Response to the TBTF consultation

My research area is focused on EU banking resolution, therefore my answers to the questions are primarily relevant for the EU banking sector. My PhD research investigates banking resolution by reference to the example of the Irish Government's approach during the 2008 financial crisis, and also to the recent Italian and Spanish resolution cases. It concluded that an efficient banking resolution system must be composed of several resolution tools in order to be adaptable for addressing all kinds of distress.

Regardless of their size (total assets, total equity, number of customers, etc.), all banks have the role to finance the economy (corporates and individuals) in good and bad times. For this reason, banks must be resilient (i.e. capacity to finance the economy even in bad times), and banks must be helped if they meet difficulties for the sake of business continuity. In that perspective, saving a bank is concerned with ensuring the financing of the economy rather than only saving *that* bank.

Question 1: Does the report draw the appropriate inferences about the extent to which TBTF reforms have achieved their objectives?

The report certainly describes the general trends, but more can be said on the specific impacts on the banking sector. Indeed, the latter remains vaguely mentioned and with little references to banks' financials and the evolution of banking business since the implementation of the reforms.

Another suggestion would be to investigate in greater detail the relationship between the state and resolution. There is indeed a tension in this report, as well as in other publications, on the topic. On the one hand, the report does not support state intervention or recapitalisation, but it is rather in favour of bail-in. On the other hand, the report does not challenge the fact that resolution regimes are public, i.e. managed by public and State-backed agencies. Here is the tension: the resolution regimes are public, but the use of public monies for resolution remains controversial. The report could investigate what the alternatives could be, e.g. a private resolution regime or a public-private resolution regime. In case of a private resolution, the feasibility and consequences of bail-in would need to be analysed. Regarding my comments on the feasibility and consequences of bail-in, I refer also to my answer to question 4.

Question 2: Does the report identify suitable findings for consideration by the relevant policy-making bodies?

The report is too general (and sometimes vague) to me,[1] and it is therefore very difficult to understand what the concrete findings and suggestions are, and what the added value is for the policy-makers and the banking sector.

[1] Report page 7: "the analysis suggests significant net benefits for society resulting from TBTF reforms", and related statements in Chapter 6, are very general and it is difficult to find in the report the arguments on which these assessments are based. Report para 2.1 page 11, "Financial institutions may become so large, complex or interconnected that their distress or failure would cause serious harm to the financial system and the economy." is a statement commonly found in several publications. However, this statement is very rarely accompanied with figures and evidences, e.g. what is meant by "large" (size of balance sheet, number of customers?), by "complex", and by "interconnected".

A first suggestion would be to narrow down the scope of research. It is rather adventurous to gather in a single report such a number of countries, because their banking landscapes and economies are much different. If the report must involve all these countries as they are FSB member jurisdictions, then a split per region would be desirable. When it comes to the EU, the report could enhance its investigation of the EU banking sector - see my answer to question 3.

A second suggestion is to be more concrete for the findings and the recommendations by using examples/cases and financial figures. Such an improvement would also demonstrate a better understanding of the banking sector and its functioning.

Question 3: Are the analytical approaches used to evaluate the effects of the TBTF reforms appropriate? Are there other approaches to consider?

More space should be allocated to the description of banking sector based on banking/financial sector's publications.[2] Answering the following questions would help in concretely describing the analysed banking sector: what are the banks' activities and what is their revenue split? What are their key financials? What are the external ratings? Are the banks profitable and why? Who are the shareholders (name and percentage of shares)? Who are the main clients?

As of now, the report seems to be based on economic statistics. This makes the report difficult to read and this could unfortunately give the impression of a poor understanding of the banking industry – which is certainly not a good reflection of the reality. More investigation and data would be needed on the banking and financial sectors in order to assess the impact of regulation (e.g. evolution of profitability) and the potential impact of resolution (e.g. impacts on shareholders and clients). Additionally, a better use of data would strengthen the statements made in the report, and it would probably call for a re-assessment of some statements.

