Evaluation of the effects of too-big-to-fail reforms

Financial Stability Board

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Inefficient Banking Systems Increase Fragility

	Capital Ratio	Profitability	Asset Quality	Costs	Fragmentation	Diversification	Size
	Bank Capital to Assets Ratio (%)	RoA, bps	Gross NPL%	Bank Branches per 100k People	Number of Credit Institutions per 100k People	Bank Financing as % of Total Credit to Private Corporates	Bank Total Assets as % National GDP
US	11.7	120.0	0.9	30.9	1.6	34%	94%
Netherlands	6.2	47.3	1.9	11.0	0.5	44%	328%
Finland	9.3	32.4	1.4	3.1	4.3	59%	305%
UK	6.8	28.0	1.1	25.1	0.6	70%	368%
Ireland	14.9	50.5	5.7	20.5	6.2	19%	391%
France	6.5	39.7	2.7	34.9	0.6	53%	440%
Spain	7.6	51.3	3.2	55.1	0.4	68%	235%
Germany	6.5	15.6	1.2	11.1	1.8	78%	264%
Italy	6.3	38.1	8.4	40.9	0.8	74%	218%
Portugal	7.0	45.1	9.4	36.0	1.4	65%	196%
Australia	6.9	84.0	0.9	28.2	0.5	50%	273%
Canada	5.3	88.6	0.4	20.0	0.3	42%	311%

Source: Algebris (UK) Limited, ECB, BoE, World Bank, OECD, BIS

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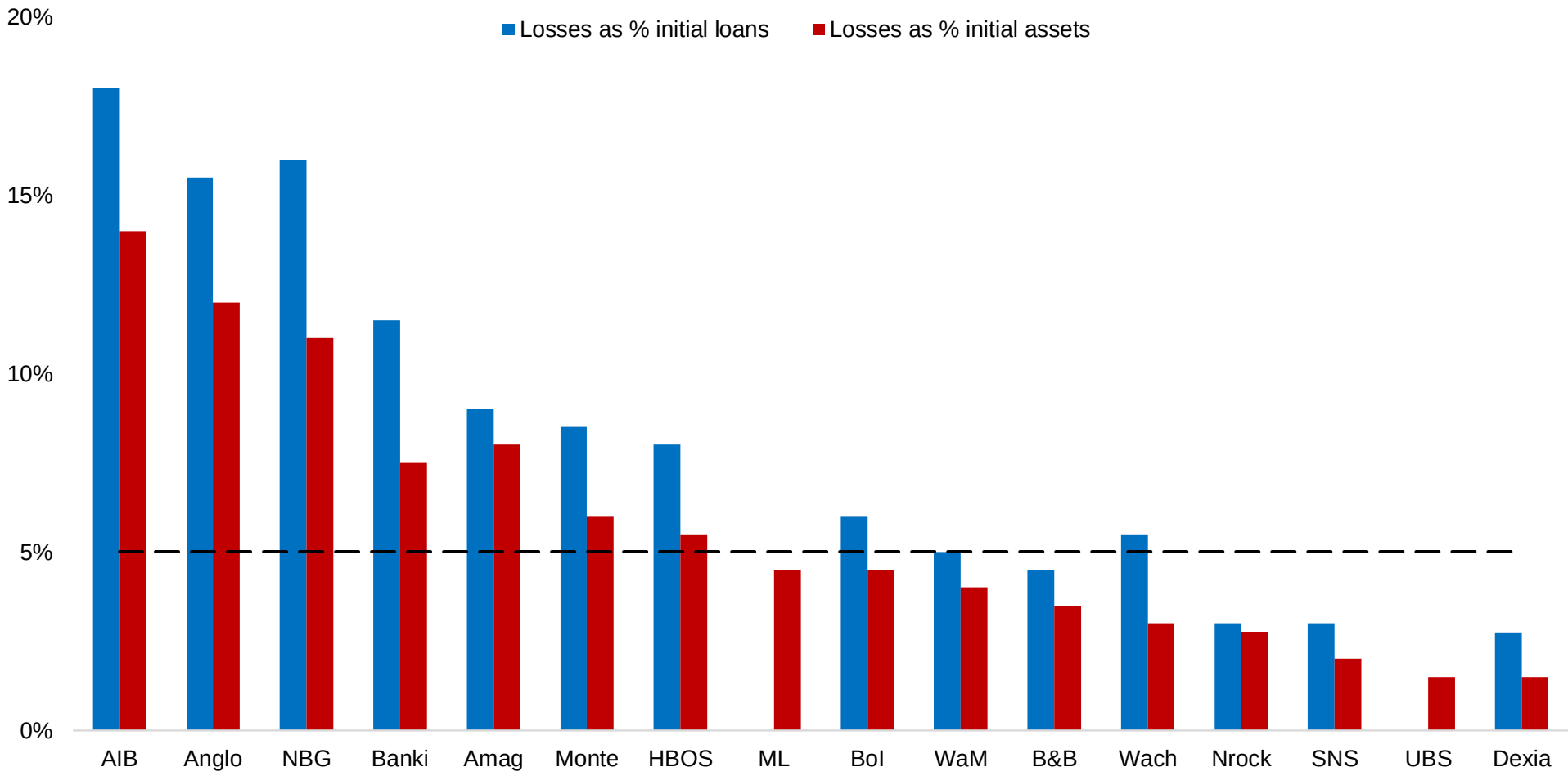
Historical Bank % Losses During the GFC, as % of Balance Sheet



