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

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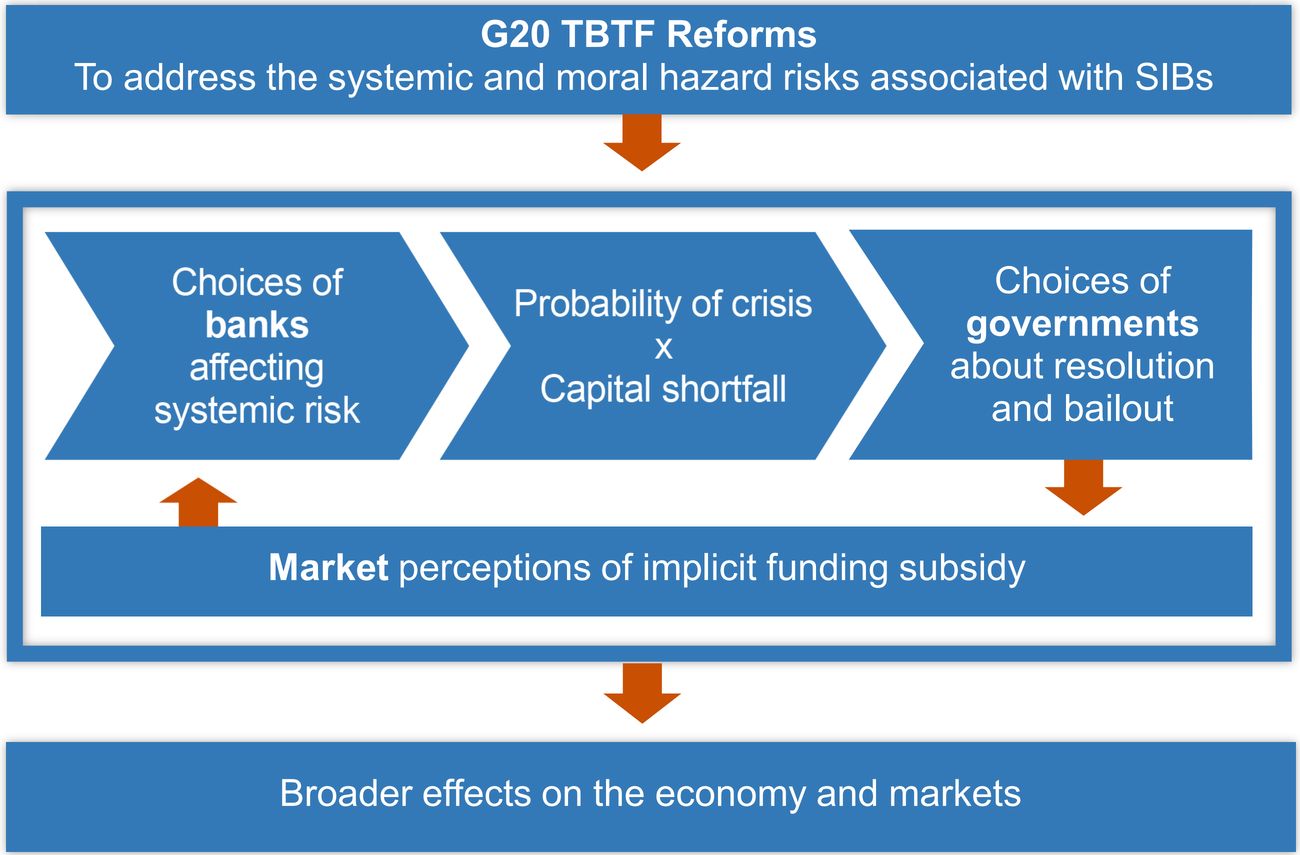
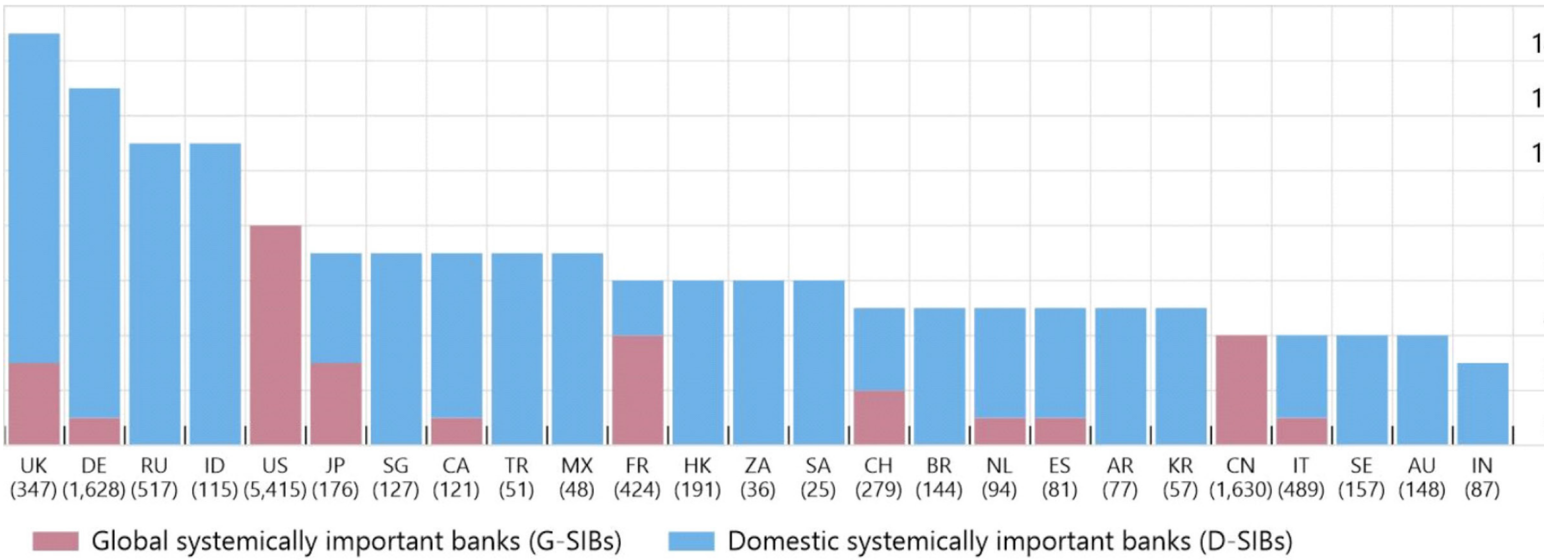
What is the too-big-to-fail problem?

