

TOO-BIG-TO-FAIL BANKING IN EUROPE. AN ENDURING CHALLENGE.

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Introduction

- **Question:** Do financial markets still expect European governments to bail-out too-big-to-fail banks?
- **Methodology:** mixed methods.
 - Quantitative analysis of **balance sheet data** and **credit ratings** of the European banks identified as TBTF.
 - **Fieldwork evidence** from twenty-two semi-structured interviews with high-profile professionals from finance and advanced business services in Europe, including TBTF banks, and high-level officials from the European regulatory agencies (all interviews conducted in spring 2021, online due to the pandemic).

Definition of TBTF

- A bank becomes ‘too-big-to-fail’ (TBTF) when it grows so **large** and **interconnected** that its failure threatens the integrity of the financial system of the national economy in which that system is embedded.
 - The term first appears in the US in 1984. Original 11 banks listed as TBTF included Bank of America, Citibank and JP Morgan, and others which have been merged since then (e.g. Continental Illinois, Chemical Bank, First Chicago; source: Dymski, 2011).
- Centrality of **expectations**: TBTF **does not just have to do with size of a bank**, but more importantly, with the expectation of what would happen was a bank let to go bust.
- Hard to confirm or dismiss in advance.
- **Credibility** of policy makers and regulators in the spotlight. Typically tend to firmly promise not to bail out TBTF banks; often after doing so.

Problems associated with TBTF banking

- TBTF banks to adopt a riskier business model than otherwise (**moral hazard**)
- Increase in market value of TBTF banks and reduced borrowing costs. An **implicit government subsidy** (e.g. O' Hara and Shaw, 1990; Brewer and Jagtiani, 2013).
- Their **vast political power** has also led authors to describe these banks as too-big-to-prosecute, in addition to being too-big-to-fail (Marshall and Rochon, 2019).

2023 list of Global-Systemically Important Banks (G-SIBs)

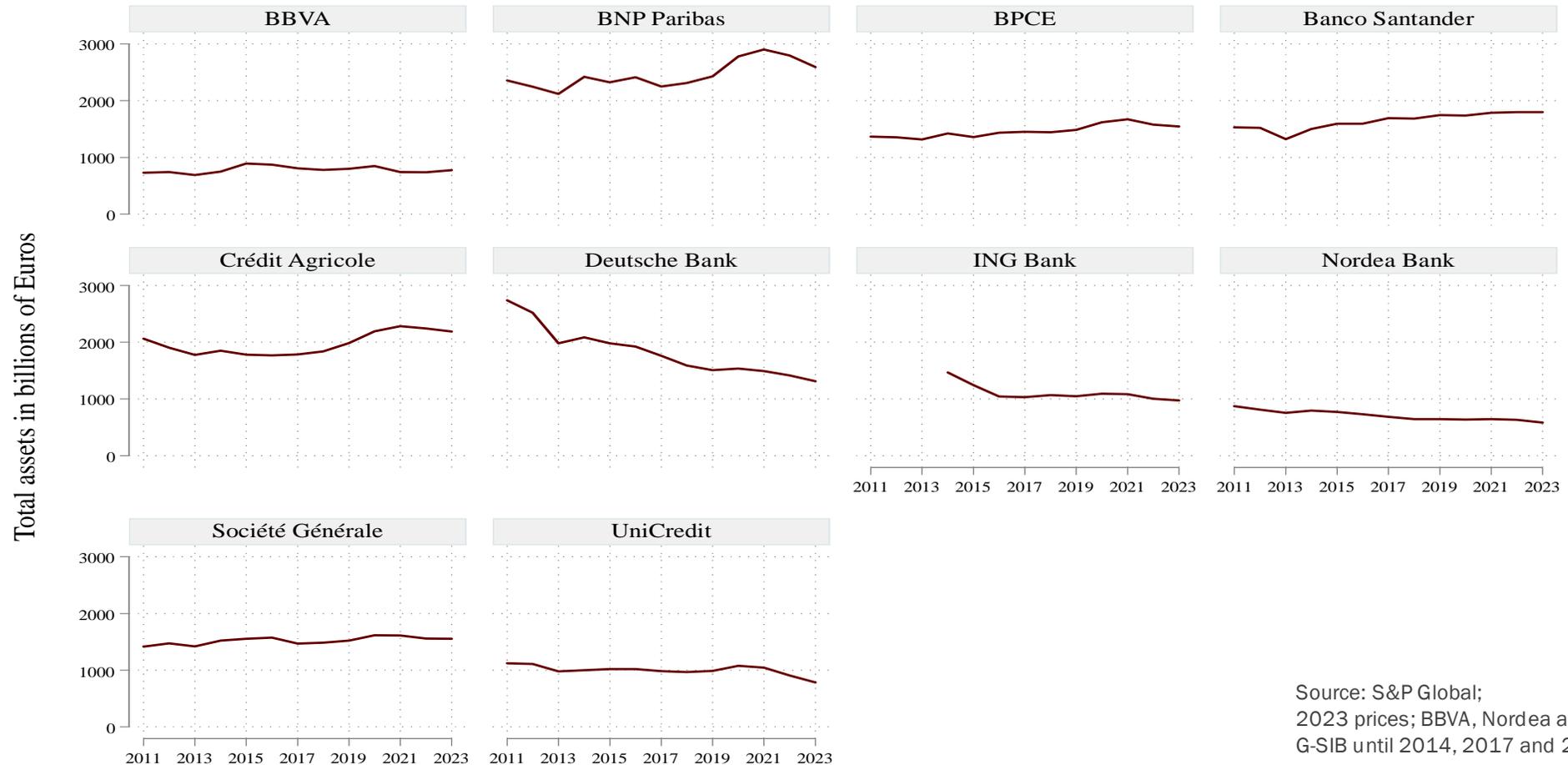
- Financial Stability Board (FSB) currently identifies 29 banks as G-SIBs.
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- Relevance of topic in the EU:
- **7 G-SIBs from the EU**, second only to the US (8 banks listed). 4 in France.
- Main implication concerns capital requirements.

