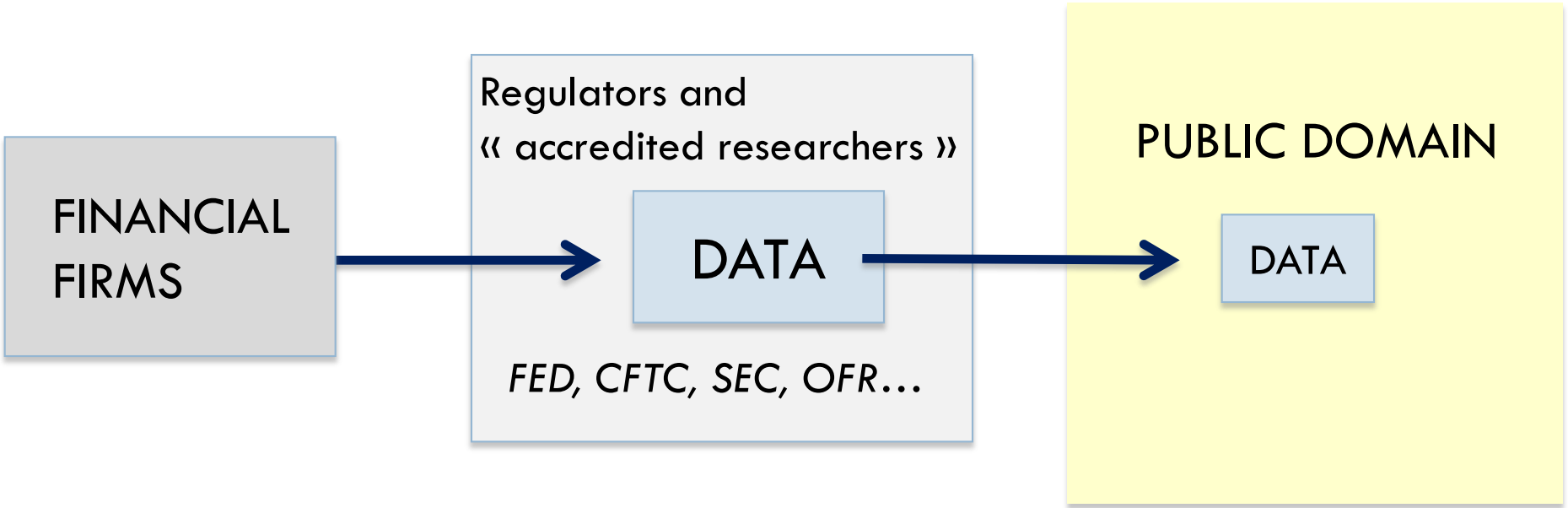
# REGULATING SYSTEMIC RISK THROUGH PUBLIC DISCLOSURE

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NBER Initiative: Systemic Risk and Macro Modeling, April 2011

# Data : public or private ?




**key parameters for financial data :**

- *Public access vs. access limited to sworn-in researchers?*
- *Granularity?*
- *Anonymity?*
- *Lag of disclosure/Frequency?*

# This Talk

- Advocates for extensive public disclosure of disaggregated data (the 13F model):
  - Public data, without limitation
  - Fine granularity
  - Nominative
  - Available with a lag / taking averages, not snapshots
- Provides a framework of optimal transparency
  - Anonymity
  - Lag
  - Granularity

# The full disclosure proposal

# The state of affairs

- Crisis lesson #1: *« autoregulation is a myth »*
  - …but it has reinforced suspicion about public intervention
  - *who regulates the regulators?*
    - *Regulatory capture / « Quiet coup » / ignorance*
    - *What do politicians maximize?*
- Crisis lesson #2: *« macro data was ok, micro data was lacking »*
- both dimensions need to be adressed
  - Transparency of micro-data addresses both…
  - …but ***no academic consensus on optimal transparency***