Source: Algebris (UK) Limited, RBS Credit Strategy, Bloomberg, company filings

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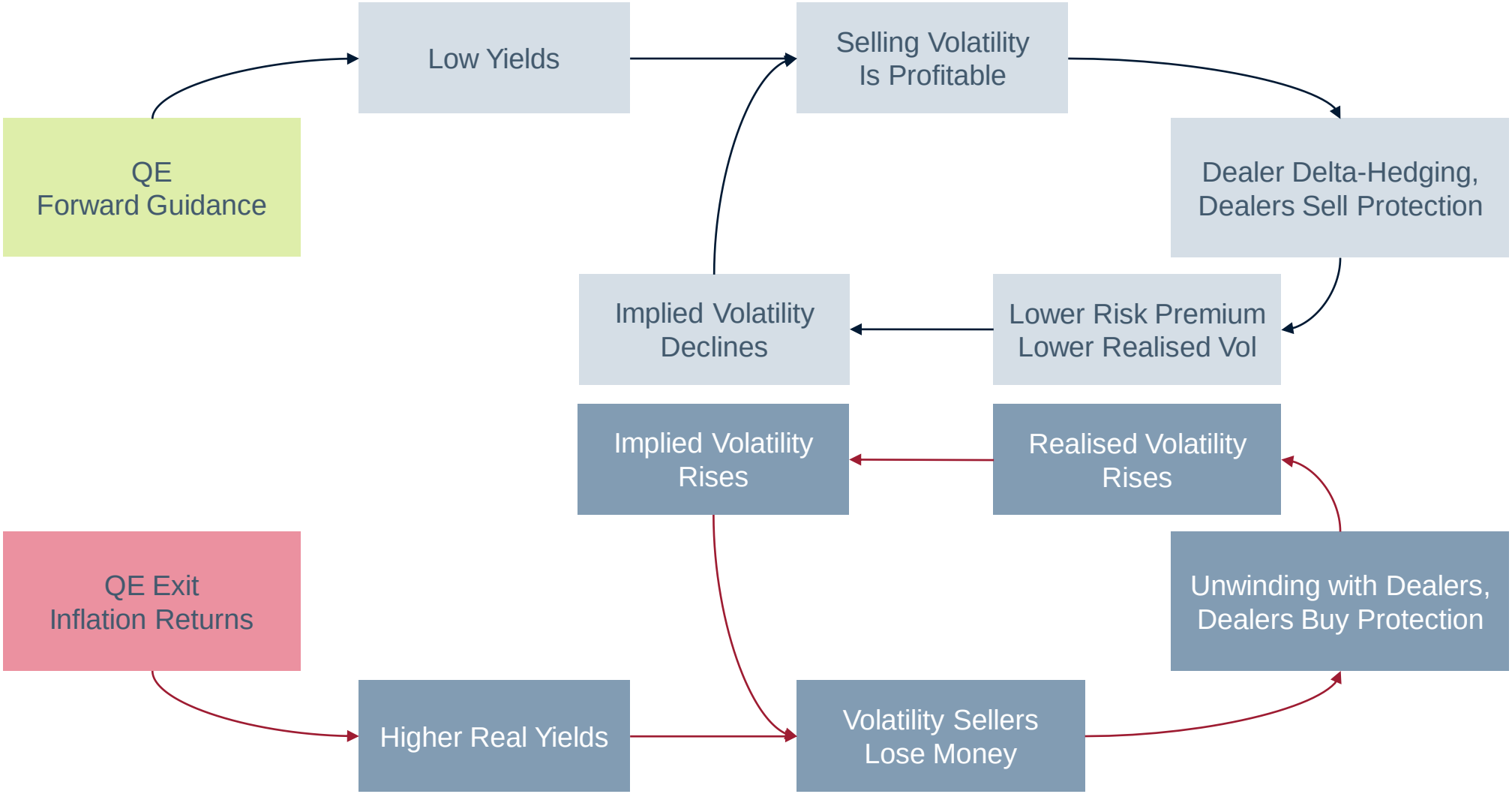
Low Volatility and Asset Bubbles