- **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

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Key findings

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

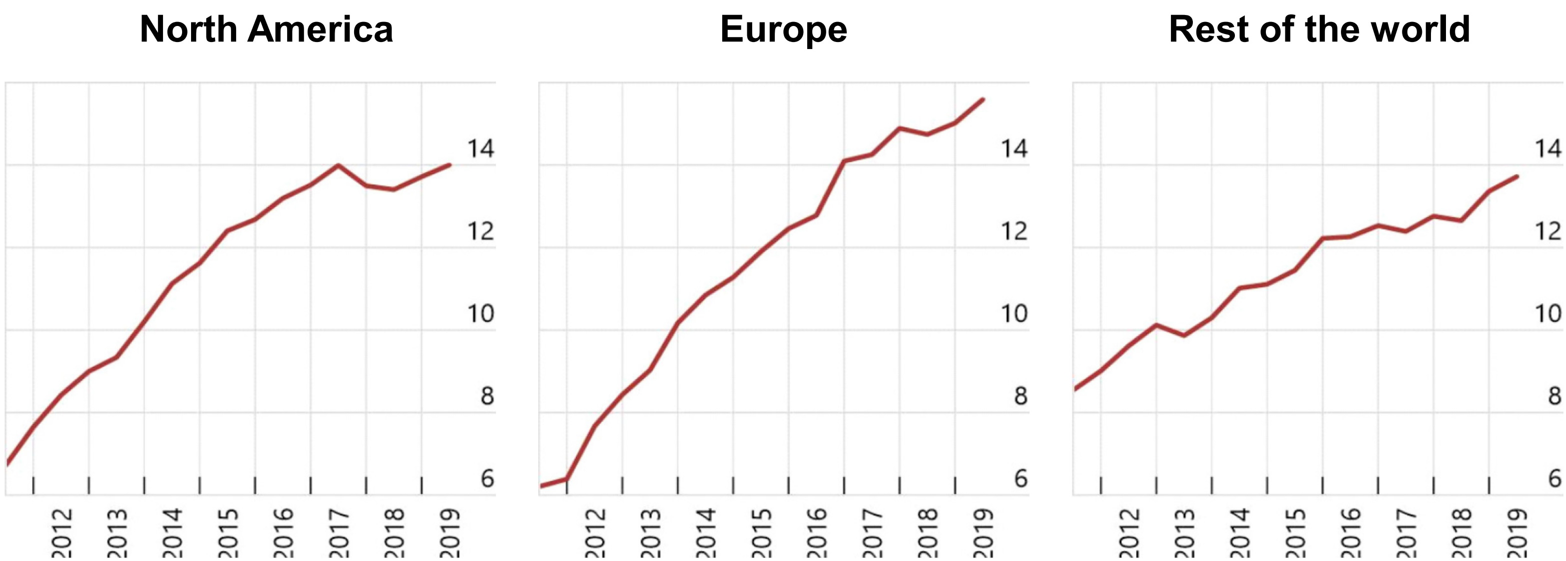
Effective TBTF reforms bring net benefits to society

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



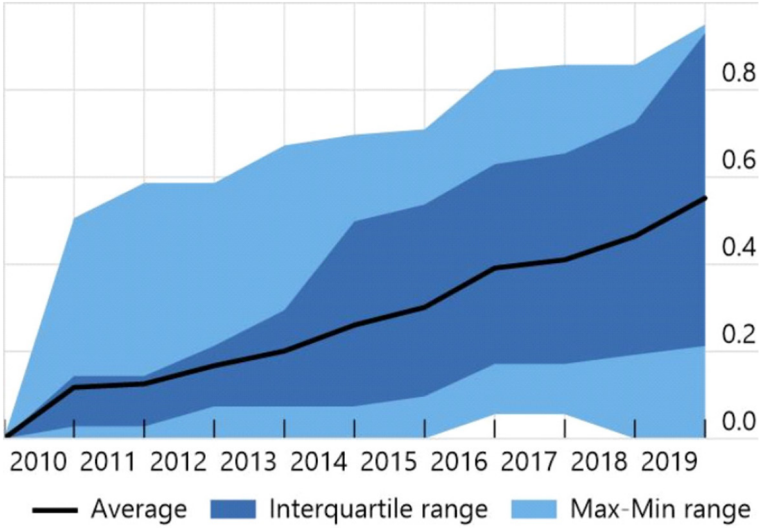
In per cent

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.

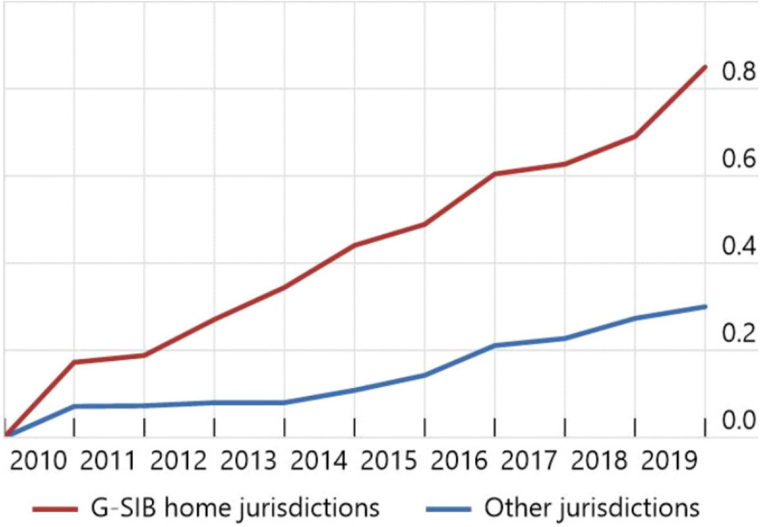
Implementation of resolution reforms made progress.