The main issue for an external reader is the lack of clarity around the sources and the methodology in use.[3] Concrete indications must be clearly given, such as which banks are part of the panel? On which basis were these banks selected? It is also advisable to classify banks per size (tier-1, tier-2, etc), to refer to league tables, and to clearly refer to their financials.[4] This classification would help to understand better, and more accurately, the importance of banks per sectors, and it would certainly help to calibrate which banks are important. Indeed, the classification "systemically important" or "too big to fail" has the pitfall to lead to an overestimation of some banks' importance.

Even a rapid search on banks' websites evidences that banks disclose a lot of information on themselves and on the banking sector generally (e.g. annual reports, press releases, research papers). The FSB report does not show references to this information,

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[2] Report Annex E, as of now, the sources seem to be secondary sources that have a macroeconomic approach. I find it problematic that statements on the banking/financial sectors are not based on an analysis of publications from these sectors. Report Annex H, it is very difficult to understand how banks' behaviour was tested in the current wording of this annex. This part of the investigation is however one of the most important, because it is the direct analysis of the banking sector.

[3] Report para 2.2 page 17 – one of the main issues is the lack of clarity around the panel of banks.

[4] Report para 2.1. page 11 – the reference to systemic importance could be clearer if figures are given to support this statement, such as size of lending portfolio, number of customers, etc.

which is regrettable because it does not evidence a good awareness of banking nor a consideration for banks' perspective.

As a conclusion, the macroeconomic approach – which seems to be the approach used in the existing report – is not appropriate to analyse the banking sector/business. Finance and accounting must be used instead, which means a greater attention to figures/financials, to markets' evolution and trends, and to business. If the purpose is to investigate the banking sector/business, then a different methodology should be used to understand the effects of regulation/resolution on the banking sector, and to have a greater impact/added value.

Question 4: Is there relevant causal evidence of the TBTF reforms that can complement the findings of the report?

A main focus of this report seems to be advocating in favour of bail-in. Bail-in concerns banks' shareholders and creditors. Therefore, one could expect a greater analysis on the banks' shareholding structures and on the composition of creditors.

During my doctoral research, which was primarily focused on the Irish banking system, I found out that the Irish State is still a major shareholder of the Irish tier-1 banks, i.e. Allied Irish Banks and Bank of Ireland, as a result of the 2008 recapitalisation. That is to say, in such a context, a bail-in would *in fine* be equal to a bail-out. Moreover, the case of Ireland is not isolated, as other EU Governments can be found among the major shareholders of other EU banks (the other main example being the 15% shareholding of the German Federal Government in Commerzbank).

For this reason, it would be advisable to deeply investigate and identify the persons or entities who are liable to pay in case of bail-in,[5] and to evaluate the financial impact on them.[6] Such an analysis would also allow to assess the potential contagion impact of a bail-in.

Question 7: Does the report accurately describe the remaining obstacles to the resolvability of systemically important banks (SIBs)? Are there other major obstacles that should be highlighted?

The report has primarily an economic approach. It must be recognised that European banking resolution has also a strong legal dimension, insofar as it is defined by law (the Bank Recovery and Resolution Directive - Directive 2014/59/EU at the EU level) and it can interfere with other legal fields such as property law or State Aid Law. Therefore, it is advisable that the consultation examines the legal issues around banking resolution.

Furthermore, the report could more explicitly refer to and analyse the recent resolutions conducted through the Single Resolution Mechanism, and, in particular, the cases

[5] Shareholding structures are public, and it is therefore very easy to analyse them. Composition of creditors is not public information, therefore an advanced study on them would mean contacting the banks to obtain information.