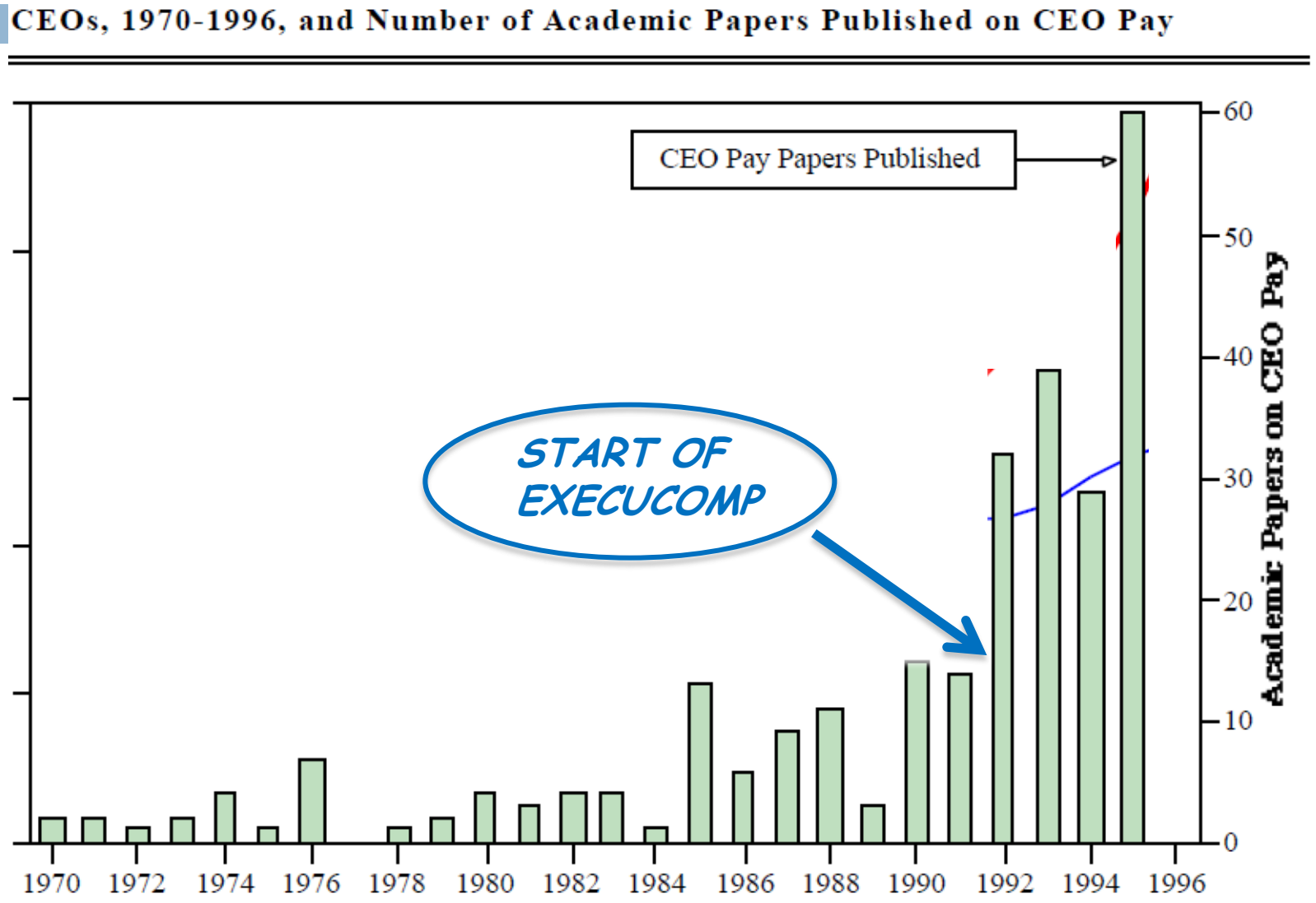
# The full disclosure proposal

- data of all asset holdings by financial institutions
  - All institutions (systemic or not) > $100m
  - Fine granularity
    - Asset by asset for traded assets / trading book
    - Need for grouping for non traded assets / banking book
      - Mention counterparties
  - Nominative data
- make this database public
  - Expertise beyond the regulator
  - Available with a lag (e.g. 3 months)

