

Financecare.

Leen Noordzij

dr.l.noordzij@leennoordzij.nl

Finance is called “the brain of the economy”, The Economist 2009. Curing the brain in the second decade of 2000 comes with a cost and evitable with high costs. The recent past has been very reassuring for the financial industry: a lot of liquidity, low rates and new financial products. One of the intended purposes of these new products is to reduce the risk in the financial system by means of repackaging the products. This has been denominated innovation. This approach is supported by many financial specialists. However, with hindsight, risks was not reduced. It went awfully wrong. We better call this type of innovation “exnovation”.

So, what can we do about it? To this end The Economist used the wording “re-regulation”.

Spreading and diluting the risk did not work. Keeping this in mind shows us the way to start working on a solution at least for a part of the problem. How? Well, compare spreading the risk in the financial system with the spreading of a virus and so it actually worked out. Spreading a virus increases the number of sick people. By means of vaccinating with a derivative of the virus(medicine) the illness can be prevented to a considerable extent. Under the condition, however, of an elaborate testing of the medicine. Usually this goes a long way. It should be. We are talking about healthcare: a matter of life and death.

It is my opinion that the system used for the introduction of a new medicine can be applied to the introduction of new financial products. There is no problem at all that in this way it can take a long time before a new financial product enters the market place. The financial industry exist already for centuries and is based on trust. Trust is as important as health. Carefully testing a new financial product is a real new challenge and opportunity. Economist, mathematicians, physicists, psychologists, etc. can be working on developing new testing procedures using simulation, scenarios and new economical models. A lot of financial and social evidence is at hand. May be these new simulation procedures can be developed by means of open innovation. As a consequence the financial industry cannot stand out from its competitors by means of a new product. They should not. The only way to be a distinguished banker is to serve your clients in a sustainable way. The financial industry is a service industry: no more no less.

In The Economist (January 25th 2014) Buttonwood presumes: “Such (financial, LN) innovation is hard to assess; unlike new medicines, financial products cannot be tested in advance.” I am convinced that those so called innovative financial products can be tested. A bank or

financial institution has to be ordered by the financial regulator to define an experiment where the innovators, their bosses and the board of that institution have to financially participate. In order to put their money where their mouth is. The application of this innovative product has to be tested for at least 5 years. And the end of this testing period it is up to the regulator how to proceed.

To what extent the banking industry is service oriented is illustrated in “House of Cards” by Cohan. A book about the disappearance of Bear Stearns.

Further reading to learn how we do not learn is sometimes hilariously demonstrated by Kindleberger and Aliber in the book “Manias, Panics and Crashes”.

Another aspect of spreading the financial virus is the role of government and the monetary policy. A lot of information on this subject is presented by Reinhart and Rogoff in their book “This time is different”.

Further reading:

Cohan, W. D., *“House of Cards. How Wall Street’s gamblers broke capitalism”*, Allen Lane, London, 2009.

Kindleberger, C. P. and R. Z. Aliber, *“Manias, Panics and Crashes. A history of financial crises”*, Palgrave Macmillan, London, 2005.

Reinhart, C. M. and K. S. Rogoff, *“This Time Is Different. Eight centuries of financial folly”*, Princeton University Press, 2009.