Proposal: 1786 (AG44) Resolution Related Resource for Large Banking Organizations

Description:

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Proposal: 1786 (AG44) Resolution Related Resource for Large Banking Organizations

Subject: Resolution-Related Resource Requirement for Large Banking Organizations

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Comments:

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Proposal: Resolution-Related Resource Requirements for Large Banking Organizations [R-1786]
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The entire background description of the proposed rule change affirms the maxim that too big to fail is too big to exist. The fundamental problem here is not how to resolve a large bank when they fail, but that entities sufficiently large to threaten the financial stability exist in the first place. Fundamental capitalism requires transparent competition, increased consolidation and too big to fail benefits destroys this pillar of our economy.

Question 1: Debt is far from safe, it is reasonable to assume that large banks primarily fail during significant instability in the economy; and the value of any assets directly coupled to this would suffer from a significant disruption. Instead a significant increase in liquid reserves should be required; in particular for any bank engaged in volatile or hard-to-price activities. Furthermore, the bedrock of the economy are small depositors, hence they should always have priority. Requiring these to be separated into a clean company is an excellent idea; but it should apply to all banks; at all times. The risk-free banking operation related to small depositors should always be kept separate from the more speculative activities, allowing the easy carve-out/IPO but not acquisition by a competitor – should the parent organisation require resolution.

Question 2: The suggestion above should be a fundamental requirement to be recognised as a bank, at any size. As disruptions caused by a resolution increases exponentially with size, larger banks should have a larger requirement for cash holdings. In addition banks failing to meet their obligations must face increasing penalties and choose between an increasing % premium on insurance or voluntary de-merger into separate entities. To avoid contagion these entities must have a stringent limit on mutual ownership/exposure; thus the too big to fail problem can be prevented or at least strongly mitigated.

Question 3: Subsidiaries of foreign banks must document their compliance/non-compliance to the

above, but further risk analysis is recommended before considering enforcement options.

Question 4: Simplicity is always better, only debt/assets held by the insured institution should be considered.

Question 5: Large banks should always be broken up before equity capital is depleted. Timely and efficient enforcement of this would be more efficient than calibration of debt requirements.

Question 6: All debt must be paid by someone this is currently not adequately priced into debt costs leading to the current market crisis. Question 7: Simplicity is better. Subsidiary debt should not be counted for the requirements of the top-tier holding company.

Question 12: See question 1. In my opinion the background does a good job of describing the current problem; however the solution suggestions of 'more of the same' lacks scope. It is obvious that larger and more concentrated institution represent an exponentially larger disruption in the event of resolution, i.e. "too big to fail is too big to exist". My suggestion is twofold. Firstly, and most importantly, small depositors should not be exposed to the speculation of their bank. Their accounts and deposits should be in a safe subsidiary with very stringent controls. This would limit a catastrophic bleed into the real economy in the event of resolution. Secondly, the solution to the resolution of large banks lies more in the direction of dis-incentivising scale-beyond-reason through exponentially more stringent insurance premiums and cash requirements scaled with institution "importance". Furthermore, any regulations must be transparent, simple and enforced. For instance any institution representing more than of its field has its reserve requirement increase exponentially. Any quarter where this is failed to be met imposes a % fine/premium scaled with institution size. Subsequent failures should incur increasing penalties; and the penalties only reset to the "base" level after a number of years of flawless compliance. Failure to meet requirements m of k times in a period is a clear demonstration of incompetence/instability and must automatically and transparently trigger resolution with a preference for breaking up the institution to foster competition and a healthy market.