

[A firewall against bailouts](#) [1]

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Allister Heath is firing on all cylinders in [today's City AM](#) [3], proposing a realistic way of avoiding a repeat of the 2008 and 2010 bank bailouts:

It is looking as if there is now serious support for a new special administration regime for banks that will include automatic debt-equity swap procedures to impose losses on bondholders in going concerns and recapitalise banks automatically. This would be a great move, strengthening the City while improving stability. Some in the Bank of England are also looking kindly on proposals to create special storage deposits, which would be separate from regular current accounts. The former would be truly safe but pay no interest; the latter will pay interest but be riskier, with depositors becoming preferred creditors in the event of a crisis with limited, if any, deposit insurance. Let us see exactly what actually emerges but the thinking has become much more sophisticated. It would allow much more market discipline to be reintroduced into the system, reduce moral hazard and protect taxpayers.

The lesson from the past two years has been that governments will always try to protect large bondholders at the taxpayer's expense. A full overhaul of the monetary and banking systems is needed in the long-term, but in the short-term the objective should be to put in place mechanisms that avoid government bailouts by burning bondholders without creating systemic collapse. Debt-to-equity swaps would have avoided the need for the Irish bailout, and would probably prevented the political rush to bail out the banks in 2008. They're not perfect by any means, but we need a realistic firewall against bank bailouts and Heath's proposals might be a good place to start.

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