



Letters

Step up competition for banks and rating agencies

From Prof Eric De Keuleneer.

Sir, Martin Wolf's proposals for financial regulation ("Seven habits that finance regulators must acquire", May 7) is very much to the point, and could be completed by another one that could be called coherence. The market economy is supposed to work best with competition and without subsidies, but the financial sector is incoherent on both criteria, relying on regular state subsidies and lacking openness and competition in some key areas.

Competition could be improved in two major sectors of finance: investment banking and credit rating. Credit rating agencies are an oligopoly because the Securities and Exchange Commission gave a privileged position to three of them, and the Basel Committee gave them an exaggerated role. Let regulators and central banks delete any reference to rating agencies; let

them be more responsible themselves for assessing the quality of banking assets; let investors be responsible for the quality of assets they purchase, and if they want to use credit rating services, let them pay for any external advice. The investment banking sector probably also needs some trust-busting. For instance, legal separation of corporate finance and broking would reduce conflicts of interest, insider dealing risks and market power (for instance for the "7 per cent commissions" initial public offering cartel), and create a welcome evaluation step in the rather uncritical originate-and-distribute model.

The financial sector gets a massive subsidy in the form of a free insurance against systemic risk, since governments and central banks let them take full advantage of the fat profits in the good times and bail them out in the bad times. Since

public interest seems to justify public intervention to avoid systemic risk, at the very least let the financial sector pay for this insurance. A kind of Tobin tax on market transactions (inspired by Keynes, like Mr Wolf's concluding remarks) could have the double advantage of limiting the most speculative transactions and be used to fund a systemic risk insurance scheme; a funding contribution based on banks assets would also be logical; a contribution based on league tables would be both logical and economically sound if one is to believe there could be a perverse relationship between league table rankings and the quality of performance, as a recent study (Bao and Edmans, 2007) suggests.

Eric De Keuleneer,
Solvay Business School,
University of Brussels,
1050 Brussels, Belgium