[6] Report para 2.1. page 12 – such an investigation may lead to a re-assessment of shareholders' behaviours. Shareholding of banks encompasses a wide range of different entities and persons, such as employees, investment funds, and States. By knowing this variety of profiles, it would be interesting to analyse the behaviours, decisions, and interests of each profile, together with the consequences of bail-in on each of them.

in Spain and in Italy.[7] These cases showed that some flexibility is needed in resolution regimes (i.e. a "one fit for all" solution does not exist) to adapt resolution measures to a bank and its banking/economic landscape. These cases also evidenced that resolution tools can be used in combination or in succession, which means that a correction or an improvement remains possible, whatever the initial resolution decision was.[8]

As a conclusion of my PhD research, I concluded that an effective resolution regime must have the following features:

- State-backed and -driven, because banks play a critical role in the economy[9]
- Different tools to address different issues: recapitalisation for emergency cash,[10] work-out agency for non-performing loans,[11] nationalisation for full control to foster resolution, merger and acquisition for business continuity of good assets, and liquidation for the exit of non-performing businesses[12]
- A sound legal basis, to be predictable and difficult to challenge
- Expensive (recapitalisation and work-out agency)[13] and must be legally and financially anticipated

Question 9: Does the report accurately describe changes in the structure and behaviour of SIBs? Are the findings about the extent to which these changes can be attributed to TBTF reforms appropriate?

The concrete impacts of the regulation on banking sector and banking business do not seem to be clearly identified, nor investigated. As stated above, banks regularly release publications on their business, and this includes comments on the impacts of external factors (such as regulation). For example, further reports may try to answer these questions: what are the impacts on banks' profitability and if any how much is the increase/decrease? What are the impacts on pricing and if any how much is the increase/decrease? What are the impacts on client relationship? Are all the banking products impacted equally?

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[7] Report Annex G – recent resolutions are actually listed in this annex, but more investigation would be needed on these resolutions (chronology, rationale, assessment of the resolution).

[8] Report para 2.1. page 14 – additionally, resolution is more than bail-in v. bail-out. Resolution authorities can use a wide panel of tools, such as a work-out agency (see for example the cases of NAMA in Ireland and SAREB in Spain during the 2008 financial crisis) or nationalisation. Therefore, resolution in the EU can be flexible and adaptable.

[9] Report page 7, the report suggested that State support to failing banks happens in developing and immature resolution regimes. I disagree with this statement, as State intervention has proven to be beneficial to restore the banking sector in many instances. However, I acknowledge that alternatives are possible (such as an independent agency or even a private agency). If this is also the argument made in the report, then the alternatives and their consequences should be investigated (e.g. is it desirable/relevant to privatise banking resolution?).

[10] In 2017, the EU Commission allowed the use of precautionary recapitalisation.

[11] See the cases of NAMA in Ireland and of SAREB in Spain during the 2008 financial crisis.

[12] All these tools were used in the EU during the 2008 financial crisis. They were afterwards legally implemented by the BRRD and developed by the Single Resolution Board. In Ireland, the resolution of Anglo Irish Bank (2008-2013) necessitated the use of all these tools.

[13] I mean that some resolution tools are expensive, and they can be necessary for addressing some issues. Therefore, their use cannot be dismissed or avoided solely based on their cost, but their cost must instead be anticipated.

The report could be more accurate on the impacts of reforms on banks' profitability. Are all the banking products equally impacted? Do all banks' financials show a decrease of profitability? How did banks' management adjust their business policies to the new regulatory requirements? Are some banks better than others in adapting to the new environment, and why? Investigating these questions may lead to conclusions different from the ones made in the existing version of the report, and may lead to more moderated conclusions.

Impacts on competition could be investigated in greater detail. Regulation applies to all banks holding a banking license within its area of application. Therefore, all banks can be seen as equally impacted. From that perspective the impact on competition might be seen as limited. Nevertheless, banks' management may have different approaches to adapt their business, and this can act as a differentiating factor. Here, the report could bring more attention of the internal policies and decisions of the banks, and to how they are able to adapt themselves to keep on doing business. In doing so, the report would acknowledge the efforts and agility of banks to adapt their business to the new regulatory rules, and this behaviour has probably contributed to the successful implementation of the new regulation.

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