# Why make info public?

- Creation of a Risk Management norm
  - Advantage of having a common asset classification
    - Forces banks to improve back-office and risk-management
    - Helps coordination
- Limits capture (« regulates the regulator »)
  - Public can ask the disturbing questions
  - Can be told: « we did not hide anything from you »
- Relies on a broader set of experts
  - Wisdom of crowds vs. monopoly
  - Forensic finance: researchers complement regulator
    - Mutual funds, insider trades, executive compenstion, stock-options back-dating, manipulations by hedge funds
    - Ex: for systemic risk: Brunnermeier-Nagel (2003)
      - Use 13Fs; establish Hedge funds ride bubbles

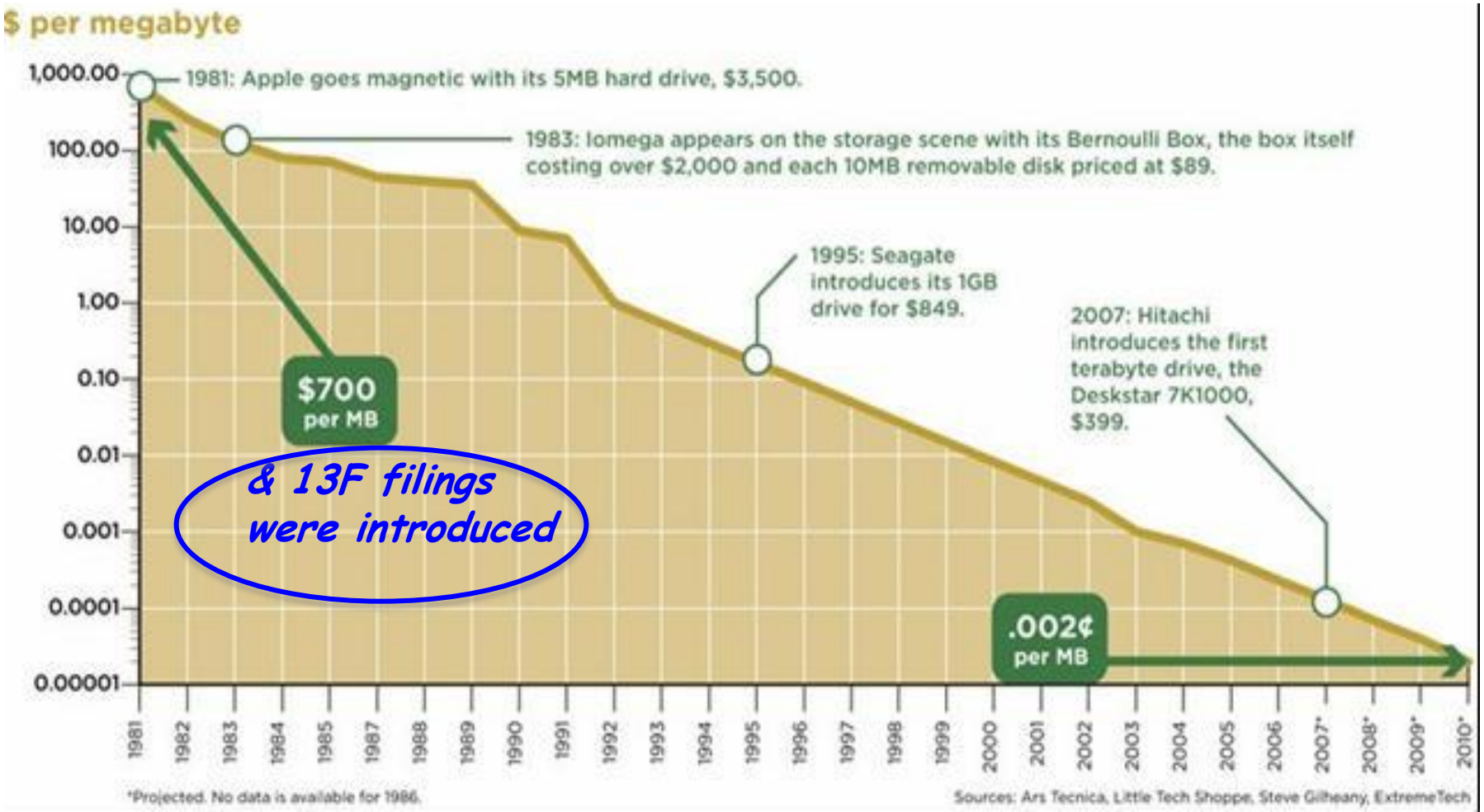
# Data availability impacts research



# A framework of optimal transparency

- 3 limits to full transparency
  - « *This is too much information to manage* »
  - « *Secrecy is vital to finance* »
  - « *Transparency favors runs / destabilization*»
- Implications for optimal levels in:
  - granularity,
  - immediacy,
  - anonymity

- Cost of storing info: *1/35000000 in 30 years*



# Counter agrument #1
# « This is too much info to manage»

- This info is ***already produced*** by financial institutions (or should be!)

  ***→little additional cost***

- The cost of storing it is negligible

- If cost of producing/storing info is one side of tradeoff, then optimal disclosure must have increased over the last 10 years…

# Counter argument #2
# « secrecy is vital to finance »

- **Theory**
  - Grossman-Stiglitz : ***production***
    - Need temporary monopoly on info to have incentives to produce it
  - Amador-Weill, Duffie-Malamud-Manso : ***transmission***
    - Too much public info reduces info transmission in markets
- **Empirics**
  - ***13Fs didn't make the stock market less efficient***
  - ***TRACE didn't reduce bond liquidity***