Forward Guidance and Short Volatility: A Feedback Loop



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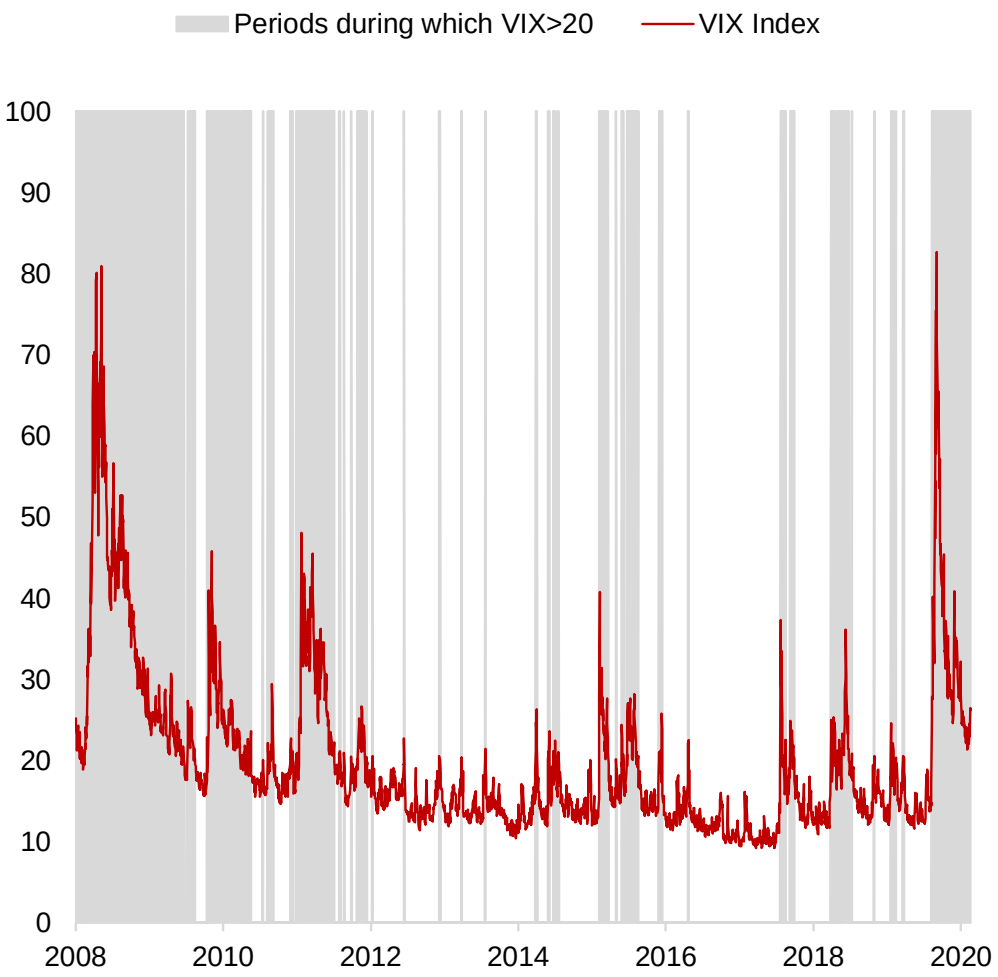
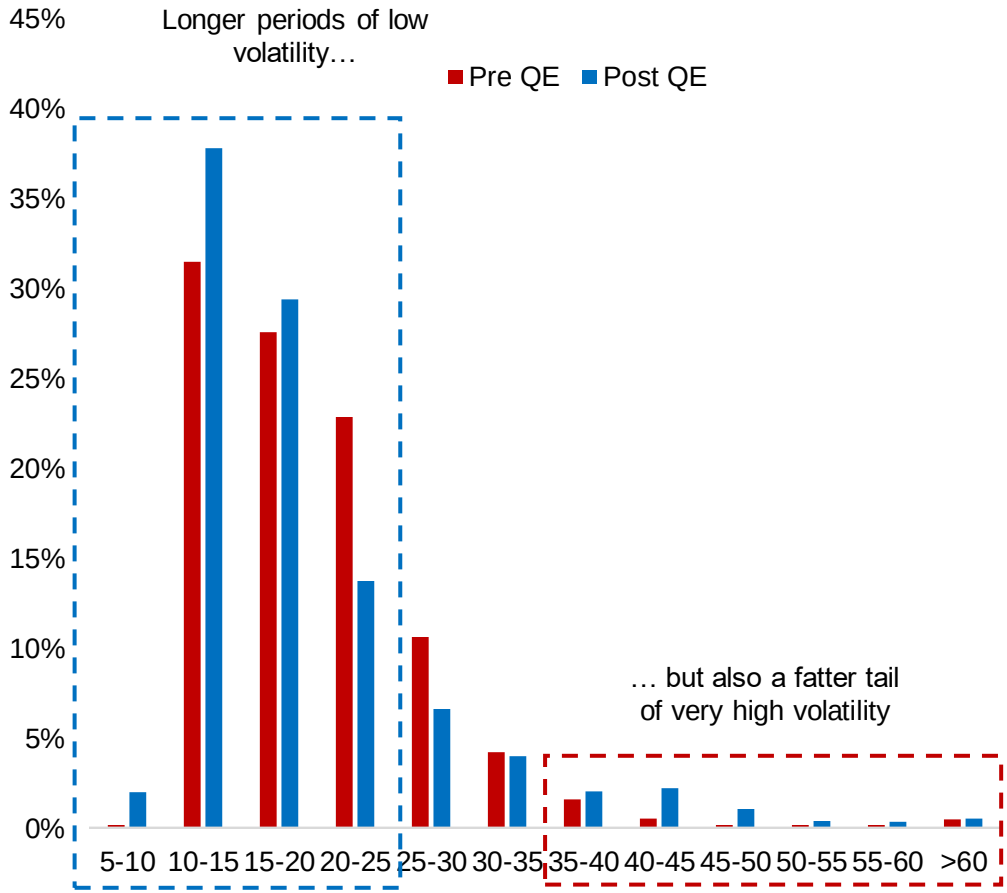
Markets: The New Too-Big-To-Fail