Resolution reform index across FSB jurisdictions



Source: FSB

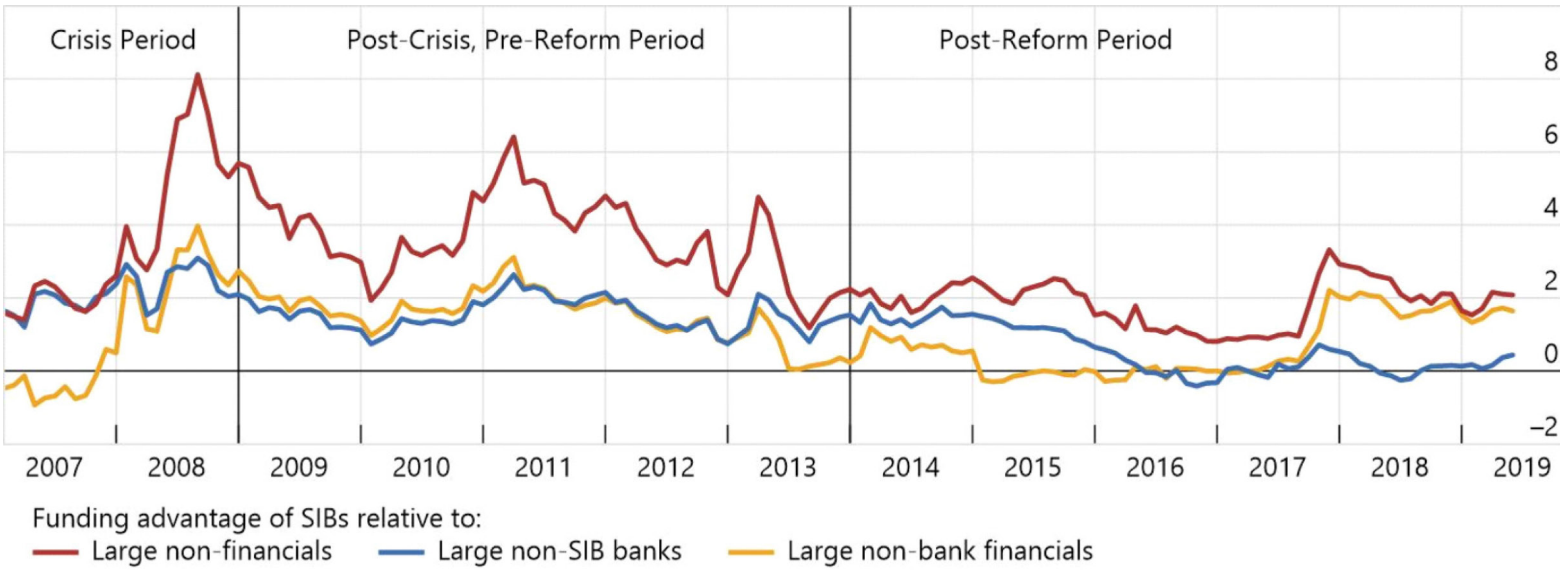
Average scores of resolution reforms for G-SIB home and other jurisdictions



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.