    - Goldstein&al.(07), Edwards&al. (07), Bessembinder&al. (06) …
  - ***Rents in finance do not seem dangerously small…***
  - ***Evidence that strong IP decreases innovation speed (outside finance)***
    - Genomics:Williams 2010; David Levine
  - ***Reg FD might have made analysts lazy***
    - Gomes,Gorton, Madureira (2007)

# Counter argument #3
# « transparency breeds panics »

- **Theory:** Opacity breeds stability
  - Global games literature: Info triggers attack / bank run
  - Hirschleifer effect: if everyone knows a bank is sick, it is dead…
  - Disclosure encourages feedback trading
- **Counter theory** arguments:
  - *Fear of panic can be good ex ante (incentives)*
  - *Transparency → Floor on bad scenario → Eliminates bad equilibria*
  - *Can be adressed with disclosure lag*
- **Empirical evidence: unconclusive**
  - On the long side, Hedge funds do not front-run on distressed mutual funds (greenwood-thesmar)
  - Would be useful to have the short side !

# the Matrix

| | Rents matter? | Relevance For Sys. Risk | « Run » danger | Standard |
|---|---|---|---|---|
| Disclosure lag | + | - | + | |
| Granularity | - | + | - | - |
| Anonymity | + | - | + | ? |

# Conclusion

- Lessons of crisis
  - Regulating regulators is the priority
  - Open ecosystem of researchers is best chance
  - All secondary effects can be addressed with disclosure lag
- Transparency of regulatory data complementary to:
  - Move to organized markets
  - Prudential regulation
- Open data trend goes beyond finance
  - Rising public demand for transparency
  - Regulation has to take advantage of technology

# APPENDIX

# Beyond finance

- Theoretical argument that trade secrets and IP rights are key for innovation
- But evidence that they strongly decrease innovation speed
- Ex: Genomics

(Williams 2010)

*Private IP*

*→30% reductions in R&D*

