not invalidate my argument; a regulatory system based on a number of tools, including reinforced disclosure to authorities, is certainly a more robust system than the current one. This criticism is particularly relevant for focusing on the costs and expected benefits of reform initiatives, which always need detailed and careful assessment - though the cost of failure has proven to be astronomical.

Individual actors in the financial marketplace have run businesses within institutions that were not conceived for those businesses.

The second criticism, often associated with the work of Merton and Bodie (2005), is that financial regulations can be bypassed by financial innovation. Indeed, these authors argue that financial organisations innovate their way away from the constraints imposed on them by regulations when their business evolves in directions inconsistent with existing rules. While the phenomenon described by Merton and Bodie is certainly present and needs to be taken into account, I do not think (and I believe that I am also interpreting these authors correctly) that this reasoning implies total ineffectiveness of regulatory constraints on financial activities. The characteristic speed, flexibility, and mobility of financial organisation certainly needs to be taken into account when considering regulatory design, but does not justify inactivity on the regulatory front. Once again, this criticism brings the attention on another aspect of implementation, essential in financial reform, which is the requirement of uniform initiatives by all relevant national authorities. Indeed, Initiatives on regulatory reform are being discussed in international fora, such as the Group of 20, the Financial Stability Board, the Bank for International Settlements. The US and European authorities, including the European Commission, have repeatedly highlighted the need to coordination and their efforts to achieve it.

6. Concluding remarks

A financial crisis is a market failure which destroys a fundamental function of financial intermediation, the function of liquidity transformation, with substantial social costs. The recognition of the mechanics of financial crises has led to a number of regulatory institutions that were designed to minimise the probability that liquidity transformation breaks down. Such institutions, however, were designed in a world that was different from today. Financial markets are now characterised by a wide diffusion of securities, derivatives and related businesses. These developments have had two effects; they have multiplied exponentially transactions and counterparty risk, and they have led to a progressive divergence between functions and institutions. In other words, individual actors in the financial marketplace have run businesses within institutions that were not conceived for those businesses. These institutions are inefficient in the current financial system. The end result is that the mechanics of financial crises have changed.

The intended contribution of this paper is to offer an analytical framework to organise a reform strategy. It thus differs from many reform templates that consist of lists of (generally eminently sensible) reform initiatives. The strategy for financial reform that I propose starts from the premise that institutions are very important in financial markets, and have to be appropriate for the businesses they run. I thus propose ways to improve existing institutions, in the interest of more efficient markets. A major aspect of my proposal is a very significant increase in the supervisory responsibilities of financial authorities, necessary for them to regain effectiveness as managers of systemic risk.

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