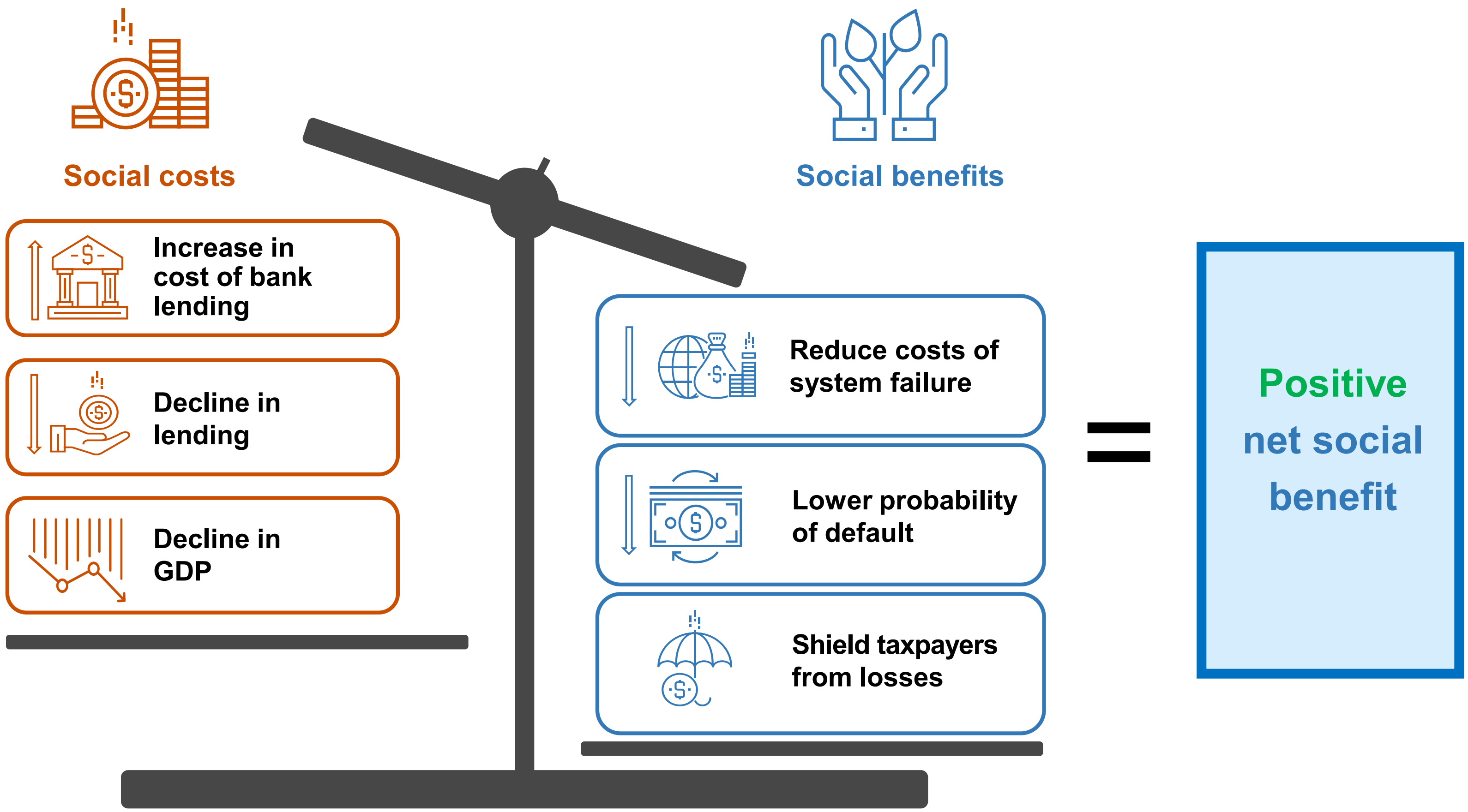
Portfolio returns (%)

