The financial valuation crisis
Stellinga, B.J.P.

Citation for published version (APA):

General rights
It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations
If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: http://uba.uva.nl/en/contact, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.

UvA-DARE is a service provided by the library of the University of Amsterdam (http://dare.uva.nl)
The Financial Valuation Crisis

The inherent limits to taming unstable markets

The way in which financial firms valuate their assets and liabilities directly affects their behavior and therefore financial stability. The 2007-9 global financial crisis exposed fundamental problems in firms’ valuation approaches and the regulations that bolstered them. In response, policymakers set out to tackle the most pressing issues, in particular the destabilizing effects of accounting practices, credit ratings, and banks’ risk models. Yet, despite a flurry of changes, policy progress – in Europe and elsewhere – has been limited. What explains this?

In this book, I argue that lack of progress stems from an underlying issue: valuation practices do more than just measure financial risks – they shape them. Practices deemed conducive to financial stability can significantly alter market functioning, potentially contributing to instability over time. This introduces a major problem for policymakers, as there is no stable link between firms’ valuation approaches and financial stability. Worse still, public prescriptiveness might stimulate herd behavior, as it mandates widespread use of inevitably deficient valuation routines. Policymakers thus often embraced incremental reforms, for want of something better. In the book’s conclusion, I discuss policy options to deal with this regulatory problem.
THE FINANCIAL VALUATION CRISIS

The inherent limits to taming unstable markets

Bart Stellinga
THE FINANCIAL VALUATION CRISIS

The inherent limits to taming unstable markets
Promotiecommissie

Promotor: Prof. dr. D.K. Mügge
Co-promotor: Prof. dr. G.R.D. Underhill

Overige leden:
- Prof. dr. A.W.A. Boot
- Prof. dr. M. de Goede
- Prof. dr. J.H. Zeitlin
- Prof. dr. E. Jones
- Prof. dr. L. Seabrooke

Universiteit van Amsterdam
Universiteit van Amsterdam
Universiteit van Amsterdam
Johns Hopkins University
Copenhagen Business School

Faculteit der Maatschappij en Gedragswetenschappen
# Table of Contents

Overview of articles in this thesis ................................................................. 9

Funding information ..................................................................................... 10

List of abbreviations .................................................................................... 11

1 Introduction ............................................................................................... 15
   1.1 The financial valuation crisis .............................................................. 15
   1.2 Gaps in the existing literature .............................................................. 18
   1.3 The reflexivity problem .................................................................... 20
   1.4 The research focus ........................................................................... 23
   1.5 Outline of the thesis ........................................................................ 25

2 Theorizing the politics of financial valuation ............................................. 29
   2.1 Introduction ....................................................................................... 29
   2.2 Governing financial valuation ............................................................. 30
   2.3 The politics of financial regulation ...................................................... 35
   2.4 Financial markets as a reflexive system .............................................. 47
   2.5 The politics of financial valuation ...................................................... 60
   2.6 Focus and methods ........................................................................... 66
   2.7 Conclusion ....................................................................................... 73

3 The unstable core of global finance. Contingent valuation and governance of international accounting standards .................................................. 75
   3.1 Introduction ....................................................................................... 75
   3.2 The rise of international accounting standards ...................................... 77
   3.3 Preference formation in global accounting standard setting ............... 83
   3.4 Financial stability and ambiguous accounting preferences ............... 84
   3.5 The Full Fair Value proposal (1997-2001) ........................................... 90
3.6 The IAS 39 controversies (2002-2005) ................................................................. 93
3.7 The financial crisis and IFRS 9 (2008-2017) ....................................................... 96
3.8 Conclusion ............................................................................................................ 103

4 Mitigating the systemic risk of credit ratings. Performativity as a stability threat and as a regulatory problem .................................................................................................................. 105
4.1 Introduction ......................................................................................................... 105
4.2 Systemic problems, a timid response .................................................................. 107
4.3 The regulatory implications of performativity ....................................................... 112
4.4 Re-regulation and its limits .................................................................................. 116
4.5 Conclusion ............................................................................................................ 126

5 The regulator’s conundrum. How market reflexivity limits fundamental financial reform ............................................................................................................................... 129
5.1 Introduction ......................................................................................................... 129
5.2 High hopes, unmet expectations .......................................................................... 131
5.3 The regulator’s conundrum .................................................................................. 135
5.4 The regulator’s conundrum in practice .................................................................. 137
5.5 Conclusion ............................................................................................................ 150

6 Fighting the financial cycle. Macroprudential policy, endogenous risks, and regulatory timidity ............................................................................................................................... 153
6.1 Introduction ......................................................................................................... 153
6.2 The coming revolution in financial regulation ....................................................... 155
6.3 The paradigm shift that got stuck .......................................................................... 159
6.4 The limits to countercyclical policy ..................................................................... 163
6.5 Conclusion ............................................................................................................ 178

