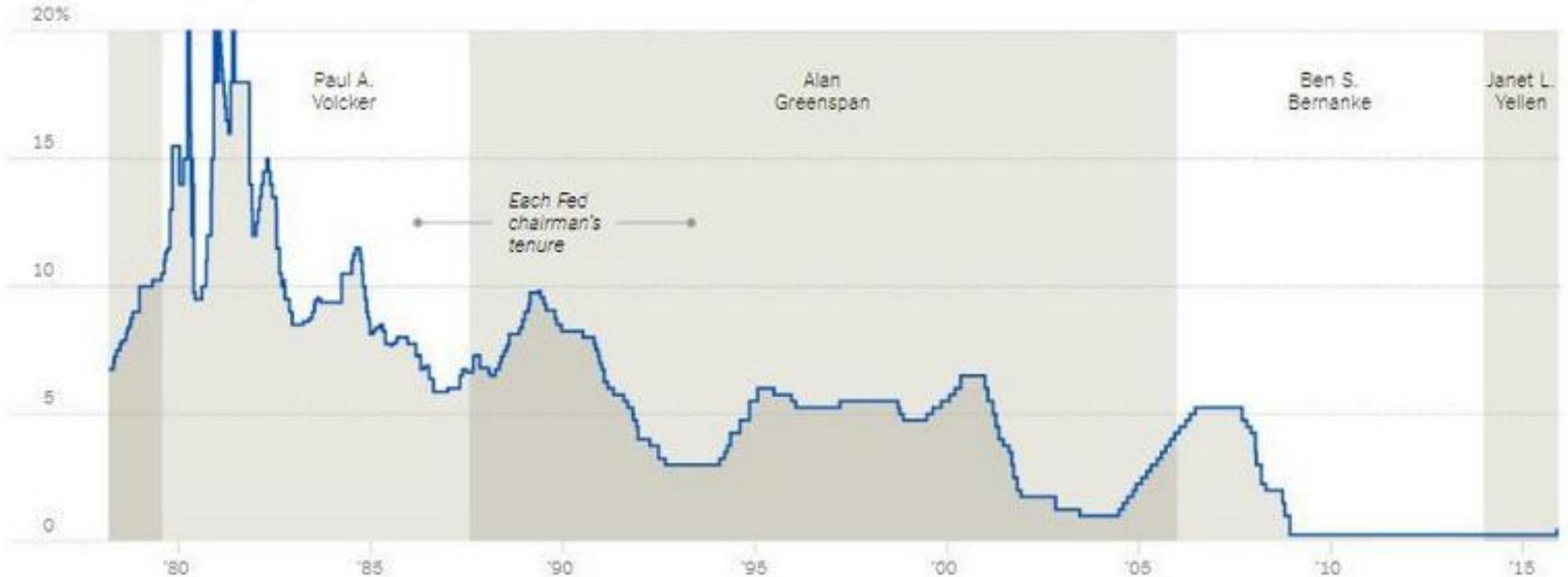
Greenspan – a true believer in “self-regulation” (economic individualism: [Objectivism](#) by Ayn Rand: “the concept of man as a heroic being”)

Government regulation is difficult, and not very effective > self-regulation

De-regulation of banking, and no regulation of derivative trading

# The Great Moderation and the “Greenspan Put”

Federal Funds Target Rate



“Clean not lean” during bubbles and crashes > moral hazard

# “The System Worked” after the GFC (Drezner)

- The Fed and other central banks stepped in to support markets

- Governments provided short-term fiscal support

(Although there was a shift to austerity in Europe, in 2010, following Rogoff & Reinhart’s work on public debt and growth)

- A (re)newed drive to regulate finance

# Coordination through the G20

	Argentina	Cristina Fernández de Kirchner <sup>[20]</sup>	President
	Australia	Kevin Rudd <sup>[20]</sup>	Prime Minister
	Brazil	Luiz Inácio Lula da Silva <sup>[20]</sup>	President
	Canada	Stephen Harper <sup>[20]</sup>	Prime Minister
	China	Hu Jintao <sup>[20]</sup>	President
	France	Nicolas Sarkozy <sup>[20]</sup>	President
	Germany	Angela Merkel <sup>[20]</sup>	Chancellor
	India	Manmohan Singh <sup>[20]</sup>	Prime Minister
	Indonesia	Susilo Bambang Yudhoyono <sup>[20]</sup>	President
	Italy	Silvio Berlusconi <sup>[20]</sup>	Prime Minister
	Japan	Tarō Asō <sup>[20]</sup>	Prime Minister
	Mexico	Felipe Calderón <sup>[20]</sup>	President
	Russia	Dmitry Medvedev <sup>[20]</sup>	President
	Saudi Arabia	Abdullah bin Abdul Aziz <sup>[20]</sup>	King
	South Africa	Kgalema Motlanthe <sup>[20]</sup>	President
	South Korea	Lee Myung-bak <sup>[20]</sup>	President
	Turkey	Recep Tayyip Erdoğan <sup>[20]</sup>	Prime Minister
	United Kingdom	Gordon Brown <sup>[20]</sup>	Prime Minister
	<b>United States</b>	<b>George W. Bush<sup>[20]</sup></b>	<b>President</b>
	European Union (European Commission)	Jose Manuel Barroso <sup>[20]</sup>	President



