



Discussion of “The Failure Mechanics of Dealer Banks”

Philipp M. Hildebrand
Vice-Chairman of the Governing Board
Swiss National Bank

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Summary of the Paper

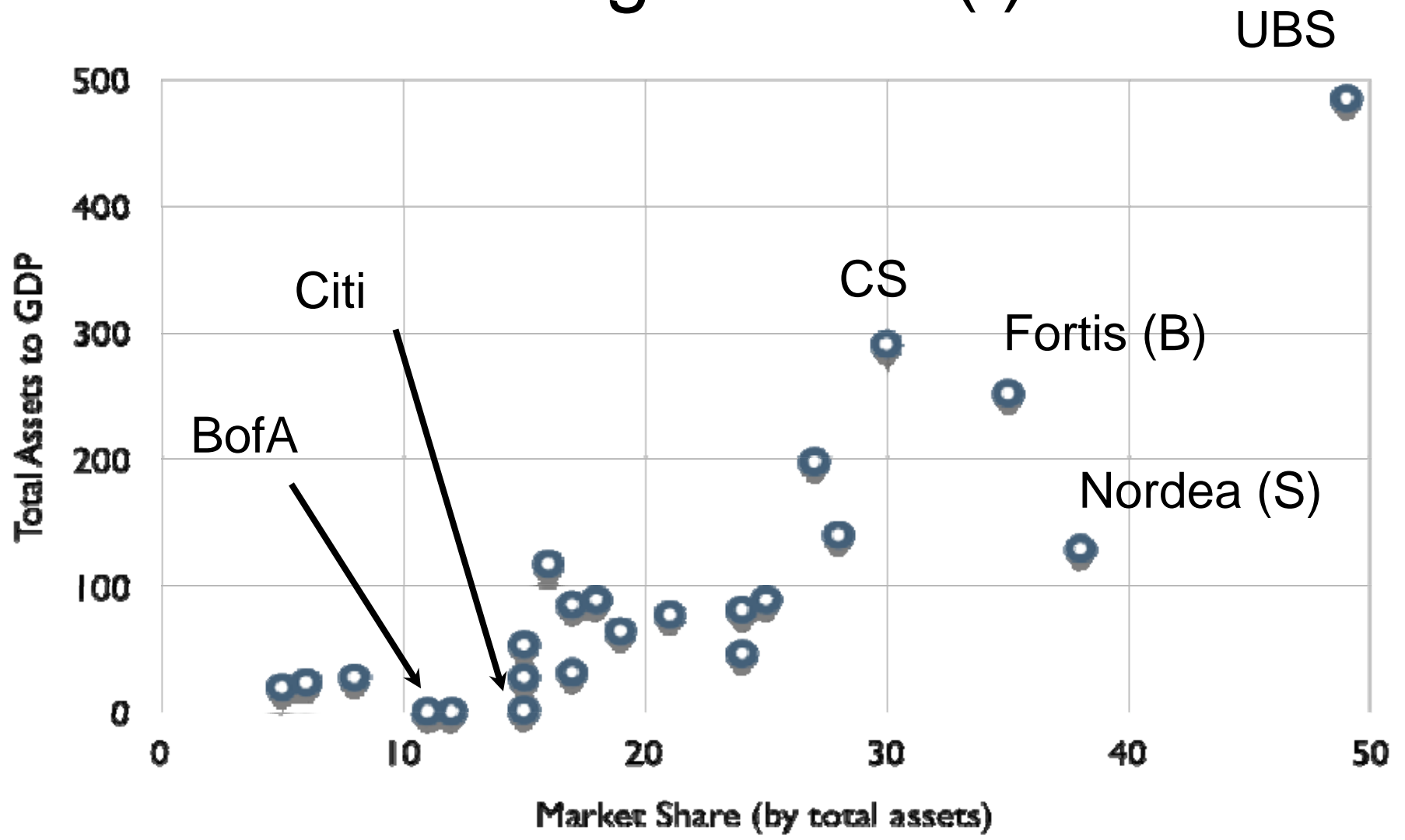
- + Excellent description of failure dynamics at large banks
- + Demonstrates the complexity of large financial institutions
- + Helpful for policy makers to identify potential domains that require public policy response
- Policy implications rather vague and not really convincing

“Too Big to Fail” Is the Main Challenge for Policy

- Large, complex institutions have been at the heart of the current crisis
 - Governments have put huge amounts of taxpayers’ money at risk to rescue them
 - “Too big to fail” undermines market discipline and creates moral hazard
- ⇒ We simply cannot afford a repeat of this disaster – maybe on an even bigger scale

