Ending Too Big to Fail: “Are we there yet?”

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*The views expressed are purely personal and should not be attributed to any organisation or body

Outline

- Current policy framework for ending TBTF
  - Identification
  - HLA
  - Resolution
  - Supervisory intensity
- Limitations of the framework
  - Cross-border resolution
  - Bail-in not costless
  - HLA properly calibrated?
- Conclusion: Need for more capital

Global SIFIs

- “SIFIs are financial institutions whose distress or disorderly failure, because of their **size**, **complexity** and **systemic interconnectedness**, would cause significant disruption to the wider financial system and economic activity.
- “To avoid this outcome, authorities have all too frequently had **no choice but to forestall the failure of such institutions through public solvency support**. As underscored by this crisis, this has deleterious consequences for private incentives and for public finances.”

G-SIB Recommendations

- Policy framework for G-SIBs: definition and identification
- Regulation:
  - G-SIBs should have higher loss absorbency
- Resolution:
  - New international standard
  - Resolvability assessments and recovery and resolution plans
- Supervision:
  - Strengthening G-SIB supervision

Identification of G-SIBs

Table 1

Indicator-based measurement approach

Category (and weighting)	Individual Indicator	Indicator Weighting
Cross-jurisdictional activity (20%)	Cross-jurisdictional claims	10%
	Cross-jurisdictional liabilities	10%
Size (20%)	Total exposures as defined for use in the Basel III leverage ratio	20%
Interconnectedness (20%)	Intra-financial system assets	6.67%
	Intra-financial system liabilities	6.67%
	Wholesale funding ratio	6.67%
Substitutability/financial institution infrastructure (20%)	Assets under custody	6.67%
	Payments cleared and settled through payment systems	6.67%
	Values of underwritten transactions in debt and equity markets	6.67%
Complexity (20%)	OTC derivatives notional value	6.67%
	Level 3 assets	6.67%
	Held for trading and available for sale value	6.67%

Designated G-SIBs

- Bank of America
- Bank of China
- Bank of New York Mellon
- Banque Populaire CdE
- Barclays
- BBVA
- BNP Paribas
- Citigroup
- Credit Suisse
- Deutsche Bank
- Goldman Sachs
- Group Crédit Agricole
- HSBC
- ING Bank
- JP Morgan Chase
- Mitsubishi UFJ FG
- Mizuho FG
- Morgan Stanley
- Nordea
- Royal Bank of Scotland
- Santander
- Société Générale
- Standard Chartered
- State Street
- Sumitomo Mitsui FG
- UBS
- Unicredit Group
- Wells Fargo

- As at November 2012; subject to annual review

Higher Loss Absorbency for G-SIBs

- G-SIBs should have loss absorption capacity beyond the minimum agreed Basel III standards
- Depending on national circumstances, this capacity can be drawn from menu of alternatives
  - Capital surcharges, contingent capital, bail-in debt etc.
- BCBS paper of 4 November 2011 recommended the additional degree of G-SIFI loss absorbency and the instruments that can be used

Global SIFIs

Table 3

Bucketing approach

Bucket	Score range*	Minimum additional loss absorbency (common equity as a percentage of risk-weighted assets)
5 (empty)	D -	3.5%
4	C - D	2.5%
3	B - C	2.0%
2	A - B	1.5%
1	Cut-off point - A	1.0%

* Scores equal to one of the boundaries are assigned to the higher bucket.

Resolution Must Be a Viable Option

- Comprehensive resolution regimes and tools
  - Resolution of any FI without taxpayer exposure to loss, protecting vital economic functions, and allowing loss to be shared by shareholders and creditors
  - Each country to have designated resolution authority
  - Restructuring mechanisms could include bail-in
- Effective cross-border mechanisms
  - Cooperation between home and host authorities
- Recovery and resolution planning (R&RP)
  - Authorities could require changes to legal/operational structure and business practices to facilitate R&RP
  - Host jurisdictions can determine juridical structure of foreign FI based on its importance and resolvability

On-going Resolution work

- BoE/FDIC Bilateral “White Paper”
  - “Top-Down” resolution strategy: single resolution authority applying powers to parent company level
  - Continuity of essential services
  - Write-down of unsecured bond holders
  - Sound subsidiaries kept open and operating
  - Restructuring measures
- EU Recovery and Resolution Directives
  - RRPs and intra-group support agreements
  - Early intervention & appointment of special manager
  - Harmonised resolution tools (bridge bank, good bank/bad bank, bail-in)

Strengthening G-SIB Supervision

- Rules are ineffective if supervisory oversight is ineffective
- FSB Supervisory Intensity and Effectiveness (SIE) working group

– Main objectives
    - Holding supervisors to higher standards
    - Enhancing the effectiveness of supervisory colleges
    - Improving firms’ risk data aggregation capabilities
    - Improving supervisory tools and methods
    - Raising supervisory expectations for risk governance

Where do we stand?

- How much capital is enough?
- Is HLA sufficiently well calibrated to remove (or at least substantially erode) implicit subsidy?
- Brown-Vitter bill in US – leverage limits based on much higher capital requirements
- How effective can we make supervision of TBTF firms?
- “It is no good making speeches in general saying we want an effective supervisor and then, when it comes to an individual bank, asking the supervisor to back down.” – Sir Mervyn King

Where do we stand? (2)

- Many “know unknowns” in bank resolution:
- Will cross-border cooperation be effective in a crisis?
- How will liquidity provision work in a cross-border resolution?
- Will bail-in-able debt be available in the right quantities and right places?
- Will depositors need to be “bailed-in” and what role for depositor preference?
    - Depositor preference + asset encumbrance = toxic brew

Conclusions

- Cross-border resolution is still a "work in progress" – its effectiveness in practice remains to be seen
- There may be limits to "bail-in"
- Bail-in not costless. Has distributional effects
- Loss may sometimes be better carried by future taxpayers
- Best way to reduce future taxpayer liability is through more capital
- Addressing TBTF adequately may need much more capital than most policy-makers have been so far willing to consider