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

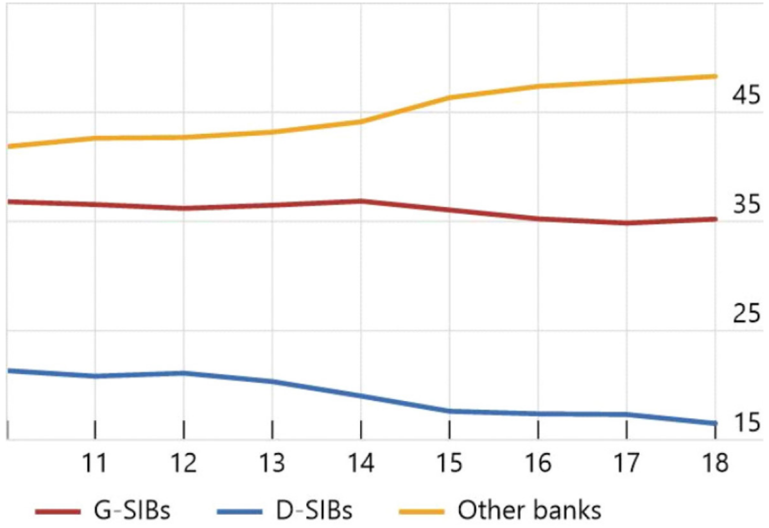

Social costs
Increase in cost of bank lending
Decline in lending
Decline in GDP
Social benefits
Reduce costs of system failure
Lower probability of default
Shield taxpayers from losses
=
Positive net social benefit

There are no material adverse effects on the real economy.

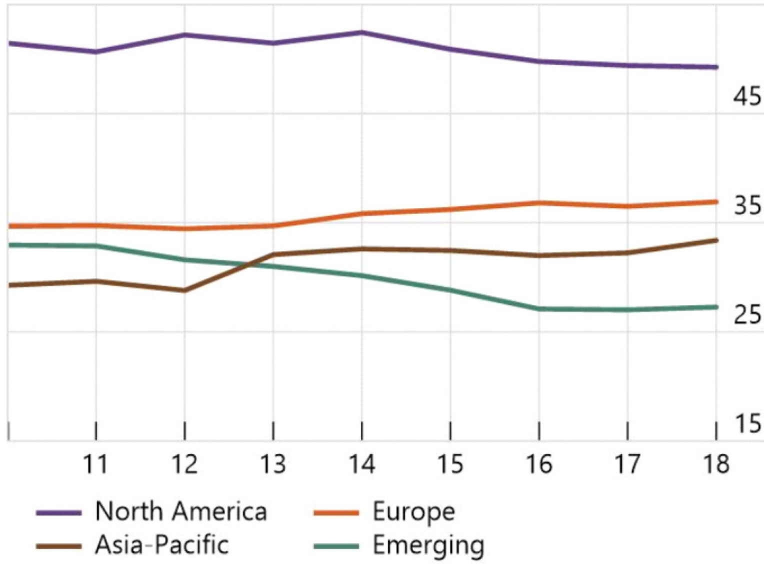
- **The ratio of credit to GDP has not fallen.**
  - Systemically important banks have lost domestic market share.
  - Other banks and non-banks have picked up the slack.
- **Market-based measures of systemic risk fell.**
- **The trend towards global financial integration slowed down after the 2007-08 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

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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!

1	Does the report draw the **appropriate inferences** about the extent to which TBTF reforms have achieved their objectives?
2	Does the report identify **suitable findings**?
3	Does the report include all **relevant evidence**?

How to provide feedback

- FSB is looking for responses from all interested parties, including supportive evidence.
- Respond to **fsb@fsb.org** by **30 September 2020** with subject “TBTF Evaluation”
- Responses will be published, unless requested otherwise.