President Bush and the other summit leaders at a working dinner in the East Wing of the White House.

# ... and worked... through Covid

- After massive financial market instability in March 2020
- The authorities stepped in... massively
- Monetary & fiscal support have been substantial
- But – significantly – the Trump administration did not coordinate policies.
- In Europe (and UK) – an effort not to repeat mistakes of moving to austerity too quickly. Support for keeping workers in their jobs (Germany pursued this policy after the GFC)

# G20 and Basel III

- Apart from dealing immediately with the GFC, G20 initiated principles of re-regulation, including:
- Higher reserve ratios and liquidity requirements:
  - Stronger Common Equity Tier 1 (CET1) capital (mainly [common stock](#) (i.e. shares):  $CET1/RWA \geq 4.5\%$  | ratios of risk-weighted assets.
  - Plus “capital conservation buffer”: mandatory 2.5% RWA
  - And “discretionary counter-cyclical buffer” (national regulators may require) 2.5%
  - Additional Tier 1 (AT1) Capital Requirement (Basel III+/IV): 1.5% RWATherefore total Tier 1 capital requirement is:  **$CET1+AT1=4.5\%+1.5%=6\%$**

In practice (according to GPT-4, 17 October 2023) US banks today have Tier 1 capital ratios of between 12% and 16% or higher, and in the UK 13% to 17%+

# Bank balance sheets

**Traditional commercial bank**

<b>Assets</b>	<b>Liabilities</b>
Reserves	Deposits
Short-term loans	Short-term debt
Long-term loans	Long-term debt
Other instruments	
	Shareholder equity

**Large (multifunctional/universal) bank**

<b>Assets</b>	<b>Liabilities</b>
Cash	Deposits
Loans	Other debt (mostly short-term)
Trading and other assets	Long-term debt
	Equity

Source: Anat Admati & Martin Hellwig, *The Bankers' New Clothes*, Princeton University Press, 2013.

# Risk-weighted assets

- **Banks have assets**, including central bank reserves, cash holdings, securities and loans. The riskiness of these loans varies, depending on collateral.
- Government bonds > mortgage-backed securities > unsecured loans (like consumer credit)
- These are weighted to give an idea of banks' overall asset risks, and hence their capital requirements. See <https://www.investopedia.com/terms/r/riskweightedassets.asp>
- Liabilities: check (cheque) and deposit accounts, borrowings, bank capital (net worth, funds from selling equity, retained earnings)

# Liquidity

- Leverage ratio  $CET1/Total\ exposure \geq 3\%$  (total exposure all consolidated assets, including non-balance sheet assets)
- Liquidity coverage ratio (LCR):

$$LCR = \frac{\text{High quality liquid assets}}{\text{Total net liquidity outflows over 30 days}} \geq 100\%$$

# New regulatory structures

- Monitoring of 30 Globally-systemically important banks (G-SIBs)...  
... by the Financial Stability Board (FSB), the Basel Committee on Banking (BCBS) and national authorities.

## **Involving stress-testing**

- Macro-prudential regulation of finance

# Other post- GFC measures

- Bank resolution procedures (“living wills”) have been established, to bail-in private investors.
- Standardised derivatives are now traded on exchanges (central counter-parties).
- Stronger consumer protection for households.



London  
Clearing  
House

# Potential weaknesses of post-GFC regime

- Much new regulation
- Little or no structural change in banking and finance
- Too-big-to-fail has become an even bigger problem
- Shadow banking activities – probably not regulated enough
- The essential nature of global finance seems unchanged

# Takeouts

- Long phases of deregulation and regulation of finance due to the inherent trade-offs between free finance and state control
- Major crashes lead to regulation
- Significant regulation after GFC – through international cooperation
- No structural reform
- Resilient to Covid-19 shock & to the rise in interest rates since late 2021 – so far
- Currently, a new phase of push-back against regulation
- Macro-indicators (monetary policy and fiscal policy) are stretched –  
*is this a “fuite en avant”?*