

# Addressing Too Big To Fail

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“If the crisis has a single lesson, it is that the too big to fail problem must be solved”

-- Ben Bernanke



# What is the problem?

## ✓ TBTF institutions

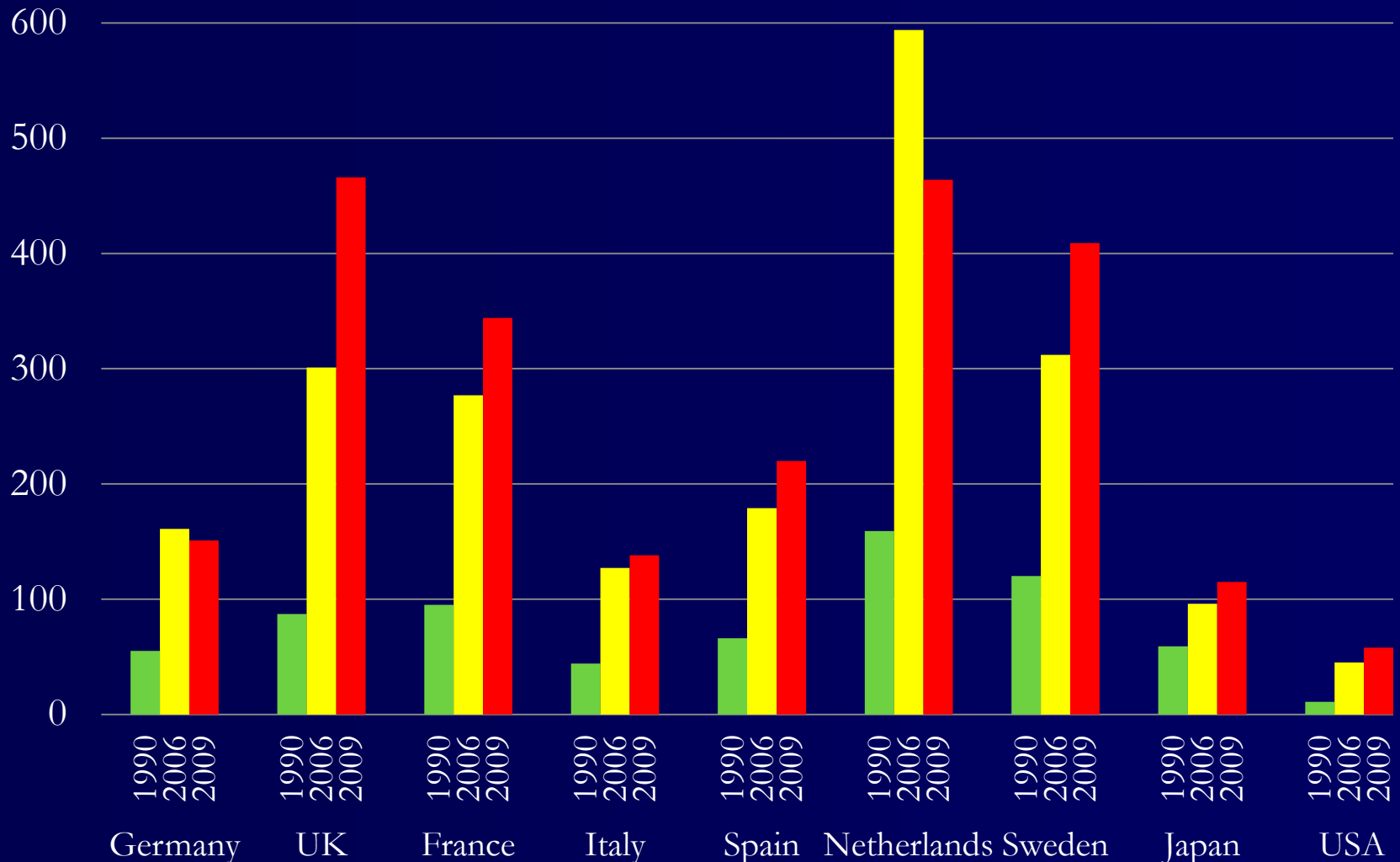
- exacerbate systemic risk by removing incentives to act prudently and creating a massive contingent liability for governments
  - ✓ (Greater write-downs during crisis – Haldane)
- distort competition
  - ✓ (Funding costs cheaper, account for lion's share of government support during crisis)
- lower public trust in fairness of system

(Goldstein and Varon, 2011)



# The problem has been getting worse

Combined assets of the five largest banks  
(percent of GDP)



Source: Goldstein and Varon, 2011



# How to identify TBTF institutions?

- ✓ Could failure seriously impair financial system stability?
- ✓ Several dimensions to be considered:
  - balance sheet size
  - interconnectedness
  - performance of systemically important functions
  - complexity of corporate structure
- ✓ Size of balance sheet captures much of problem



# Should there be a special TBTF regime?

- ✓ Does identifying a TBTF institution exacerbate the problem?
- ✓ Does a regime for Systemically Important Financial Institutions (SIFIs) solve the problem?



