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/

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

\[
SRISK_{it} = E_t \left[ k(Debt_{it+h} + MV_{it+h}) - MV_{it+h} \mid R_{mt+h} \leq -40\% \right] \\
= kDebt_{it} - (1 - k)(1 - LRME_{S_{it}}) \times MV_{it}
\]

where \( MV_{it} \) is the market value of equity of the bank, \( LRME_{S_{it}} \) 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 $\Pr \left( \text{Crisis} \right) > 0.5$

$\Pr \left( \text{Crisis} \right)$ 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


• “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](#)