G-SIBs as of November 2023¹⁰ allocated to buckets corresponding to required levels of additional capital buffers

Bucket ¹¹	G-SIBs in alphabetical order within each bucket
5 (3.5%)	(Empty)
4 (2.5%)	JP Morgan Chase
3 (2.0%)	Bank of America Citigroup HSBC
2 (1.5%)	Agricultural Bank of China Bank of China Barclays → BNP Paribas → China Construction Bank → Deutsche Bank Goldman Sachs Industrial and Commercial Bank of China Mitsubishi UFJ FG UBS
1 (1.0%)	Bank of Communications (BoCom) Bank of New York Mellon → Groupe BPCE → Groupe Cr�dit Agricole → ING Mizuho FG Morgan Stanley Royal Bank of Canada → Santander → Soci�t� G�n�rale Standard Chartered State Street Sumitomo Mitsui FG Toronto Dominion Wells Fargo

Changes in size since the 2010 crisis

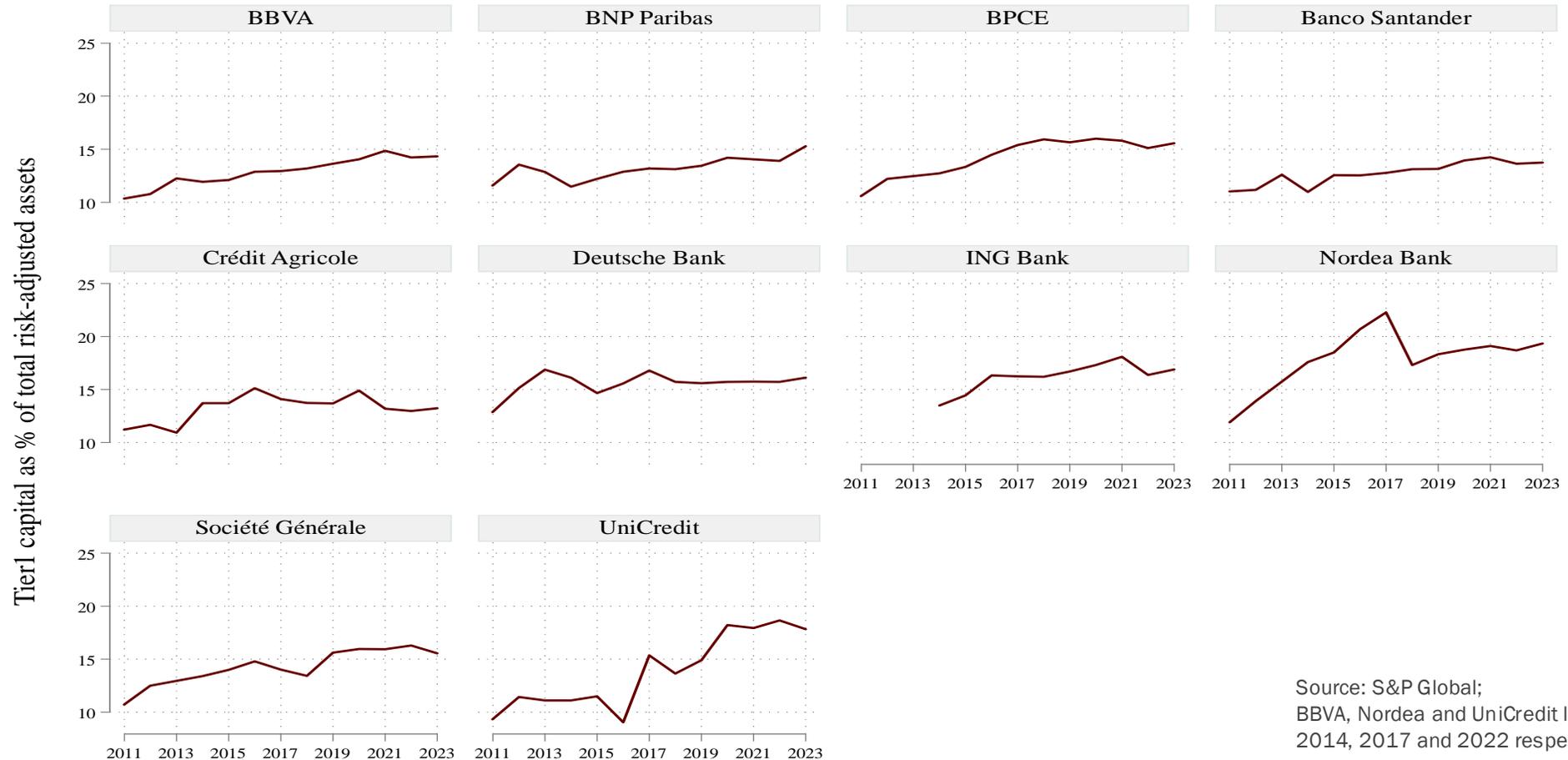
Changes in asset size



Source: S&P Global;
2023 prices; BBVA, Nordea and UniCredit listed as
G-SIB until 2014, 2017 and 2022 respectively.

