

# Discussion of Patrick Bolton and Martin Oehmke

## *'Bank Resolution and the Structure of Global Banks'*

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# Key question and approach

- How to deal with resolution of global systemic financial institutions?

## Objectives:

- Orderly and timely resolution
- Preserve critical functions
- Keep tax payer out of the picture

## How?

- FDIC type P&A does not work (complexity)
- Liability focus: recapitalization via SPOE or MPOE?

# Highly valuable type of research

- Guide policymakers in understanding key trade-offs with respects to choice between cross border bank resolution regimes
  - How (national) regulators' incentives interact with those of the banks involved
- Build bridge between academic research and practice
  - Stylized model to bring in richness...

# Results/insights

- Minimum TLAC regulation might be needed
- Absence of supra-national powers imposes severe constraints on feasibility coordinated (SPOE) resolution
  - Ex ante and particularly ex post
- More asymmetry between countries, pushes toward MPOE
- Potential impact on banking structure and incentives

# Relevance beyond question...

- War stories from The Netherlands/Belgium – Fortis...
  - Likeminded countries, MoU's would suffice...

# Key modelling features

- Bank resolution possible
- Diversification benefit in global banking
- Complementarities in banking operations across borders → gives benefit to SPOE (on top of diversification)
- No runs, short term financing (unless not fully riskless) source of profits
- Long term financing is costly, may lead to underfunding
- Ex ante investment in own (stand-alone) structure could insure against loss of complementarities later

# Benefits of coordination (SPOE)

- Better allocation of risk bearing capacity – TLAC
- and preserving complementarities in the business

# Comments

Obviously, scope had to be limited...

- No timely intervention beyond scope
- TLAC is available, no shortage
- No runs, externalities limited



# Comments cont'd

Are we ignoring assets/legal structure complexities?

[Except...] Ex ante investment in own (stand-alone) structure could insure against loss of complementarities later (upon failure of SPOE)]

Liability focus has some logic (see FDIC/BoE, 2012; FSB, 2014; Dodd-Frank/BRRD)

- Timely resolution more or less needed for this
- Clarity on assets and where they are is needed
  - But where assets are not always clear; asset grabbing not unusual, etc. Strategic behavior...

# Comments cont'd – Interaction bank incentives, regulatory behavior

- Extension: SPOE transfers could affect incentives in each local operation
  - Incentives involve effort to improve returns (not risk taking)
  - Interesting result: sharing mutes those incentives, yet countervailing effect: lower TLAC reduces dilution of returns to effort!

But is bank run locally? Approach/results assume this... Seems at odds with SPOE...

# Comments cont'd – Adding pre resolution phase: forbearance

- Elephant in the room.... Forbearance... (e.g. Italy and bad loans..)
  - Compare SSM to SRM in EU → interesting observation: “Of course, whether the creation of such a supra-national resolution authority is politically feasible is a separate question”.
  - Impact SPOE versus MPOE on forbearance incentives

# Banking structure

## Interaction regulation/bank behavior

- Bank may adjust its own structure to deal with lack of coordination ex post
  - Anticipating chaos of SPOE, they may go for stand-alone structures with country specific back offices and systems to perfectly match MPOE
  - Note: some countries have put this in as requirement (e.g. New Zealand)

# Branches versus subsidiaries

- What does analysis imply for branch/Subsidiary choice? E.g. Nordea went to branch structure
  - Is branch structure natural analogy for SPOE? Or is there more to it?

# Hybrid models

- I like the notion of a hybrid model... in paper, very limited – some locally dedicated risk bearing capacity to limit ex post transfers (and time consistency issues) – helps preserve SPOE
- More general notion of hybrid: is SPOE versus MPOE a discrete choice?
  - Regionally you can have SPOE, yet overall MPOE over the regions...
  - More??