7 Conclusion ............................................................................................................. 181
7.1 Introduction ......................................................................................................... 181
7.2 Main findings ....................................................................................................... 182
Overview of articles in this thesis

This thesis is based on five stand-alone articles, three of which have already been published. The bibliographic details of the published articles are as follows:


For the two co-authored articles, both authors contributed in equal manner. The two articles that at the time of writing have yet to be submitted are single-authored.
Funding information

This work was supported by the European Commission Research Director General, Horizon 2020 Framework Program under the grant ‘European Legitimacy in Governing through Hard Times’ (#649456-ENLIGHTEN)
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFS</td>
<td>Available-for-Sale</td>
</tr>
<tr>
<td>AMF</td>
<td>Asset Management Fund</td>
</tr>
<tr>
<td>ARC</td>
<td>Accounting Regulatory Committee</td>
</tr>
<tr>
<td>BCBS</td>
<td>Basel Committee on Banking Supervision</td>
</tr>
<tr>
<td>BIS</td>
<td>Bank for International Settlements</td>
</tr>
<tr>
<td>CCB</td>
<td>Countercyclical Buffer</td>
</tr>
<tr>
<td>CEBS</td>
<td>Committee of European Banking Supervisors</td>
</tr>
<tr>
<td>CESR</td>
<td>Committee of European Securities Regulators</td>
</tr>
<tr>
<td>CGFS</td>
<td>Committee on the Global Financial System</td>
</tr>
<tr>
<td>CRA</td>
<td>Credit Rating Agency</td>
</tr>
<tr>
<td>CRD</td>
<td>Capital Requirements Directive</td>
</tr>
<tr>
<td>CRR</td>
<td>Capital Requirements Regulation</td>
</tr>
<tr>
<td>EBA</td>
<td>European Banking Authority</td>
</tr>
<tr>
<td>EBCI</td>
<td>European Bank Coordination Initiative</td>
</tr>
<tr>
<td>EBF</td>
<td>European Banking Federation</td>
</tr>
<tr>
<td>EC</td>
<td>European Commission</td>
</tr>
<tr>
<td>ECB</td>
<td>European Central Bank</td>
</tr>
<tr>
<td>EFAMA</td>
<td>European Fund and Asset Management Association</td>
</tr>
<tr>
<td>EFR</td>
<td>European Financial Services Round Table</td>
</tr>
<tr>
<td>EMIR</td>
<td>European Market Infrastructure Regulation</td>
</tr>
<tr>
<td>ESMA</td>
<td>European Securities and Markets Authority</td>
</tr>
<tr>
<td>ESRB</td>
<td>European Systemic Risk Board</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>EUP</td>
<td>European Parliament</td>
</tr>
<tr>
<td>EWI</td>
<td>Early Warning Indicator</td>
</tr>
<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
</tr>
<tr>
<td>FFVA</td>
<td>Full Fair Value Accounting</td>
</tr>
<tr>
<td>FPC</td>
<td>Financial Policy Committee</td>
</tr>
</tbody>
</table>
FSA  Financial Services Authority
FSAP  Financial Services Action Plan
FSB  Financial Stability Board
FSF  Financial Stability Forum
FVA  Fair Value Accounting
FVO  Fair Value Option
GAAP  Generally Accepted Accounting Principles
G-SII  Global Systemically Important Institution
HCA  Historical Cost Accounting
HQLA  High Quality Liquid Asset
IAS  International Accounting Standard
IASB  International Accounting Standards Board
IASC  International Accounting Standards Committee
IFRS  International Financial Reporting Standard
IMF  International Monetary Fund
IOSCO  International Organization for Securities Commissions
IPE  International Political Economy
IRB  Internal Ratings Based
JWGBA  Joint Working Group of Banking Associations
JWGSS  Joint Working Group of Standard Setters
LTI  Loan-to-Income
LTV  Loan-to-Value
MBS  Mortgage-Backed Security
NSFR  Net Stable Funding Ratio
OCC  Office of the Comptroller of the Currency
OECD  Organisation for Economic Cooperation and Development
OEP  Open Economy Politics
O-SII  Other Systemically Important Institutions
PIT  Point-in-Time
SARG  Standards Advice Review Group
<table>
<thead>
<tr>
<th>SEC</th>
<th>Securities and Exchange Commission</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSF</td>
<td>Social Studies of Finance</td>
</tr>
<tr>
<td>STS</td>
<td>Science and Technology Studies</td>
</tr>
<tr>
<td>TTC</td>
<td>Through-the-Cycle</td>
</tr>
<tr>
<td>VoC</td>
<td>Varieties-of-Capitalism</td>
</tr>
</tbody>
</table>