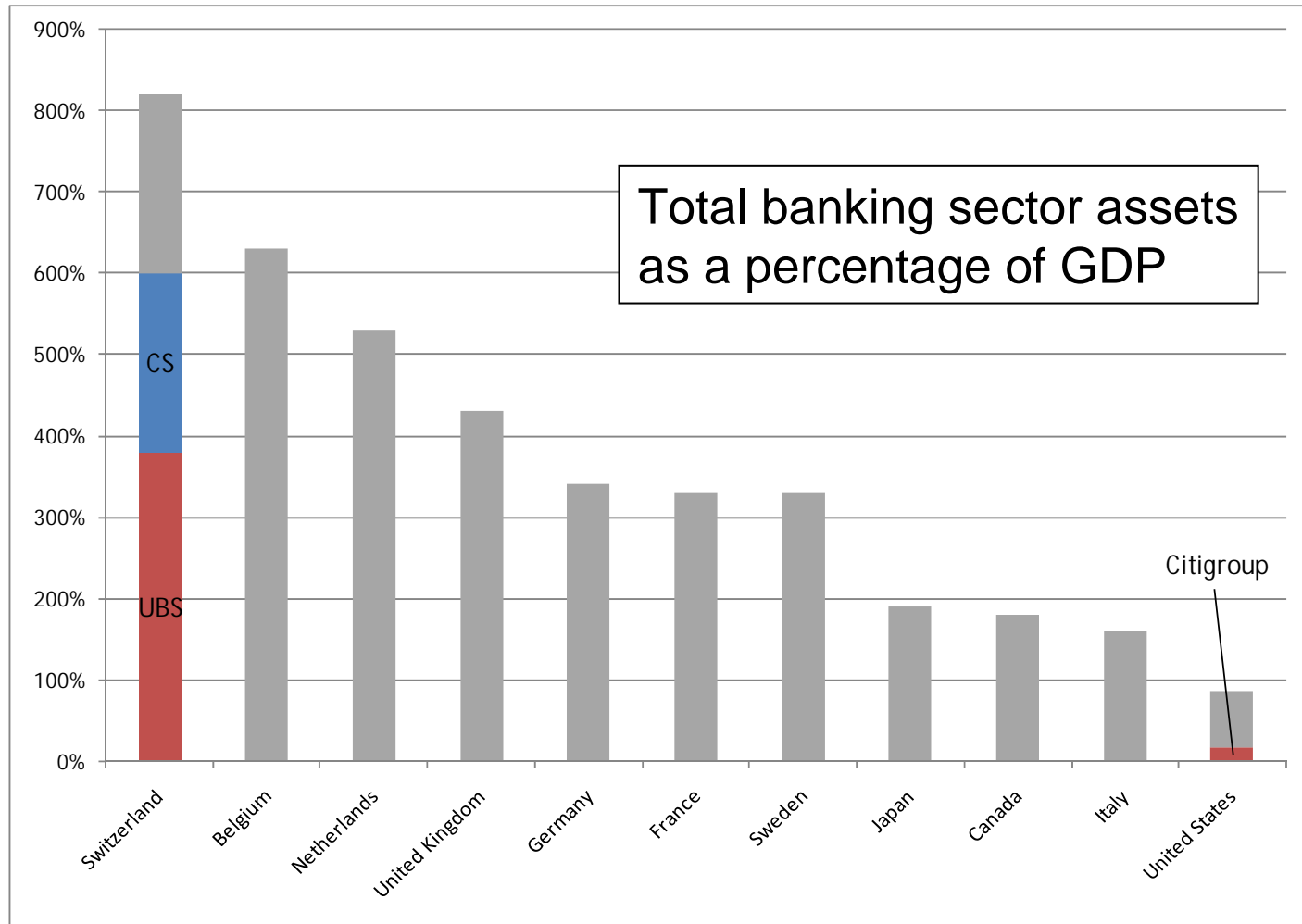
An International Perspective on “Too Big to Fail” (I)

SCHWEIZERISCHE NATIONALBANK
BANQUE NATIONALE SUISSE
BANCA NAZIONALE SVIZZERA
BANCA NAZIONALE SVIZZERA
SWISS NATIONAL BANK



An International Perspective on “Too Big to Fail” (II)

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Sources: SNB, *Annual Reports (2007 and 2008)*, IMF

A Ladder Approach to “Too Big to Fail”

I. Prevention

- Tighter regulation to reflect systemic risk

II. Winding Down

- Enable large banks to fail

III. Size Limits

- From “too big to fail” to “small enough to fail”



I. Prevention

1) Capital

- Tighten risk-weighted capital requirements
- Introduce a supplementary measure

2) Liquidity

- Approach based on stress scenarios
- Substantive tightening of requirements

II. Winding Down

The Legal Approach

- Resolution procedures for large banks
- International harmonization of bankruptcy rules
- Cooperation in crisis management

Challenges:

- Complex
- Time-consuming
- Highly political

II. Winding Down

The Organizational Approach

- More decentralized organization of banks
- Allow easy splitting up of banks

Challenges:

- Economies of scale and scope
- Protectionism



III. Size Limits

- Set incentives to limit size
 - E.g., capital requirements increasing in size
- Outright size limits
 - E.g., restrict total assets to a percentage of GDP or limit market share



“In short, we need an end to too big to fail.”

Sheila C. Bair
Chairman FDIC
March 19, 2009