

## Helping regulators prevent the next financial crash

Groundbreaking research by LSE economists has influenced the design of new regulations aimed at preventing a repeat of the recent global financial crisis

### What was the problem?

A small event can cause a major financial shock that spills over into the wider economy.

The recent

for the UK Government Office for Science Foresight Project, Zigrand and others highlighted how high frequency trading the use of computer programmes to rapidly trade assets can exacerbate crises.

## What happened?

The research resulted in significant changes to overall regulations and to regulations in the specific area of high frequency trading.

### *Overall regulation*

One of the main impacts of the LSE research has been its influence on the way global and national regulators have designed rules to prevent a repeat of the 2008 crisis. The research led the Basel Committee at the Bank of International Settlements to insist that large institutions whose failure could cause a wider crisis hold more capital in reserve.

Goodhart played a role in influencing the financial regulation agenda of the Group of 20 the largest economies while Shin played an influential role as adviser to the President of the Republic of Korea ahead of the Seoul Group of 20 Summit in 2010. Advice by Goodhart and Shin to the Bank of England influenced regulatory reform in the UK.

Danielsson gave evidence to the Treasury Select and House of Lords Economics Affairs committees and held meetings with HM Treasury together with Zigrand to discuss endogenous risk. The research has also been used by the Banque de France, the New York Federal Reserve Bank and the European Central Bank and influenced the Icelandic and Luxembourgish central banks where Danielsson and Zigrand are advisors.

### *Regulation of high frequency trading*

The Foresight research on high frequency trading, in which Zigrand acted as lead expert and Danielsson and Goodhart as commissioned experts, has been highly influential in both European and American policy-making contexts.

Plans to impose a half-second resting for all trading orders were dropped from the EU Markets in Financial Instruments Directive II ahead of a vote by the MEPs following discussions with Zigrand and colleagues. Instead, an alternative proposal in the Foresight report for time stamps based on synchronised atomic clocks across trading venues was added to the Directive. The European Securities and Markets Authority (the EU regulator) and the national regulators of Germany, France and the Netherlands have also consulted with Zigrand and colleagues.

should follow the lead example and model of the UK Foresight project on computer

# Research impact: making a difference

The LSE researchers have also made presentations to various policy-making bodies, including 10 Downing Street, the EU Joint Research Centre, and in the US to the Senate Banking Committee, House Committee on Financial Services, and the Commodities Futures Trading Commission.

Zigrand was cross-examined by the UK Parliamentary Commission on Banking Standards and the LSE research was explicitly referenced in the House of Lords. LSE research has also influenced regulations covering European hedge funds, derivatives and counterparties.

work in this area has contributed to preventing a



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