VIX Pre and Post QE

Length of High Vol Periods



Proportion of Days When VIX Falls in the Range



Source: Algebris (UK) Limited, Bloomberg

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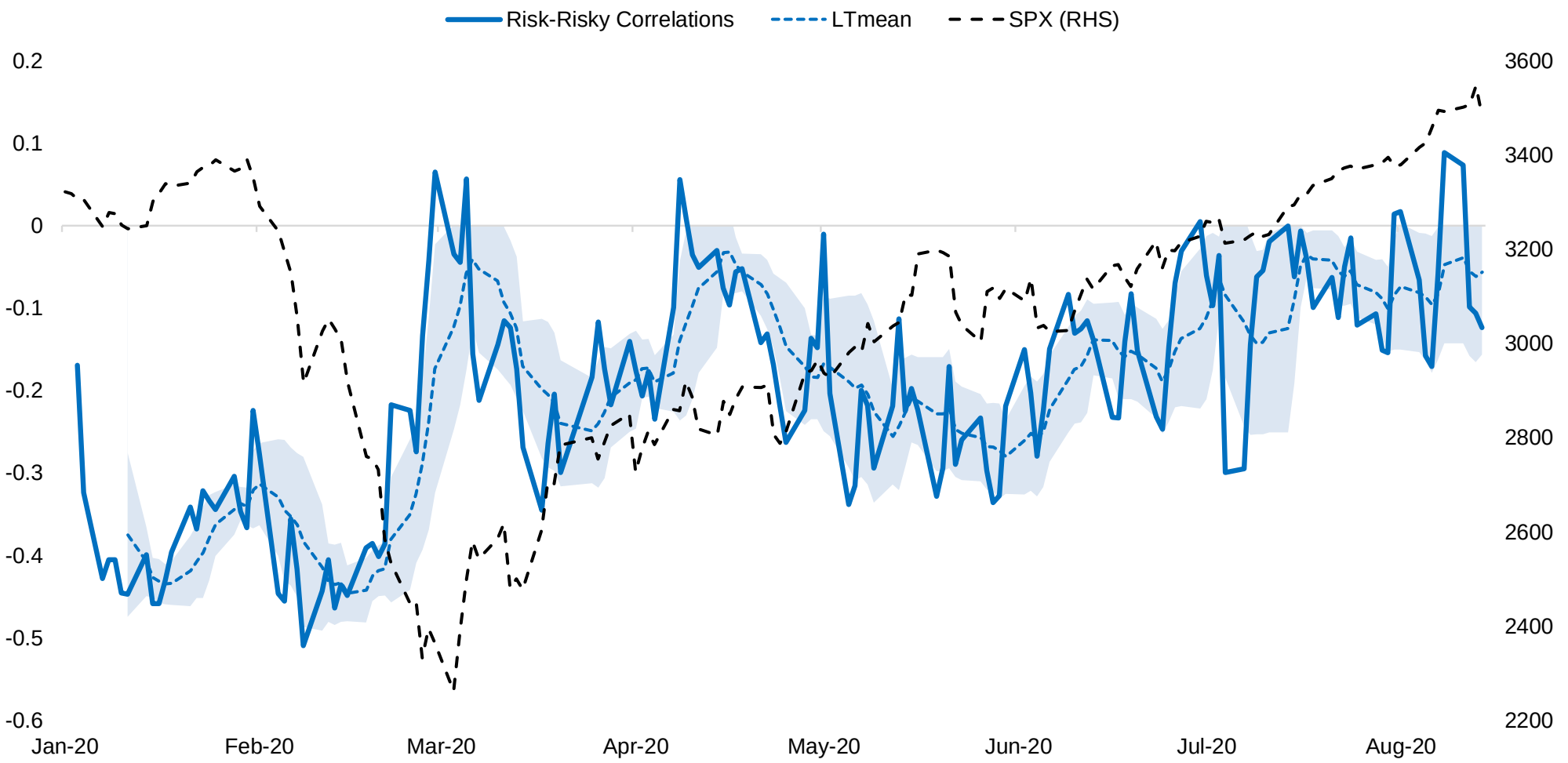
Risk-free Assets: No Longer Balancing Portfolios

