FSB virtual workshop
on the effects of too-big-to-fail reforms

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What is the too-big-to-fail problem?

- Banks may become so large, complex, or interconnected that their failure would cause harm to the financial system and the economy.
- The too-big-to-fail (TBTF) reforms are intended to reduce the costs and probability of financial crises.
  - Minimum requirements specifying amount of equity or debt absorbing losses when a bank is resolved
  - Enhanced supervision
  - Comprehensive resolution regime and improved resolvability

→ The TBTF reforms address the systemic risk and moral hazard associated with systemically important banks.
G20 TBTF Reforms
To address the systemic and moral hazard risks associated with SIBs

Choices of banks affecting systemic risk
Probability of crisis x Capital shortfall
Choices of governments about resolution and bailout

Market perceptions of implicit funding subsidy

Broader effects on the economy and markets
The focus is on systemically important banks.

Source: FSB and TBTF evaluation survey
Key findings

Indicators of systemic risk and moral hazard have moved in the right direction

Effective TBTF reforms bring net benefits to society

There are still gaps that need to be addressed
Indicators of systemic risk and moral hazard fell.

- **Capital ratios** of SIBs increased by more than those of other banks.
  - But larger banks still have lower ratios of equity to assets.
- **Profitability** has fallen relative to other banks.
  - This reflects higher capital, lower risk, and higher funding costs.
- **Lending** has not declined.
  - There are no other significant changes in the balance sheet structure of G-SIBs compared to other banks.
- **Complexity** of global banks remains high.
G-SIBs’ capital ratios have markedly increased

In per cent

- North America
- Europe
- Rest of the world
Feasibility of resolution has improved.

- **Implementation of resolution reforms has made progress.**
  - Effective resolution enables authorities to allocate losses without disrupting critical functions.
  - Legal powers and coordination arrangements are in place, particularly in jurisdictions that are home to G-SIBs.
  - Resolvability is on a longer track.

- **Total loss-absorbing capacity (TLAC) has increased.**
  - Issuance of TLAC has so far been absorbed by markets.
  - Most G-SIBs already meet their 2022 final TLAC requirements.
Implementation of resolution reforms made progress.

Resolution reform index across FSB jurisdictions

Average scores of resolution reforms for G-SIB home and other jurisdictions

Source: FSB
Stakeholders consider resolution to be more credible.

- **Implicit funding subsidies have declined.**
  - Funding cost advantages of systemic banks peaked during the financial crisis, remain high, and then fell.
  - But they remain higher than before the financial crisis.

- **Market discipline has improved.**
  - Riskier banks pay higher rates of interest.
  - Credit rating agencies have removed the assumption that a failing bank will receive sovereign support in many jurisdictions.
  - Prices and credit ratings of structurally subordinated debt suggest that market participants price the risk of resolution.
Funding cost advantages of SIBs have fallen – but remain higher than before 2007-2008.

Portfolio returns (%)

Sources: Federal Reserve bank of St Louis (FRED); Eikon; Kenneth R. French website
Indicators of systemic risk and moral hazard have moved in the right direction

Effective TBTF reforms bring net benefits to society

There are still gaps that need to be addressed
Social costs

- Increase in cost of bank lending
- Decline in lending
- Decline in GDP

Social benefits

- Reduce costs of system failure
- Lower probability of default
- Shield taxpayers from losses

Positive net social benefit
There are no material adverse effects on the real economy.

- The ratio of credit to GDP has not fallen.
  - Systemically important banks have lost domestic market share.
  - Other banks and non-banks have picked up the slack.

- Market-based measures of systemic risk fell.

- The trend towards global financial integration slowed down after the 2007-08 crisis but has not reversed.
  - There is no evidence that reforms reduce cross-border lending.
  - There is no support for fragmentary effects of internal TLAC.
  - Internal TLAC supports orderly resolution and incentivises coordination.
Domestic market shares of systemically important banks have fallen.

By bank type

G-SIBs’ domestic market shares, by region

In percentage

Source: TBTF evaluation
Indicators of systemic risk and moral hazard have moved in the right direction

Effective TBTF reforms bring net benefits to society

There are still gaps that need to be addressed
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**Obstacles to resolution** can be reduced further.
- Detailed work on resolvability continues.
- State support for failing banks has continued.
- Resolution of central counterparties is work in progress.

**Information** can be improved.
- Adequacy of levels of transparency needs to be considered.
- All stakeholders would benefit from closing information gaps.

**Monitoring** can be enhanced.
- Application of reforms to D-SIBs
- Risks from shift to non-bank financials need to be monitored.
We need your feedback!

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<th>Does the report draw the <strong>appropriate inferences</strong> about the extent to which TBTF reforms have achieved their objectives?</th>
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**How to provide feedback**

- FSB is looking for responses from all interested parties, including supportive evidence.
- Respond to [fsb@fsb.org](mailto:fsb@fsb.org) by **30 September 2020** with subject “TBTF Evaluation”
- Responses will be published, unless requested otherwise.
The too-big-to-fail evaluation consultation report:

The evaluation framework:

Results of previous evaluations:
Since 2017

Evaluations:
- Derivatives clearing
- Infrastructure finance
- SME financing

Early 2019

Start of TBTF evaluation

Early 2021

Final report of the TBTF evaluation