

## Executive Summary from Lawrence H. Summers' Webinar

March 16, 2023

- **A summary in four bullets:**
- This was a very poorly managed bank without a chief risk officer for many months. Supervisors don't seem to have been on the case. The episode highlights important issues of how we incorporate fluctuations in market value in bank balance sheets.
- SVB shows that the concept of uninsured deposits needs to be thought through carefully. If the failure of a bank with 1% of the system's assets constitutes a systemic event because of the contagion, then we need to rethink the structure of our financial system.
- Lagarde gets an A+ today. It is important to signal resistance against financial dominance and the idea of slacking off in fighting inflation because of financial stability.
- While there are many important lessons for us today, I would be surprised if students of a US history course in 2035 will have cause to learn about this particular episode, and that's how we want it to be. The same could not be said about 2008.
- **What went wrong? [4:20](#)**
  - This was a very poorly managed bank: no chief risk officer for 9 months, problematic culture...
  - At the same time, supervisors don't seem to have been on the case. Such as massive growth in deposits is exactly the type of think supervisors should pay attention to.
  - The episode highlights important issues of how we incorporate fluctuations in market value in bank balance sheets. The concept of holding to maturity is quite problematic.
- **Do banks deserve their market power? [18:42](#)**
  - With competition, we should expect their market power to go away.
  - At the same time, the Fed's aversion to narrow banking models is not good. Why shouldn't there be a bank that simply buys treasury bills?

- The failure of SVB shows that the concept of uninsured deposits needs to be thought through carefully.
- If the failure of the 16th bank, with less than 1% of assets, in a highly idiosyncratic market constitutes a systemic event because of the contagion, then there is a great deal of conceptual rethinking needed around the structure of our financial system.
- **Which grade would you give regulators' response to SVB? [28:47](#)**
  - Beware of the policy doctrine of “huff and puff and pay”: the policymakers who give the strongest moral hazard speeches at the beginning of a crisis and impose the most brutal solutions end up authoring the largest bailouts.
  - I would give the authorities high grades. But there are many open questions, especially about the Fed's facility lending at par, should the government get some equity in exchange for this?
  - There are also questions about how the holding company will be handled.
- **Beware financial dominance: Christine Lagarde gets an A+ today. [40:53](#)**
  - Lagarde gets an A+ today. The ECB carried on with its monetary policy with a clear rhetoric separating the monetary policy concern from the financial stability concern.
  - The ECB made a key point that what's important when you have multiple objectives is to have multiple instruments.
  - It is important to signal resistance against financial dominance. We cannot slacking off in fighting inflation because of financial stability.
  - The Fed should raise rates by 25bps in the next meeting
- **Do we need to overhaul our financial architecture? [49:28](#)**
  - Yes, we should be enthusiastic about narrow banks.
  - In terms of the maturities of government bonds: in a world we're inflation is uncertain, short-term debt may yield more certain debt costs. Rollover risk is a matter of confidence in the country, better to deal with it at the gov level than banking level.
  - At the same time, as Olivier Blanchard points out, you may be able to engage in more expansionary fiscal policy if you can lock in interest rates.

- Relevant paper: Greenwood, R., Hanson, S.G., Rudolph, J.S. and Summers, L.H. (2016) Debt Management Conflicts Between the U.S. Treasury and the Federal Reserve. Available at: <https://www.jstor.org/stable/10.7864/j.ctt15hvr8b>
- **From Mexico, to Japan, to crypto, what can the world learn from this last week?** [54:16](#)
  - On Japan and its yield curve control: Pegs of any kind are a hotel that is easier to check into than check out of. We know these things don't end well.
  - On emerging economies: I would be surprised if it was a good idea for EMs to guarantee large chunks of the liabilities of the 20th or 30th largest banks in their country (SVB equivalent).
- **Ending on a positive note.** [1:01:30](#)
  - While there are many important lessons for us today, I would be surprised if students of a US history course in 2035 will have cause to learn about this particular episode, and that's how we want it to be. The same could not be said about 2008.