2-Day Rolling Correlations – 10 Minute Intervals



Equities used: SX5E, SX7E, SPX, EEM, FTSEMIB, UKX and BKX; Rates used: OE1, RX1, TY1; Credit used: Xover, CDX HY, Senior Fin and EM local sovereign.
Source: Algebris (UK) Limited, Bloomberg

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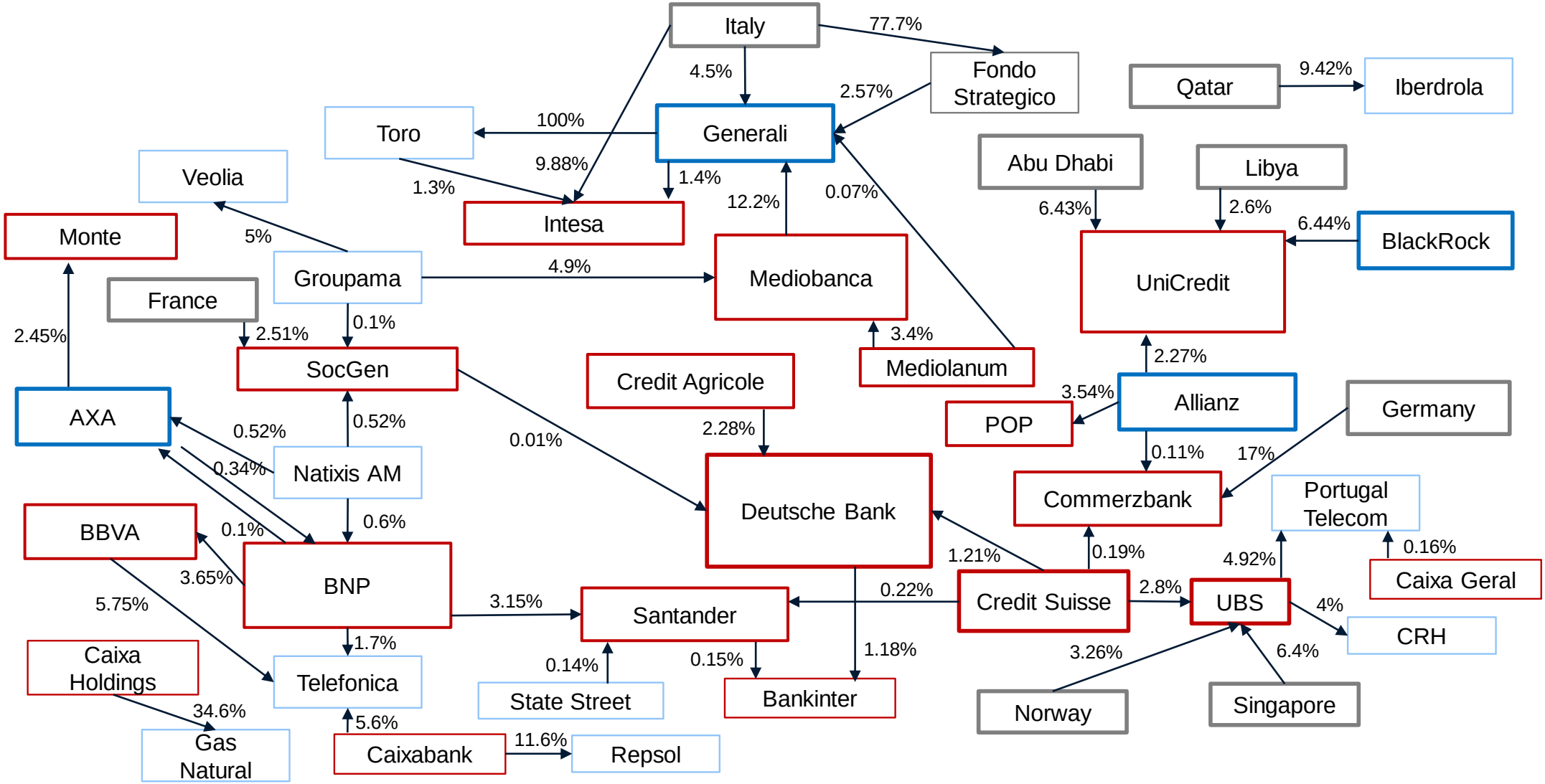
Cross-holdings and Systemic Risk Propagation