Changes in capitalisation ratios

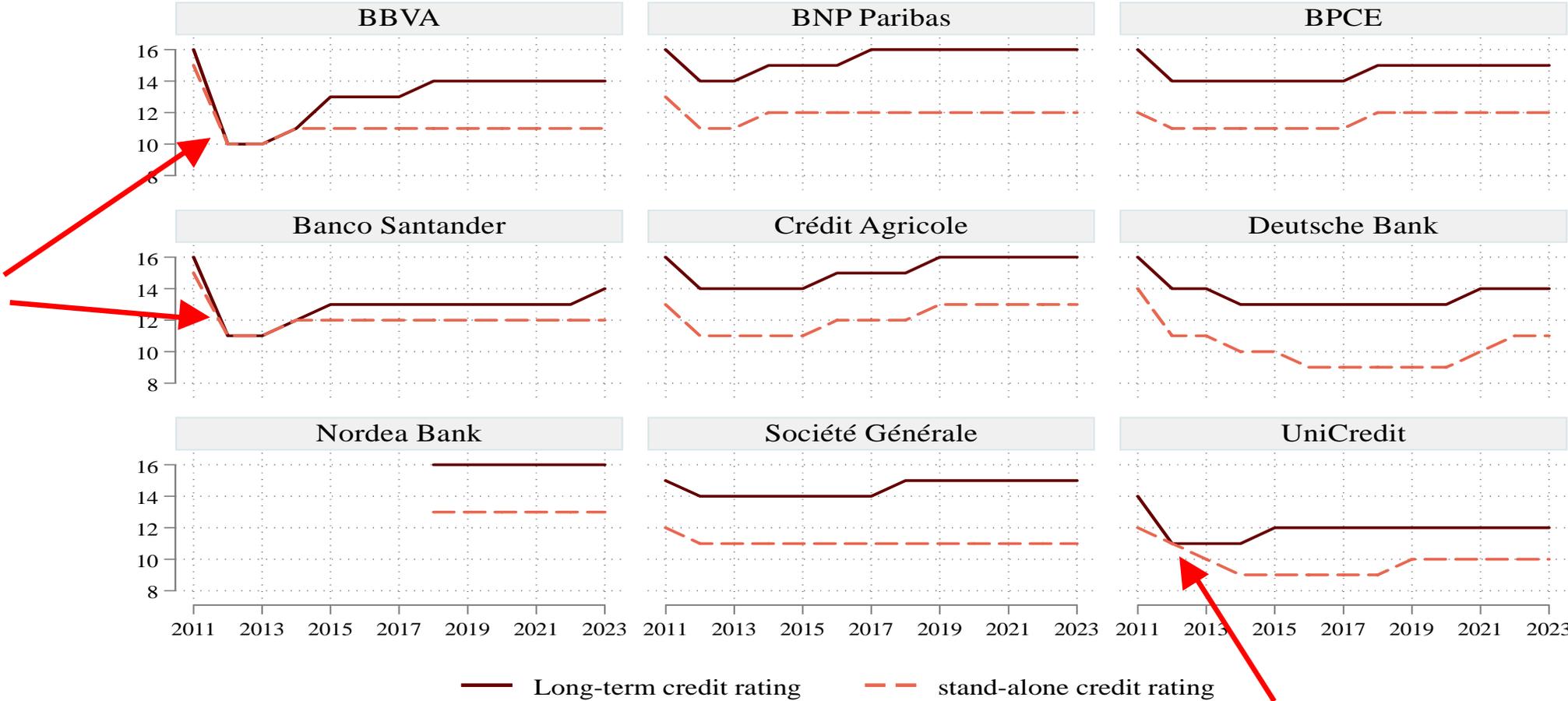
Changes in Tier-1 capital ratios



Source: S&P Global;
 BBVA, Nordea and UniCredit listed as G-SIB until
 2014, 2017 and 2022 respectively.

Persistent gaps between G-SIBs' long-term and stand-alone ratings.

Credit rating uplifts for global systemically important banks



Findings from our fieldwork

- A) almost a unanimous agreement on the adequacy of post-crisis bank reforms.
- Though (perhaps unsurprisingly) interview partners from G-SIBs were the ones that raised most concerns about adverse implications of new reforms. Several complained about the **need for more capital**, the **increased bureaucracy** to meet new regulatory requirements, and ultimately the **adverse effect on banks' profitability** (e.g. INT_9, INT_10, INT_13, INT_16).
- Most common critique was towards the **incompleteness of the European Banking Union**, particularly the absence of a pan-European deposit guarantee scheme (e.g. INT_11, INT_15).

Findings from fieldwork

- B) All interview partners that were asked if TBTF banks are still likely to be bailed out by governments in the scenario of financial distress **acknowledged such possibility, or at least did not exclude it**, despite their overall sense of satisfaction with post-crisis reforms (e.g. INT_2, INT_8, INT_9, INT_16, INT_17, INT_18, INT_20).
- In several cases views were balanced:
- *“Until you actually get bust, [resolution planning] translates in nothing else than paperwork.”* (INT_9).

