# Reflections on FSB's Report on Too Big To Fail

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# How have Banks responded post-GFC?

- Leverage, Size, Aggregate Risk, …

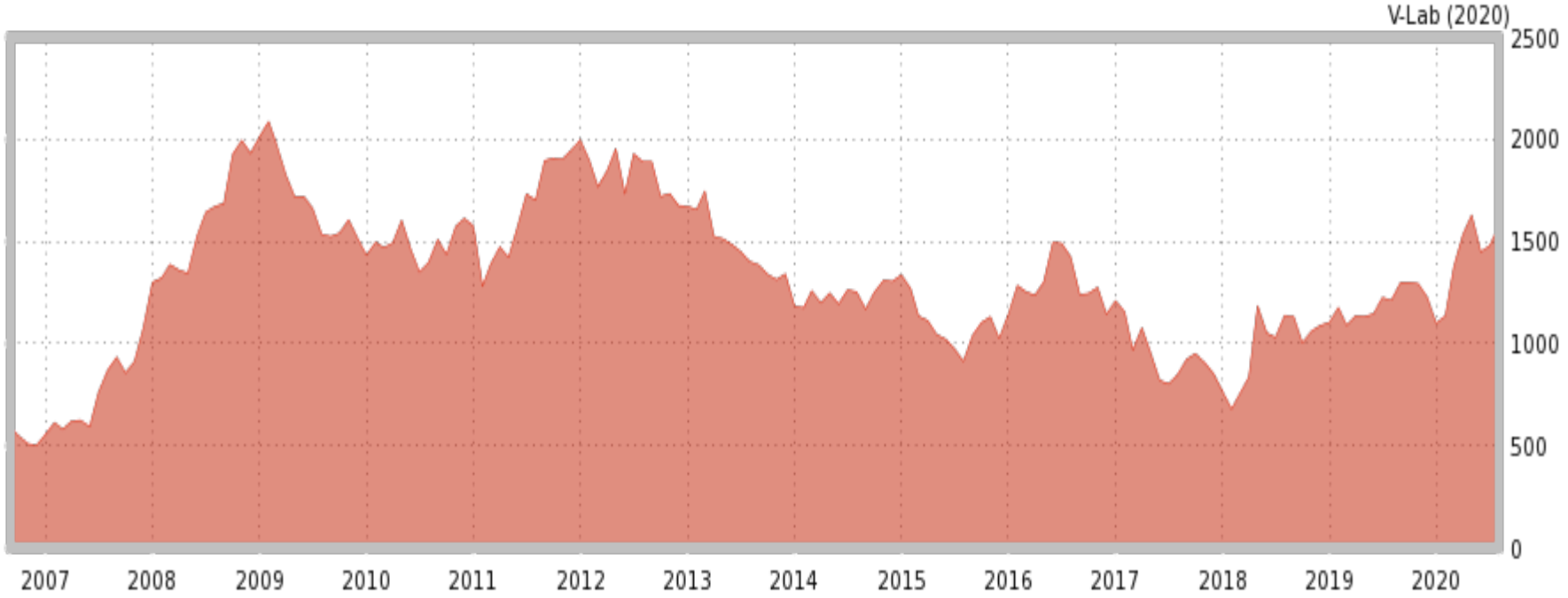
The Volatility Laboratory (Vlab): vlab.stern.nyu.edu/welcome/risk/ ▸ Vlab

SRISK: the capital a firm would need to raise in the event of a crisis (Acharya et al. (2010, 2012); Brownlees and Engle (2011))