Source: Algebris (UK) Limited. Bloomberg 2016

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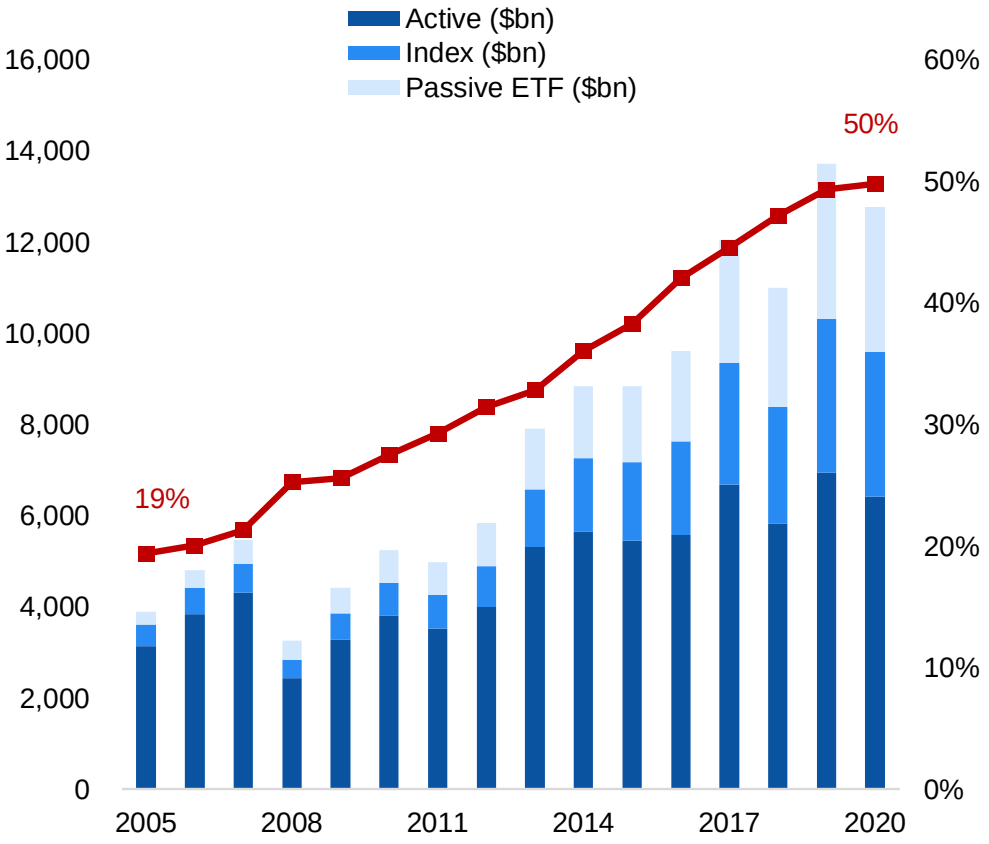
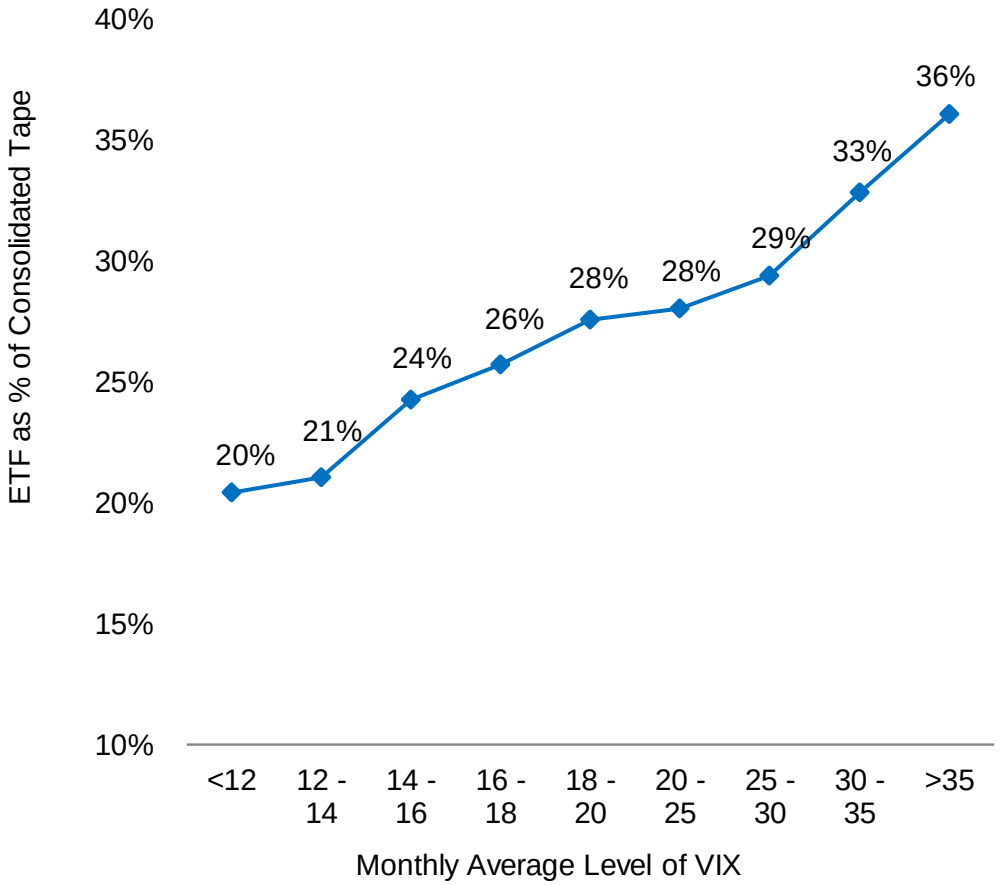
Markets: Increased Fragility
The Passive Investing Feedback Loop

Passive & Index investing increased to 50% of the US Equity Market



ETF usage rises as market volatility increases
(ETF Volumes as a % of the Total Tape, by Average Monthly VIX Levels)