Findings from fieldwork

- C) mixed responses as to whether G–SIBs want to be identified as such.
- INT_12 from a French G-SIB told us:
- *“...my bank made a conscious effort to [...] move into Tier 3, to get out of Tier 2 and to get rid of some businesses and to only go into the investment banking businesses where we have a niche [...] other banks that weren’t sure, like the German banks, have just been up and down, they **can’t compete with the Americans** [...] I would say **Tier 1 [...] is only for the Americans** [...] no European banks can compete with the Americans, they have to understand that and figure out how they’ll redo their models and the ones that aren’t realising that are going to go out of business.”*

Findings from fieldwork

- On the other hand, INT_14 from another European G-SIB described their status like participation in Champions League:
- *“... generally speaking, we are in a good group of banks. [...] I think we tell ourselves that, if you are a global FC, you play Champions League football, but then in the **super Champions League**, where only the Spanish and Italians and the English get to play, then that **comes at a price**. And it also **gives you a kind of status**, [...] If you are a Champions League football player, you [...] have to do everything top, otherwise you will never win. You have to be 10 out of 10 in everything you do. And that realisation took a bit of time to get a grip on us, but that is **actually an advantage**. Because you make yourself a safer bank at the end of the day.”*

Policy recommendations

- **Complete separation** between investment banking and retail banking, similar to the Glass–Steagall Act.
- **Cap in bank size.** One idea how to make such limits operational could be by introducing steep hikes in corporate tax rates for banks exceeding a certain size.
- Establish a **large public bank** as counterpart to TBTF banks (Marshall and Rochon, 2019). Besides its potential to better serve the economy, such a bank could also remove part of the TBTF threat if able to quickly absorb a TBTF bank's retail operations.

Thank you!

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Appendix A. Numerical transformation of credit ratings (source: Moody's).

	credit quality	alphanumeric	numerical equivalent
Investment Grade	highest	Aaa	19
	very high	Aa1	18
		Aa2	17
		Aa3	16
	high	A1	15
		A2	14
		A3	13
	good	Baa1	12
		Baa2	11
		Baa3	10
Speculative Grade	speculative	Ba1	9
		Ba2	8
		Ba3	7
	highly speculative	B1	6
		B2	5
		B3	4
	substantial credit risk	Caa1	3
		Caa2	2
		Caa3	1

Appendix B. List of interviews.

	Sector	Position	Date
INT_1	Accountancy & Consulting	Global Advisor	07/04/2021
INT_2	FinTech	CEO	12/04/2021
INT_3	Accountancy & Consulting	Head of Chair & Board Practice; Co-Founder	12/04/2021
INT_4	Accountancy & Consulting	Economic Advisory Services Director	12/04/2021
INT_5	Accountancy & Consulting	Director	13/04/2021
INT_6	National Authority	Senior FinTech specialist	13/04/2021
INT_7	Multinational Authority	Executive board member	13/04/2021
INT_8	G-SIB	Head of Global Asset Management for EMEA	14/04/2021
INT_9	G-SIB	Head of Models and Valuation Processes	14/04/2021
INT_10	G-SIB	Senior Associate at Global Client Management & Business Development	15/04/2021
INT_11	Multinational Authority	Director, Banking Markets, Innovation and Consumers	15/04/2021
INT_12	G-SIB	Managing Director, Capital Markets	16/04/2021
INT_13	G-SIB	COO, Global Banking	19/04/2021
INT_14	G-SIB	Head of Research	20/04/2021
INT_15	National Authority	Director-Advisor of the Department of Economic Analysis and Research	20/04/2021
INT_16	International investment bank	Director	21/04/2021
INT_17	National Authority	Chief Executive Director, Banking Supervision	21/04/2021
INT_18	Business/Professional Association	CEO	22/04/2021
INT_19	National Authority	Director	22/04/2021
INT_20	G-SIB	Managing Director, Head of Sustainable Finance	23/04/2021
INT_21	G-SIB	Managing Director, Investment banking	26/04/2021
INT_22	G-SIB	Vice Chairman, Capital Markets & Advisory EMEA	30/04/2021