Roundtable on the Banking and Capital Markets Union – Bail-in vs. Bail-out

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Disclaimer

The views expressed are those of the author and do not necessarily reflect the official view of the European Commission.

The ERFRA exercise – farewell to bail-out in general?

- Economic Review of the Financial Regulation Agenda
  - A cumulative evaluation of the impact of the "Banking Union" on potential losses hitting public finances (PF)
- The "political wish": *no public money* will be spent on bank resolution once all the legislation is in effect
- The JRC finding: *much less public money*

	PF conditional on a crisis event similar to the recent (% of EU GDP)	*Notional likelihood* of no PF losses
(1) Baseline	3.7%	20%
(2) All reforms	0.46%	12%
Ratio of 2 to 1 (%)	12.43%	

The role of bail-in in the ERFRA exercise

- After bail-in, the safety net is not that important

	Baseline	Baseline+bail-in	All reforms
Capital	230	230	363
Bail-in	0	296	219
RF	0	0	58
PF	478	182	68

- A better safety net might (have) allowed a smaller bail-in
- There are some "loose ends" of the rules, and for a reason
  - Exceptions due to "financial stability considerations"
  - Remember Cyprus...
- Germany is considering such exemptions in legislation

Is bail-in indeed omnipotent?

- Where do bail-in losses go? We do not know much of it!
  - Data needed: detailed cross-exposure in bonds by banks
  - Or at least at the sectoral level
  - Financial accounts data are like that but not fine enough...
- The JRC bail-in project
  - Extrapolate the detailed cross-exposure matrix of *sectors*
  - The banking sector of a country is hit by a large shock
  - Trace its impact on other sectors using the estimated exposure matrix
- A lot of bail-in losses would create further losses and safety net intervention needs
  - Then the safety net might become more important again!
  - It goes on until they reach some ultimate loss absorbers

The general question: the moral hazard vs good loss-absorber tradeoff

- The government may be a good loss absorber (though not always)
- But bail-out creates moral hazard
- Who are the good ultimate loss absorbers?
  - Governments?
  - Households?
  - "Financial deep pockets" like sovereign wealth funds?
- LOLR institutions – CBs? Supranationals?
  - An issue of democratic authorisation, accountability and control...

Do we have a good understanding of such "financial chains"?

- Theory
  - The literature on credit chains: Kiyotaki-Moore 1997, Allen and Gale 2000, Boissay 2006
  - New literature on financial complexity – Caballero-Simsek 2013, Zawadowski 2013,...
  - Endogenous financial networks: Babus 2013, Babus-Kondor 2014, ...
  - The role of a LOLR in such a framework?
- Data issues
  - The ESCB MARS attempt to look at cross-border exposure
  - Can the SSM help?