Source: Algebris (UK) Limited, GS Research

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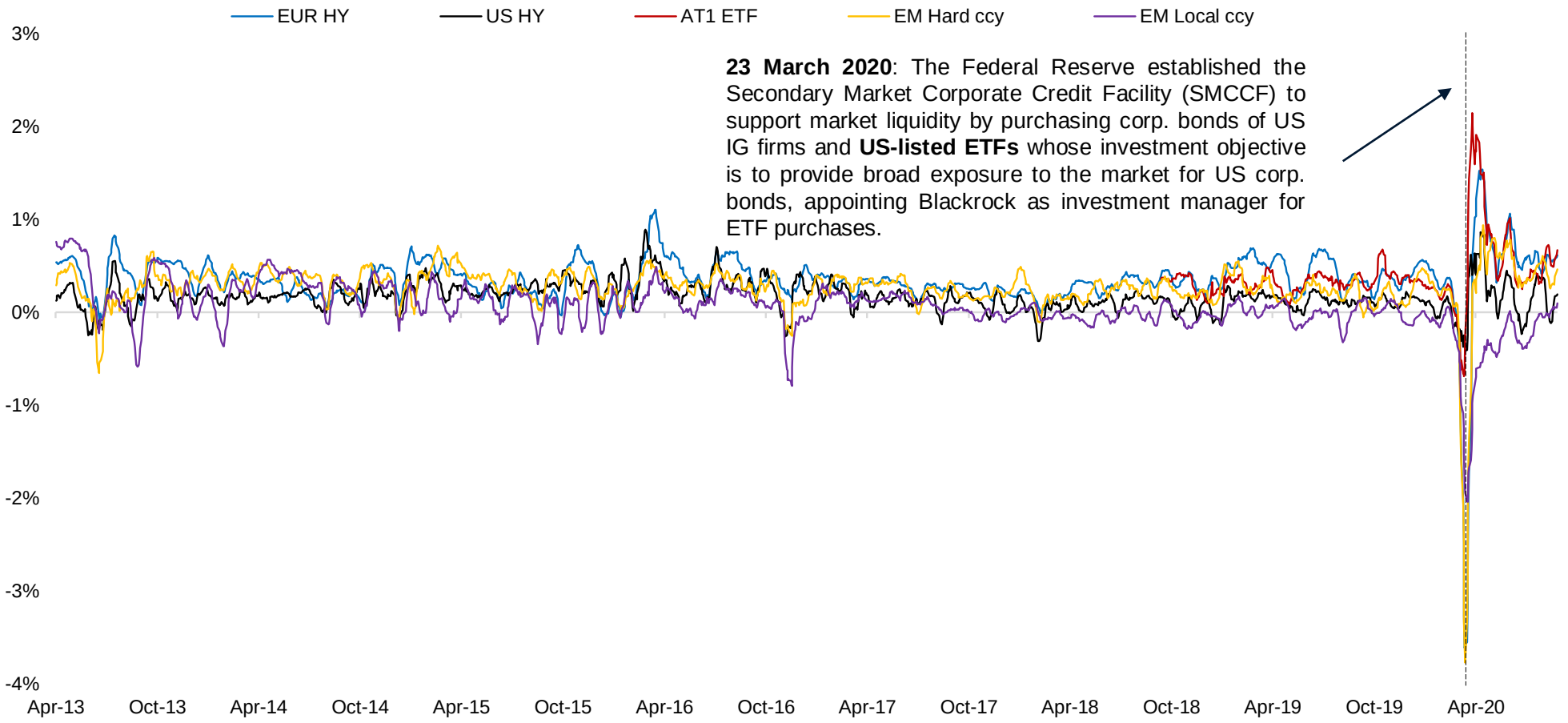
Markets: Increased Fragility

ETF Selloff During the Covid-19 Crisis

Fund Percentage Premium/Discount vs NAV

10-Day Moving Average



Source: Algebris (UK) Limited, Bloomberg. Data as of 02.09.2020

Note: EMB US - iShares J.P. Morgan USD Emerging Markets Bond ETF (EM Hard ccy); JNK US - SPDR Bloomberg Barclays High Yield Bond ETF (US HY); AT1 LN - Invesco AT1 Capital Bond UCITS ETF (AT1 ETF); IHYG LN - iShares EUR High Yield Corp Bond UCITS ETF (EUR HY); SEML IM - iShares JP Morgan EM Local Government Bond UCITS ETF (EM Local ccy)

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Policy and Markets: Time Inconsistency and Fragility

Fragility is Common, Anti-Fragility is Rare

	Fragile	Robust	Anti-Fragile
Medicine	Anaesthesia	Vaccine	Mithridatism
Pension System	Defined Benefits	Defined Contributions	Social Shock Absorbers
Technology	Centralised Hard Drive	Underground Storage	Cloud Storage
Mythology	Damocles	Ulysses	Hydra
Nature	Dinosaurs	Land Turtle	Ant Colony/Bacteria
Objects	Tea Set	Anvil	Spring
Financial Markets	Passive Investing/Herding Financial Engineering/Complexity	Active Management	Tail Risk Strategies
Monetary Policy	Forward Guidance	Rule-Based Approach	Macro-prudential Policy
Capital Structure	Debt	Equity	AT1
Sovereign Debt	Hard Currency External Debt	Domestic Currency Debt	Growth-Linked Debt
Economic Agents	Politicians	Regulators	Long-Term/Contrarian Investors
Government Structure	Eurozone	Singapore	Switzerland

Source: Algebris (UK) Limited. With reference and inspiration from *Antifragile: Things that Gain from Disorder*, N. N. Taleb (2013)

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