Let the Worst One Fail: A Credible Solution to the Too-Big-To-Fail Conundrum

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ECB Monetary Policy Conference

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    - Ultimately, not the bank as a whole makes investment decisions but individuals inside the bank

Relation to the literature

- Moral hazard and the too big to fail problem
  - Farhi and Tirole (2012), (Keister 2016), Chari and Kehoe (2016)

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- Bail-in instead of bail-out
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- Financial crises
  - Nosal and Ordonez (2016)

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- Banks can choose to do the right thing x (it is called an ex ante safety investment), which decreases their returns in normal times but increases their returns in crises times
- Idiosyncratic bank shocks and aggregate shock (normal or crisis) realize in period 2, banks survive, fail, or are bailed out

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- Therefore, we now make the bailout amount increasing in x, we reward good behavior
- This reward may overcome the morally hazardous incentives to lower x

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- If the good bank says No to money, then we again end up rewarding bad behavior
- But who ultimately decides all of this? And who is the bad actor in the first place?

Banks are made of people

Fortune

What is happening at Credit Suisse? Key questions at the heart of the turmoil being compared to a potential 'Lehman moment'

Credit Suisse then unwittingly exacerbated its problems after an internal memo by new CEO Ulrich Körner was leaked on Friday, in which he told...

5 days ago

Reuters

Credit Suisse in market spotlight despite moves to calm ...

Credit Suisse shares fell as much as 11.5% before coming off early lows to end down just 1%. Its international bonds also showed the strain,...

5 days ago

Forbes

Is Credit Suisse Going Bust?

Swiss banking giant Credit Suisse is struggling to restructure in the wake of scandals and accusations which include money laundering for...

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Credit Suisse's APAC operation has become a poaching ground for rivals looking to plug gaps in their corporate finance operations.

Christopher Chua, the bank's Hong Kong-based deputy head of mergers and acquisitions has resigned to join HSBC, and headhunters warn that others could follow in the run-up to the bank's new strategy announcement on October 27.

Credit Suisse's CEO Ulrich Korner is expected to shrink or close parts of the investment bank, and some staff are deciding to head for the exit now and grab a good opportunity elsewhere rather than wait.

But senior bankers who decide to leave before year-end will have to pay back any unexpired portion of restricted upfront cash awards (UCAs), which were paid last year to retain managing directors or directors earning $250k or more.

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- But they might just move on to the next bank (they probably came from Lehman Brothers)

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- 71.2% of Americans think that banks should not be bailed out
- 66.4% of Americans agree to the statement that the government is intervening too much
- 83.2% of Americans strongly agree to the statement that bankers are too rich and cannot be trusted

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* Another aspect: banks are made of people that take risks and follow their own incentives
* People need to be on board with the policies