TOO BIG TO FAIL BANKS IN THE AGE OF GLOBALIZATION

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Abstract

Since the emergence of the 2007-2008 global financial crisis governments and policy makers have understood the need to identify and implement solutions in order to prevent these crises in the age of globalization. As banks have been seen to be systemically important institutions in a market economy, they have become subject to numerous reglementations during the time. In this respect, the Financial Stability Board published for the first time a list of large banks considered as too big to fail financial institutions in 2011. The aims of our paper are to address the concept of too big to fail and to illustrate its application in the case of the global banking system. To such ends, the authors used a quantitative research method. The paper demonstrated that the too big to fail concept represents an important topic in the banking world. Also, it showed that there are several global systemically important banks located in Europe, North America and Asia. The financial impact of globalization and the global financial crises are among the major factors that led to the emergence of too big to fail banks.

Key words: *too big to fail, global banking system, globally systemically important banks, Financial Stability Board, globalization*

JEL Classification: *F49, F65*

1. Introduction

The banking crises and the failures of big banks in the 1980s and 1990s questioned the effectiveness of the supervisory process and of bank regulations in North America. As the seventh-largest bank of the United States of America (USA), Continental Illinois National Bank and Trust Company faced a rapid increase of its nonperforming/bad loans and a significant shrinking of its share price in 1984 (Shull, 2010; Nurisso, 2017). Due to the fact that the bank was on the road to bankruptcy the Federal Deposit Insurance Corporation provides an assistance package that saved the American bank, but a great deal of controversy emerged and centered on whether large banks had to be treated preferentially. The Continental assistance package was emblematic for the designing and implementation of the "too big to fail" (TBTF) doctrine and policy (Moyer and Lamy, 1992; Wall, 2016).

In 2007, the year of the economic bubble, the financial services sector became a powerful wealth-creation mechanism and its products (e.g., securities, mortgages) were among the drivers of the economy, mainly in the USA (Sorkin, 2018). However, August 2007 brought losses in a relatively small segment of the US financial system and later, the mid-September 2008 witnessed a full-fledged financial crisis at a global level (Mishkin, 2010).

Since the emergence of the 2007-2008 global financial crisis governments and policy makers have understood the need to identify and implement solutions in order to prevent these crises in the age of globalization. The crisis led to the biggest contraction of the global economy after the end of World War II, an unprecedented number of bankruptcies (e.g., the fall of Lehman Brothers), a huge increase in the number of people unemployed, the decrease of wages, the rise of poverty, and a massive decrease of wealth in the vast majority of the countries around the world (Verick, 2010; Claessens, 2013).

One of the main causes that contributed to the appearance of global financial imbalances was the inadequate supervision and regulation (Allen, 2009; Merrouche and Nier, 2010; Solt, 2015). As banks have been seen to be systemically important financial institutions in the market economy (Buiter, 2007) and their failures are costly (Dungey, 2015), they have become subject to numerous reglementations during the time. In this respect, the Financial Stability Board (FSB) decided to establish a list of large banks considered as TBTF financial institutions in 2009 and published it in 2011 (Financial Stability Board, 2011). The aims of our paper are to address the concept of TBTF and to illustrate its application in the case of the global banking system.

The remaining parts of the paper are organized as follows: Part 2 displays the literature review. Part 3 deals with the research methodology. The results are presented and analysed in Part 4. Paper ends with conclusions.

2. Literature review

TBTF represents rather a fuzzy concept that has different meanings for different people (Hurley, 2010). Researchers assert that:

- TBTF represents "a policy under which the federal government does not allow large financial firms to fail for fear of damaging the financial system" (Burton and Brown, 2006, p. 365).
- TBTF are "institutions that carry high systemic risk…any business (though typically a bank or financial institution) that is especially important to economic stability" (Joines, 2010, p. 2).
- TBTF is "a doctrine postulating that the government cannot allow very big firms (particularly major banks and financial institutions) to fail, for the very reason that they are big" (Moosa, 2010, p. 1).
- "a TBTF firm is one whose size, complexity, interconnectedness, and critical functions are such that, should the firm go unexpectedly into liquidation, the rest of the financial system and the economy would face advers consequences" (Bernanke, 2010, p. 20).
- "a TBTF firm is generally a large complex firm that is perceived to require either or both special regulation to discourage failure while alive and/or a special resolution regime when dead in which governments can intervene and not have the insolvent firm resolved through the usual resolution (bankruptcy) processes that apply to other firms in the same industry, at least with respect to allocating losses" (Kaufman, 2013, p. 2).
- "the term TBTF originally referred to the size of large U.S. money center banks, which were considered to cause financial instability upon unorderly failure and thus mandated government intervention in case of crises" (Moenninghoff, 2018, p. 3).

The above definitions show that TBTF is seen either as a policy or an institution/firm. Also, the definitions emphasize the need to allow these institutions/firms to survive even when they are in danger to fail as their existence is important for the economic stability and/or financial system. On the other hand, a TBTF policy brings negative effects such as the distortion of the competition, the destroying of public finances, the misallocation of credit, and the removal of the market discipline (Strahan, 2013; Huertas, 2014).

3. Research methodology

In order to achieve the goals of the paper the authors used a quantitative research method. First, they identified the places that provide scientific information such as the important libraries from Bucharest (e.g., Central University Library, British Council). Second, a comprehensive literature review was carried on through the use of several electronic databases and professional networks for researchers (e.g., Springer, Google Academic, ScienceDirect, IDEAS/RePEc, ResearchGate). Third, the information was gathered from sources of secondary data such as books, articles and reports belonging to the domains of finance, banking and economics.

4. Results

The TBTF concept has gained prominence especially in the global banking system. The increasing financial impact of globalization imposed the adoption of a plethora of measures in this system. In this sense, the G20 leaders issued the declarations of the Toronto and Seoul summits. According to the G20 Toronto Summit Declaration the reform agenda in the financial sector rested on four main pillars as follows:

1. A strong regulatory framework.
2. Effective supervision.
3. Resolution and addressing systemic institutions.
4. Transparent international assessment and peer review (G20a, 2010).

Later, the G20 Seoul Summit Declaration expressed the need to deliver "instruments to strengthen global financial safety nets, which help countries cope with financial volatility by providing them with practical tools to overcome sudden reversals of international capital flows" (G20b, 2010, p. 2).

Thus, the G20 leaders assert that "they endorse the work of the Financial Stability Board in addressing the 'too big to fail' problem" (Gür, 2015, p. 16). In order to address the TBTF problem the FSB defined systemically important banks as "financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity" (Financial Stability Board, 2011, p. 1).

In 2011, the FSB published for the first time in the history the list of globally systemically important banks (Table no. 1). At that time, the list comprised 29 banks located in the following three continents: 17 banks from Europe (4 banks from the United Kingdom (UK), 4 banks from France, 2 banks from Germany, 2 banks from Switzerland, 1 bank from Netherlands, 1 bank from Denmark, 1 bank from Spain, 1 bank from Italy, 1 bank from Belgium and France), 8 banks from North America (8 banks from USA), and 4 banks from Asia (3 banks from Japan, 1 bank from China). In other words, the USA occupied the first place with 28.57%, followed by the UK and France, each of them with 14.28%.

Table no. 1. Global systemically important banks in 2011

Europe	North America	Asia
HSBC (UK) Barclays (UK) Royal Bank of Scotland (UK) Lloyds Banking Group (UK) BNP Paribas (France) Groupe Crédit Agricole (France) Société Générale (France) Banque Populaire CdE (France) Dexia (Belgium-France) Deutsche Bank (Germany) Commerzbank (Germany) Credit Suisse (Switzerland) UBS (Switzerland) ING Bank (Netherlands) Nordea (Denmark) Santander (Spain) Unicredit Group (Italy)	JP Morgan Chase (USA) Bank of America (USA) Bank of New York Mellon (USA) Citigroup (USA) Goldman Sachs (USA) Morgan Stanley (USA) State Street (USA) Wells Fargo (USA)	Mitsubishi UFJ FG (Japan) Mizuho FG (Japan) Sumitomo Mitsui FG (Japan) Bank of China (China)

Source: Financial Stability Board, 2011

In 2017, the list of global systemically important banks comprised 30 banks around the world as follows (Table no. 2): 14 banks from Europe (4 banks from the UK, 3 banks from France, 2 banks from Switzerland, 1 bank from Netherlands, 1 bank from Denmark, 1 bank from Spain, 1 bank from Italy, 1 bank from Germany), 9 banks from North America (8 banks from the USA, 1 bank from Canada), and 7 banks from Asia (4 banks from China, 3 banks from Japan). In other words, the USA occupied the first place with 26.66%, followed by the UK and China, each of them with 13.33%.

Table no. 2. Global systemically important banks in 2017

Europe	North America	Asia
HSBC (UK) Barclays (UK) Royal Bank of Scotland (UK) Standard Chartered (UK) BNP Paribas (France) Société Générale (France) Groupe Crédit Agricole (France) Credit Suisse (Switzerland) UBS (Switzerland) ING Bank (Netherlands) Nordea (Denmark) Santander (Spain) Unicredit Group (Italy) Deutsche Bank (Germany)	JP Morgan Chase (USA) Bank of America (USA) Citigroup (USA) Goldman Sachs (USA) Wells Fargo (USA) Bank of New York Mellon (USA) