The End

Myth 5
Bail-in debt will flee – there simply won't be enough resources to do a bail-in when the time comes.

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- The EU is introducing similar resourcing rules into its legislation, as well as requirements to use private funds before state resources or resolution funds can be tapped.

Myth 6
While bail-in might work for a one-off idiosyncratic crisis, it won't work in a systemic crisis like 2008. That's the important case, where the government has to intervene.

- When the first bank fails, no-one knows if it's a one-off problem or the start of a general banking crisis.
- A Lehman bail-in would have avoided losses for Lehman's customers and counterparties, and market stress would have been dramatically lower.
- Handling this would require a broader bail-in, where multiple banks were recapitalized at the same time.

Myth 3
Bail-in might be a nice idea, but doesn't it require new legislation?
In today's dysfunctional political environment, new legislation for a complex problem is likely to be impossible

Single-point-of-entry(SPE) - Not too big to fail

- The Federal Deposit Insurance Corporation(FDIC) acts as receiver of the bank holding company, allowing subsidiaries to continue operating.
- Assets will be transferred to a bridge company, and debt and equity issued by the parent company will be written down to cover losses.

Myth 7
Big banks operate in many countries with different laws. Cross-border legal complexities mean bail-in is unworkable for international banks.

- Once the central issue has been addressed, three legitimate cross-border issues will need to be addressed for an international bail-in to work.

1. Bailinonability
2. Cross-border contracts
3. Cross-border recognition

Myth 4
Investors in big banks expect they will be bailed out in a future crisis – this lets big banks borrow at unfair, super-cheap rates because of their TBTF status. If you change that,debt costs will explode. The market can't handle this.

- US investors have already adapted to the new reality of bail-ins.
- Analysis by Credit Suisse's debt strategists last year shows the market has largely completed the transition to bail-in pricing.

Conclusion

- Bank resolution is a practical reality in some countries today, and other markets are not far behind. The net effect of these measures will bring greater resilience and discipline into the banking system, and help prevent individual problems from turning into systemic shocks.
- Old myths are being overtaken by new realities.

Myth 2
Why not just make big, complex banks smaller and simpler – isn't that a far more direct way to solve TBTF?

- Some have asserted more recently that the real problem isn't size, it's that big banks are "too complex to manage".
- While complexity introduces some challenges in banking, it also provides some important benefits.

Myth 8
Even if the US is making progress, Europe will never agree to this.

- Unlike the US, which has been resolving failing banks since the FDIC was created in the 1930s, state aid and bail-outs have a much deeper tradition in Europe.
- In December, the EU reached political agreement on a new resolution directive, which establishes a powerful bail-in capability.
- While the legislation is complex, the essence is that private investors will absorb losses and recapitalization burdens in bank failures. This agreement should provide a decisive break with the past.

Bail-in

- Bail-ins are situations where creditors agree to forgo their short-term claims and/or agree to a restructuring that reduces their holdings.
- Bail-ins began as a public policy tool with Cyprus, which forced creditors and some depositors to forfeit some of their holdings to keep the banks alive.
- Bail-ins are less politically taxing than bailouts, but could have a number of negative sideeffects in the financial markets, including higher interest rates.

Bail-out

- A bailout is a colloquial term for a loan to a company or country that is facing serious economic or financial trouble.
- Bailouts can have a number of potential negative consequences, including moral hazards that encourage excessive risk-taking.
- International investors should keep these negative consequences in mind, while making sure they avoid any potential pitfalls.

Too Big to Fail
Old myths, new realities

ex. Banking

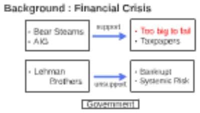
Myth 1
There isn't a good way to handle a big bank failure safely. Isn't that the real lesson of 2008?

- The bankruptcy of Lehman Brothers – the only recent real-world test of a major financial failure caused enormous financial and economic disruptions.
- The US Congress with no good options besides a huge, deeply unpopular "bail-out" of the banking system.

Too Big to Fail

asserts that certain financial institutions are so large and so interconnected that their failure would be disastrous to the economy, and they therefore must be supported by government when they face difficulty.

Background : Financial Crisis



Myth 1
There isn't a good way to handle a big bank failure safely. Isn't that the real lesson of 2008?

- Over the past five years, policy-makers have converged on a simple approach, called "bail-in".
- In the event of failure, bail-in converts debt into equity. It uses internal capital rather than taxpayer dollars to absorb losses and recapitalize the firm.

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Background : Financial Crisis

- Bear Stearns
- AIG

support →

- Too big to fail
- Taxpapers

- Lehman Brothers

unsupport →

- Bankrupt
- Systemic Risk

Government

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