# Line of Attack: Too Big

- ✓ Capital surcharge
- ✓ Tax surcharge
- ✓ Competition policy
- ✓ Size limits
- ✓ Turn infrastructure into a utility

Are big institutions useful or necessary?



# Line of Attack: Allow Failure

- ✓ Special resolution regimes
- ✓ Living wills
- ✓ Cross-border arrangements
- ✓ Contingent capital
- ✓ Creditor bail-in





# G20 recommendations on Financial Regulatory Framework Reform

- ✓ Identification guidelines
- ✓ SIFIs-specific measures
- ✓ Cross-border intervention
- ✓ Resolution regime (incl. cross-border)
- ✓ Supervisors mandate
- ✓ Supervisory colleges
- ✓ Peer reviews



# G20 recommendations on Financial Regulatory Framework Reform

## ✓ Identification guidelines

Produce guidelines to assess if an institution is systemically important.

Global policy development – **Completed** (October 2009)

## ✓ Resolution regime (incl. cross-border)

## ✓ Supervisors mandate

## ✓ Supervisory colleges

## ✓ Peer reviews



# G20 recommendations on Financial Regulatory Framework Reform

- ✓ Identification guidelines
- ✓ SIFIs-specific Measures

Resolution framework, higher loss-absorbency capacity, more intensive supervisory oversight, robust core market infrastructure, etc.

Global policy development - **Under way**

National/International policy implementation – **Under way:**

! National authorities are developing and implementing measures for SIFIs. Legislation will be needed in a variety of areas.

- ✓ Peer reviews



# G20 recommendations on Financial Regulatory Framework Reform

- ✓ Identification guidelines
- ✓ SIFIs-specific measures
- ✓ Cross-border intervention

Introduce a legal framework for crisis intervention, develop recovery plans, and establish crisis management groups for major cross-border firms.

Global policy development - **Under way**

National/International policy implementation – **Under way:**



Adequate legal frameworks for crisis intervention are yet to be introduced in many jurisdictions. Crisis management groups have been established, but much further work on recovery and resolution plans and on cross-border co-operation is needed.



# G20 recommendations on Financial Regulatory Framework Reform

Develop key attributes of effective resolution regimes, including an international framework for cross-border resolution arrangements.

Global policy development – **November 2011**

National/International policy implementation – Not yet applicable.

- ✓ Resolution regime (incl. cross-border)
- ✓ Supervisors mandate
- ✓ Supervisory colleges
- ✓ Peer reviews



# G20 recommendations on Financial Regulatory Framework Reform

Give supervisors strong and unambiguous mandates, sufficient independence to act, appropriate resources, and a full suite of tools and powers to identify risks proactively and address them.

Global policy development – **Under way**

National/International policy implementation – **Under way:**



The FSB progress report on Supervisory Intensity and Effectiveness notes that weaknesses in these areas remain in many jurisdictions

- ✓ Supervisors mandate
- ✓ Supervisory colleges
- ✓ Peer reviews



# G20 recommendations on Financial Regulatory Framework Reform

## ✓ Identification guidelines

Establishment of supervisory colleges for significant cross-border firms.

National/International policy implementation – **June 2009:**



While supervisory colleges have been established, work is needed to improve their effectiveness in sharing information and collectively addressing risks.

## ✓ Supervisory colleges

## ✓ Peer reviews



# G20 recommendations on Financial Regulatory Framework Reform

- ✓ Identification guidelines
- ✓ SIFIs-specific measures
- ✓ Cross-border intervention

Regular peer reviews will be conducted by FSB on the effectiveness and consistency of national policy measures for G-SIFIs.

Global policy development – End-2011

National/International policy implementation – Beginning in 2012

- ✓ Peer reviews





# G20 recommendations on Financial Regulatory Framework Reform

- ✓ Identification guidelines ✓
- ✓ SIFIs-specific measures !
- ✓ Cross-border intervention !
- ✓ Resolution regime (incl. cross-border)
- ✓ Supervisors mandate !
- ✓ Supervisory colleges !
- ✓ Peer reviews



# Some concluding remarks

- ✓ Still much difficult work to be done
- ✓ Not clear that these measures will survive contact with the enemy
- ✓ Need to ensure that at the national level no institution is too big to fail
- ✓ Benefit of large financial institutions exaggerated
- ✓ Still scope for a more ambitious breaking up of financial institutions if political will can be found



Thank you

