We must pay attention to possible long-term outcomes before committing to prolonged deregulatory efforts.

As an aide for banking and financial services to New York Governor David Patterson, Vasisht witnessed the economic havoc caused by the GFC at the state level, much of which occurred against a backdrop of financial deregulation that had been occurring over the course of a decade. He recalls,

I saw firsthand how a crisis can devastate families and households and neighborhoods. It also gave me an appreciation for how important it is to pay attention to the deregulatory agenda. It is very technical, it is very complicated, and it can impact people in profound ways.

Vasisht notes the huge loss of household wealth, the increase in neighborhood blight, the rise in so-called “zombie” properties (those that had been foreclosed on and for which the ownership was uncertain), shuttered businesses, and vandalism that occurred as a result of the GFC.

Compounding matters, the heightened level of economic uncertainty created by the GFC led to a fiscal crisis for New York because tax receipts of all types—sales tax, personal income tax, and corporate tax revenues—fell dramatically, which impacted many essential services, including education, transportation, and housing. Vasisht recalls,

For example, state personal income tax revenue projections fell by around 50% or more during the most acute phase of the crisis. That created a multi-year, multi-billion-dollar deficit in the state budget and a fiscal crisis as the state's general fund was eventually depleted of money. That sparked a whole host of issues and considerations of difficult policies, including raising taxes and fees, increasing tuition at public universities, imposing crippling budget cuts at state agencies, cutting school tax rebates, delaying payments to local government, and so on. We even considered furloughing employees and issuing IOUs instead of tax refunds.
Financial deregulation and its effects can be difficult to track because it often occurs in bits and pieces at the margins, and so the overall consequences may not be apparent initially. However, said Vasisht, “as a package, [deregulation] really does have a negative impact on the resilience of the stability of the financial system.”

**More work needs to be done to ensure that banks and the financial system have greater resilience.**

In the wake of the GFC, steps were taken to boost the resiliency of banks, including requiring higher levels of capital and liquidity, says Vasisht. Stress tests were implemented to evaluate banks’ ability to withstand a crisis as severe as the GFC or worse. Vasisht maintains, however, that more work needs to be done to ensure that global systemically important banks and counterparty problems can be resolved without causing chaos in the financial markets or relying on bailouts funded by taxpayers. Nonetheless, he argues, once the economy rebounded, the focus shifted to easing regulatory burdens. He says,

> Countercyclical policies would suggest that we should be building up capital first, finalizing the liquidity rules, and making sure that our stress-testing framework is robust. We can continue to do the work to make stress testing more realistic, including taking into account the boomerang effects and the second-order effects. But we seem to be doing the opposite: loosening the supplementary leverage ratio, pulling back on the liquidity rules, and reducing the strength and frequency of stress testing.

Instead of becoming lax during quiet times, Vasisht suggests that regulators stay diligent and continue to strengthen regulatory requirements and supervision. He also would focus on nonbank areas such as broker-dealers, hedge funds, and money market funds. He would also look at the clearing entities. After the Dodd-Frank Act, he says, many derivatives must be centrally cleared, which “makes the system safer overall, but has concentrated a lot of risk in the central counterparties.” The clearing entities are systemically important, says Vasisht, but “we have systemically important institutions that don’t have an appropriate regulatory framework yet.” He also points out that although the FDIC likely has resolution authority over these entities, the FDIC is not their regulator and is not involved with them on a day-to-day basis, raising questions of how successful a resolution would be. These are the areas on which he would like to see continued focus.

**Supervision can be a powerful crisis-planning tool, but it must be robust and effective.**

One area that tends to get overlooked in the financial system, especially amid a crisis, is supervision and enforcement, says Vasisht. It’s a hugely important role that tends to take a backseat to regulatory requirements, but it can have a tremendous impact on a bank’s resiliency, internal controls, and practices which can strengthen it for a crisis. The nature of supervision demands confidentiality because of concerns about bank runs, he says. Yet, for supervision to play a meaningful role, it must be robust and effective; it requires more attention. Says Vasisht,
It’s not enough to come up with the rules of the road, which is what regulation is. You have to make sure those regulations are being implemented the right way and that supervisors are doing what they need to do effectively. . . .

The job of the supervisor is very difficult. Because of the opaque nature of supervision, because we’re concerned about bank runs historically, supervision tends to be confidential. That’s where people can have a further impact on resilience and risk management.

I’ve found that bank examiners, because of the complexity of their job and because of the reliance that they have on the institutions themselves, may not be as forceful as they could be to ensure the safety and soundness of particularly large complex financial institutions. That is an area that needs to be looked at much more carefully. . . . and I think that if we do that, we will make inroads to being sure that banks are better managed from a risk perspective and that we have a better handle on their activity.

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