References

The too-big-to-fail evaluation consultation report:

https://www.fsb.org/2020/06/evaluation-of-the-effects-of-too-big-to-fail-reforms-consultation-report/

The evaluation framework:

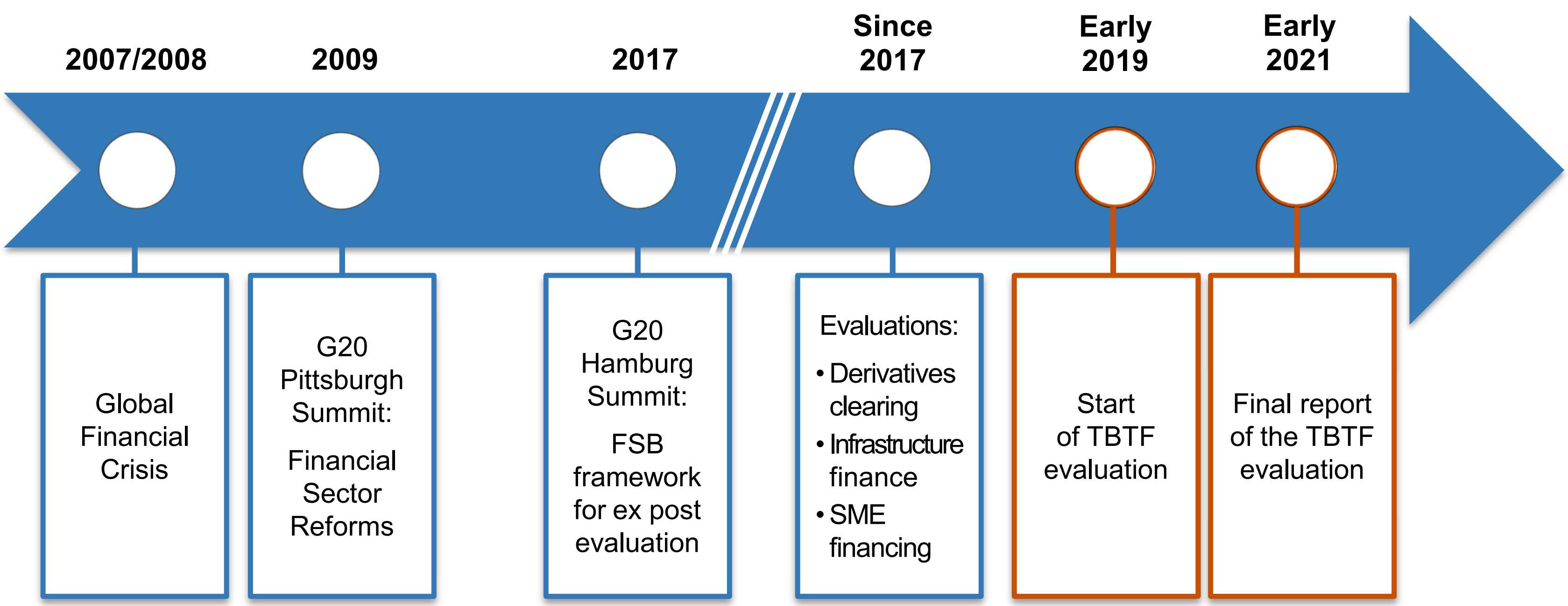
https://www.fsb.org/2017/07/framework-for-post-implementation-evaluation-of-the-effects-of-the-g20-financial-regulatory-reforms/

Results of previous evaluations:

https://www.fsb.org/2019/11/evaluation-of-the-effects-of-financial-regulatory-reforms-on-small-and-medium-sized-enterprise-sme-financing-final-report/

htwww.fsb.org/2018/11/evaluation-of-the-effects-of-financial-regulatory-reforms-on-infrastructure-finance/

https://www.fsb.org/2tps://018/11/incentives-to-centrally-clear-over-the-counter-otc-derivatives-2/



2007/2008
Global Financial Crisis
2009
G20 Pittsburgh Summit:
Financial Sector Reforms
2017
G20 Hamburg Summit:
FSB framework for ex post evaluation
Since 2017
Evaluations:
• Derivatives clearing
• Infrastructure finance
• SME financing
Early 2019
Start of TBTF evaluation
Early 2021
Final report of the TBTF evaluation