# Discussion of Taming SIFIS Freixas and Rochet

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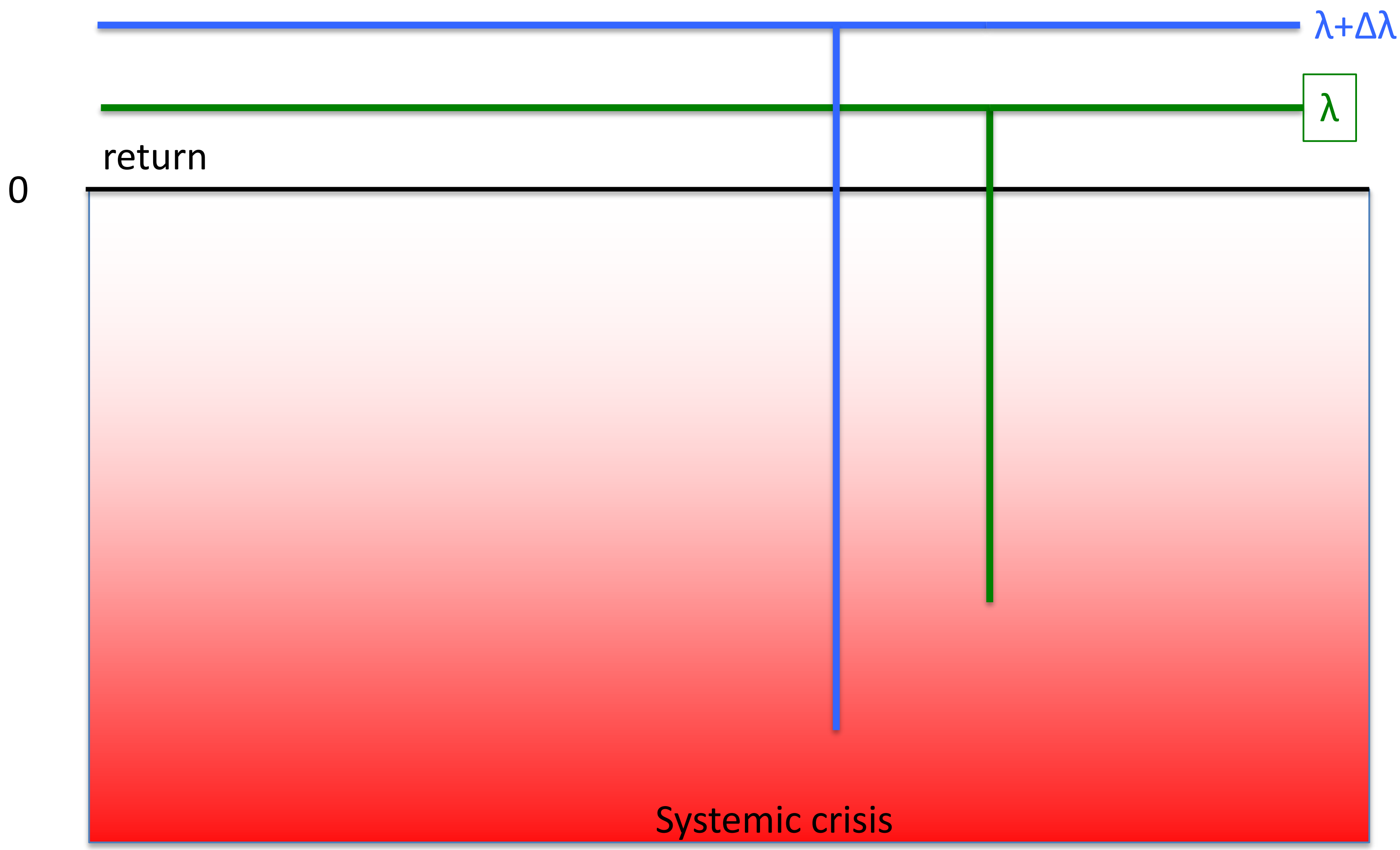
October 19, 2011

# Overall View

- Paper makes an important contribution to the emerging literature on SIFI regulation
- The approach taken is sensible
- But
- I think there are theoretical, empirical and political issues that are relevant to the paper

# The problem



# Model

- Given Costs and probability of crisis
- Can solve for optimal tax
- Optimal contract

# Issues 1 (theory)
# Who is systemic

- It is assumed the bank is systemic
- But banks that are systemic face lower funding costs than other banks
- Because creditors have an expectation of a bailout
- And creditors are better informed about $\lambda$ than shareholders or supervisors
- So banks have an incentive to become systemic, (size, more risk)
- Why fully bail out creditors?

# Issues 2 (empirics)
# Who knows $\lambda$

- Here assumed $\lambda$ is known
- But in reality not so
  - Manager does (hopefully)
  - Shareholders and supervisors do not (except partially)
  - Creditors know more than either but less than manager
- So everybody observers a noisy signal of $\lambda$

# Issue 3 (politics)
# The treasury

- “systemic risk authority (SRA). This special institution must benefit from the backing of the Treasury (in order to be able to cover the huge losses associated with a crisis) but at the same time must be independent from political powers, so as to resist the temptation of a bail-out, which is always the ex post efficient solution to a crisis.”
- Is this feasible?

# Summary

- Elegant paper on a key topic
- Some theoretical, empirical and political issues
- Incorporating them may add nothing but algebra with results the same