

Andreas Dombret: The “too big to fail”-problem and the roots of international cooperation

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at a reception to bid farewell to Mr Thomas Notheis, financial attaché, and to welcome his successor, Mr Alexander Sattler, Mumbai, 30 October 2014.

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Ladies and gentlemen

Thank you, Consul General Siebert, for hosting this event here at your residence. I am happy to have the opportunity to officially thank the Bundesbank’s outgoing representative, Thomas Notheis, and to welcome his successor, Alexander Sattler.

Allow me to say a few words on the roots of international cooperation. Not too long ago, the saying was that when the United States sneezes, the world catches a cold. This is certainly still true, and the turbulence following the Federal Reserve’s announcement of tapering was a case in point.

However, we have reached a point where the health of the world economy is not just determined by the state of the US economy. The world in which we live has become very small over recent decades. And, in a small world, every policymaker in every country must be aware that his or her decisions can influence other countries as well.

The world is interconnected by a close-knit network of trade relations and via a globalised financial system. Financial markets in particular have become integrated to such a degree that a small distortion at one end of the world can quickly spread and affect the entire system. In 2008, the failure of a single investment bank in the United States caused a global financial crisis and a worldwide recession.

Such banks are usually referred to as “too big to fail”. They are woven so deeply into the fabric of the financial system that their failure can tear everything apart. Consequently, when push comes to shove, governments are compelled to bail out these banks to avoid a systemic crisis. This adds up to an implicit and cost-free insurance for large banks, which sets all the wrong incentives.

Thus, tackling the “too big to fail”-problem is paramount to create a stable financial system. This is a well-established fact that has also been acknowledged by India. From 2015 onwards, a number of Indian banks will be classified as domestically systemically important. Nevertheless, banks that are too big to fail pose a problem that is global in scope and has to be resolved not only at the national but also at the global level.

The Financial Stability Board is currently finalising criteria that global systemically important banks will have to fulfil in future regarding their capital structure. In particular, they will need a minimum amount of loss-absorbing capacity. This will allow for an orderly resolution of those banks and protect taxpayers from having to foot the bill.

Another major step towards remedying the “too big to fail”-problem has been taken with regard to cross-border resolution. Recently, 18 global banks and the International Swaps and Derivatives Association agreed to implement new rules on derivatives trading. Whenever a large bank fails, these rules will allow authorities to temporarily suspend the rights of other banks to terminate derivatives contracts. This will buy precious time to organise an orderly resolution of the failed bank.

While these steps certainly bring us closer to resolving the “too big to fail”-problem, there is still further to go. Thus, further cooperation on this and on other issues is necessary to make the financial system a safer place over time. International cooperation always starts at the personal level, with personal relations forming the root of successful cooperation. This is

where our representatives here in Mumbai come into play. Their task is to build networks, to share information and ideas, to explain the Bundesbank's positions and to facilitate cooperation.

For the past four years, Thomas Notheis has served as the Bundesbank's representative here in Mumbai. There is no doubt that he has had a challenging job: as he was our first representative in India, he could not draw on existing experience and had to build up a network from scratch. Judging from the distinguished crowd gathered here today, he has done an excellent job. I would therefore like to thank him personally and on behalf of the Bundesbank for his service here in Mumbai.

Given the excellent job that Thomas Notheis has done in Mumbai, I am particularly happy that he is taking his experience and skills to another post abroad. For the next three years, he will serve as the Bundesbank's representative in Beijing. But coming back to Mumbai, I would also like to take the opportunity to welcome our new representative, Alexander Sattler.

Before joining the Bundesbank, he previously worked as a policy advisor at GIZ, the German Federal Government's agency for international development cooperation. Furthermore, with his background in both economics and political science, he worked most recently as an expert in the Bundesbank's International Monetary Affairs Division, dealing in particular with global financial stability issues relating to the International Monetary Fund. Some of you have already met him, and I am certain that he will be a worthy successor to Thomas Notheis.

One final thought I would like to leave you with: our decision to have a permanent representative here in Mumbai shows that the Bundesbank acknowledges the importance of the Indian economy and the role of its financial market in Asia and the rest of the world. I strongly believe that our presence here in Mumbai will deepen friendship and cooperation, not only between Alexander Sattler and his peers but also between the Bundesbank and the Reserve Bank of India, and eventually between Germany and India.

Thank you!