The fallout from too big to fail…

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Bank resolution – investor perspective

- Historical perspective –
  1) post Lehman/pre-sov crisis – bankruptcy hurts everyone
  2) sov crisis - bailouts hurt the sovereign
  3) post sov-crisis – "resolution" hurts less

- Pre-sov crisis, too big to fail was the friend of the investor….

- Sov-crisis changed this…although it's not a zero sum game…

- All about the distance to default….

- But this is not about investor self interest!

- So what were / are investors looking for in post "too big to fail" framework?

Investor checklist

- An over-arching framework for banks that reduces systemic and specific bank failure risks – yes, ongoing – the Directive is only part of this….(investor and authorities aligned)

- A clear roadmap in the event of “trouble” – Why? Straight to bankruptcy is costly…Yes, the Directive will give us this universally across the EU. A positive step

- Clarity of bond-holder treatment in the event of resolution (liability cascade) – Why? Pricing the risks…..Yes, we have this too. This is another step forward

- Consistency vs. flexibility – the references to flexibility in the Directive particularly with regard to systemic banks and staggered implementation makes sense to us

- So, the response to too big to fail has been reduced systemic risks, orderly resolutions of insolvent banks, and a clear debt hierarchy – what’s not to like?

Investors happy? Supportive yes, but questions remain

- Did we need to make bail in's compulsory and put caps on access to resolution funds?

- Timing – what happens pre-2015? And pre-2018

- Unclear to what extent the directive will be adopted as a template prior to implementation date – in particular what is the hurdle for imposing losses on senior debt in 2014 for example?

- So – we are not yet in normal times…the difficulties in pricing remain, and we must still speculate on which banks are too big to fail…

- Deposits ranking above senior debt post 2018 – can this be defended?

Implications

- Senior markets will remain difficult to price and issue

- Greater name and capital structure differentiation in market pricing – this is here to stay. Sub debt will be volatile

- Covered bonds already investor friendly, become even more attractive – this is the asset class with least uncertainty in event of bank failure

Discussion topics

- Has the Cyprus “case study” given authorities a false sense of security with regard to wiping out senior?

- Deposits ranking above senior debt post 2018 – can this be defended?

- How / how else would you change the Directive?