

Everything you always wanted to know about systemic importance (but were afraid to ask)

By P. Alessandri, S. Masciantonio and A. Zaghini

3rd EBA Policy Research Workshop, 25-26 November 2014

Comments by Olivier de Bandt (*)

(*) Additional comments by JB Feller and MD Kersuzan are gratefully acknowledged

I. Summary

Very ambitious paper

1. **Assembles a large database** on GSIBs and DSIBs on the period 2007-2012, which helps assess the FSB-BCBS GSIB identification methodology by other stakeholders
2. **Still useful since July 2014**, when most indicators for 2013 have been released: paper provides data on previous years as well as additional data (ROE, ROA)
3. **Very interesting results**
 - on changes in the international banking system: increasing weight of emerging countries; crisis and its aftermath (takeovers by other GSIBs); UK banks in the EU
 - on link with other variables: size (which is not enough), ROA, ROE, leverage, capitalisation (not informative), market to book value, while sufficiently cautious not to conclude

II. Comments (1/4)

1. Concept of Systemic risk and GSIB identification: what is the objective?

- ❑ **L. P. Hansen (2012):** measuring systemic risk helps design the relevant regulatory interventions that can be accounted for and challenged within an economic model: assessment of GSIBs should support policy action
- ❑ **Definition of systemic risk sometimes unclear** in the paper: need to distinguish between:
 - « systemic importance » Firm -to- System
 - « systemic fragility » System -to- Firm
- ❑ **Objective of BCBS-FSB GSIB identification:** ensure the existence of loss absorbency capacity, participation by GSIBs to the cost of a possible bailout, should it become unavoidable, correct for externalities that are associated with too big-to fail (lower financing costs); neither PD, nor LGD as should be expected loss directly for the bank, indirectly for the banking system/the economy
- ❑ **Arguably, same criticism to other indicators** (usually System-to-firm)

II. Comments (2/4)

2. Empirical strategy should be clarified:

- ❑ **No information on statistical fit outside the year where FSB published data:** how reliable are the conclusions based on the 2007-2010 sample characterized by many changes linked associated with the financial crisis?
 - Why 100 banks and not 75? What about EU or euro area sample? No sensitivity analysis. How to solve the issue of smaller institutions that can create systemic risk?
 - Coverage of UK banks seems to exhibit a drop in table 4.4 between 2009 and 2010
- ❑ **Lack of statistical framework to test the impact of size or any component on SI:**
 - Perignon & Hurlin (2013) - ranking depends on the most volatile component; Hauton & Heam (2014) - interconnexion goes beyond size.
 - Correlation analysis may not be sufficient. Long/short regression framework is an obvious candidate to deal with missing variable bias (e.g. when regressing SI on size, which is one component of SI)

II. Comments (3/4)

3. Tradeoffs involved in the framework should be further investigated

- How to define optimal cut-off point / threshold for identifying GSIBs in the light of the conclusion that SI has little information content on banks' probability of failure
- Calibration Cap on substitutability criticized but no alternative proposal
- Analysis of the role of investment banking in the crisis: may also question the methodology on banks in emerging markets, like China, can we take it at face value?

II. Comments (4/4)

4. Other remarks

- Paper is not self contained, need to refer to other paper
- Concentration in French banks: need to take into account subsidiaries in other EU countries; in addition, concentration in solo terms is lower than in smaller Euro area countries and decreased since 2008, as shown by ECB (2013) figures

5. Further research :

- Use database for **multivariate analysis** to revisit the crisis, to control for endogeneity and lags, to take non-linearity into account, to **calibrate the optimal size of the capital buffer** for GSIBs as well as for DSIBs
- Assess the **impact of MSU**, which may trigger more integration, on the basis of various scenarios

Thank you for your attention