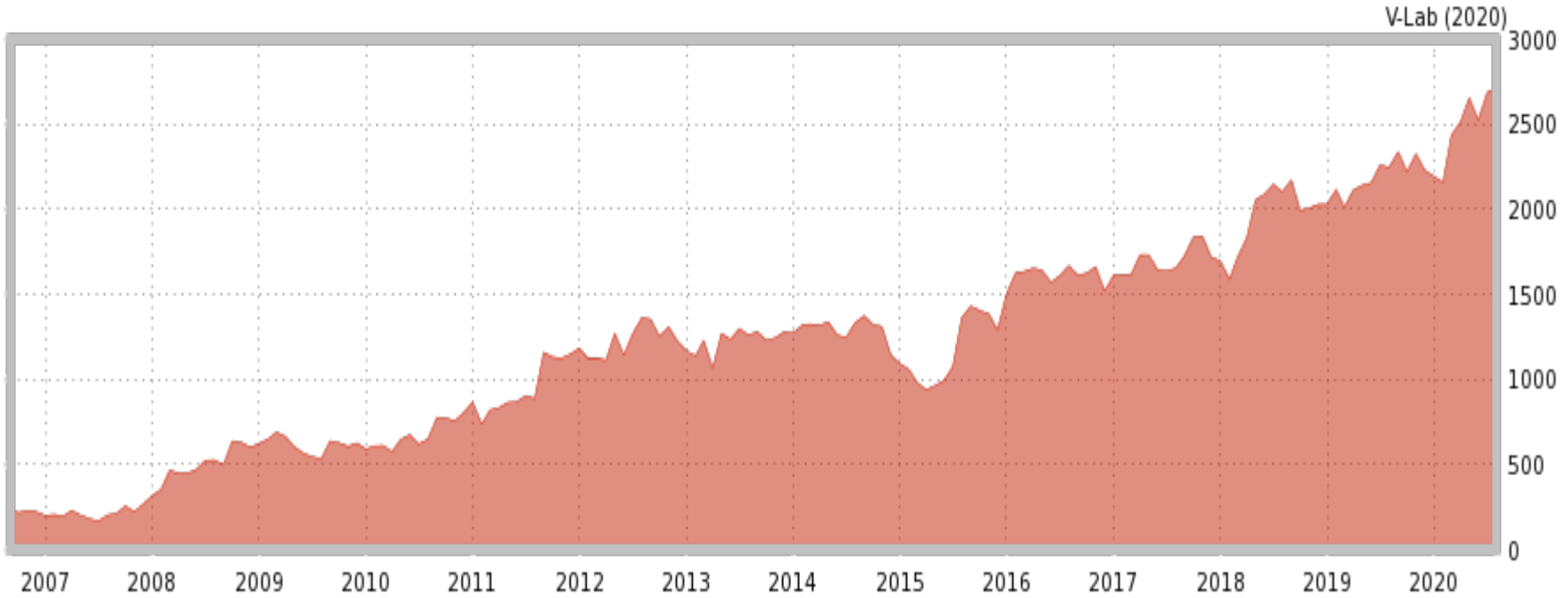
$$\begin{aligned} SRISK_{it} &= \mathrm{E}_t\left[k(Debt_{it+h} + MV_{it+h}) - MV_{it+h} | R_{mt+h} \leq -40\%\right] \\ &= kDebt_{it} - (1-k)(1 - LRMES_{it}) * MV_{it} \end{aligned}$$

where $MV_{it}$ is the market value of equity of the bank, $LRMES_{it}$ is its long-run marginal expected shortfall, and $k$ is the prudential capital ratio.

Europe




Asia




China and Japan are the Largest contributors To Asia's SRISK, China being more Important as an Incremental SRISK since 2008

SRISK
Capacity
makes
Pr (Crisis) > 0.5

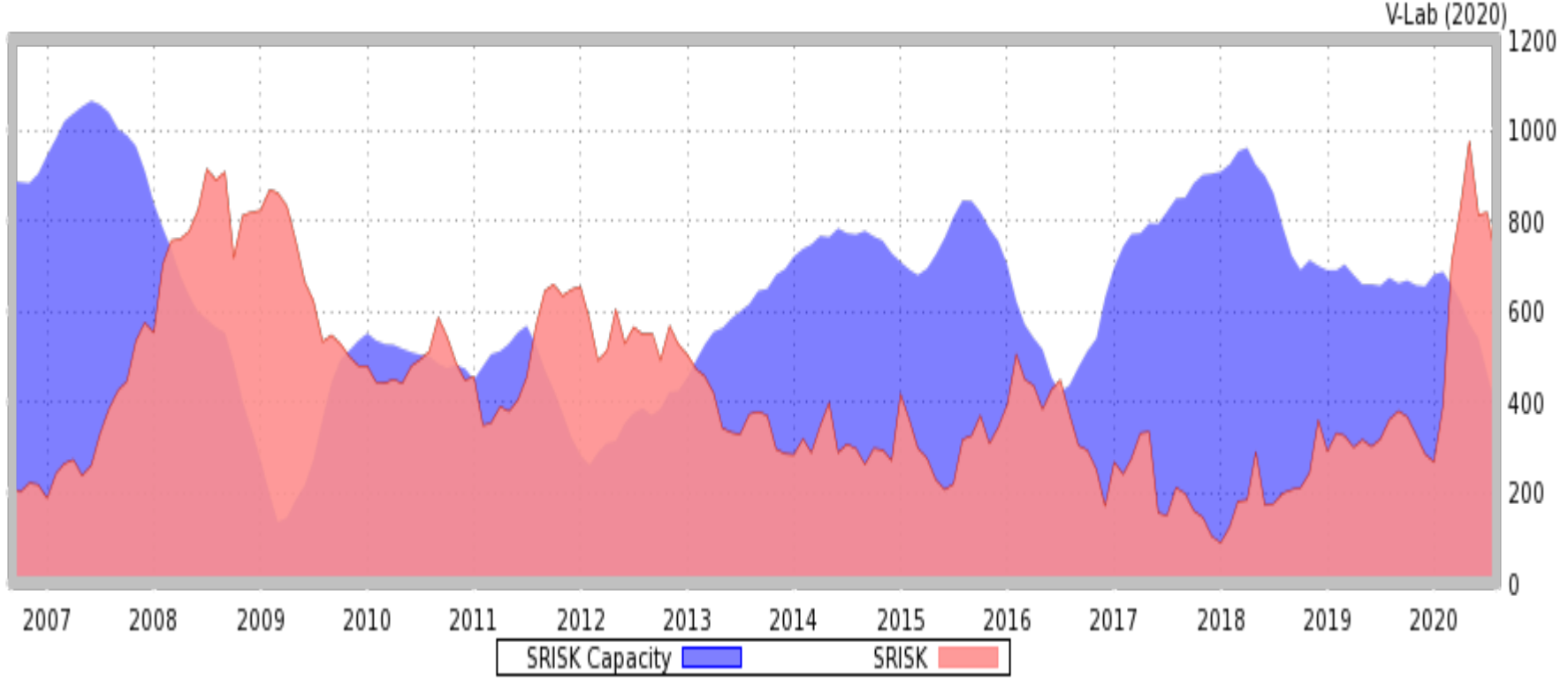
Pr (Crisis) is
Estimated using

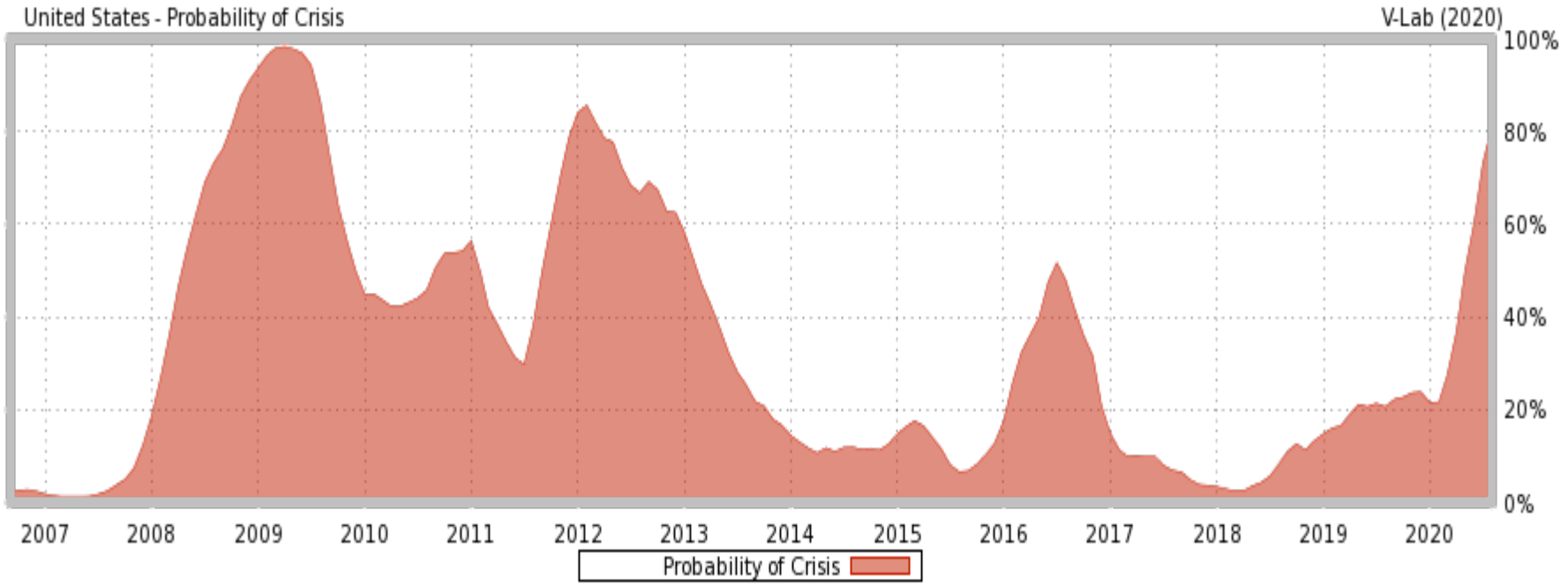
Romer and
Romer (2017)
Narrative-based
Indicator of

Credit Supply
Disruption

exceeding level of
4, which makes it

More than a
Minor Credit
Disruption



# Shadow always touches the feet!

- Bank finance versus Market finance
  - Automatic stabilizer (deposit insurance) vs Demand for immediacy
- Market finance in a stress scenario
  - Rollover risk, Freezes
  - Too Systemic To Fail?
- Spillover to banks via contingent contracts (Acharya-Steffen, 2020)
  - Corporate “dash for cash”
  - Bank credit line drawdowns imply bank capital has contingent lock-ups…
- Central bank lender of last resort to banks
  - Is “shadow banking” and “market finance” increasingly a claim on the central bank “put” option in times of aggregate stress?
  - Moral hazard of extraordinarily large central bank balance-sheets!

# References


- **"Capital Shortfall: A New Approach to Ranking and Regulating Systemic Risks"** (Viral V Acharya, Robert Engle and Matthew Richardson), 2012, *American Economic Review Papers and Proceedings*, 102(3), 59-64. Download PDF

- **"How Much SRISK is Too Much?"** (Robert Engle and Tianyue Ruan), Working Paper, NYU Stern School of Business, 2018

- **The risk of being a fallen angel and the corporate dash for cash in the midst of COVID** (with Sascha Steffen), forthcoming *Review of Corporate Financial Studies*
  (Long version) Download PDF (July 2020)
  (Short version) Download PDF, in COVID Economics: A Real Time Journal
  (Video) Short NBER presentation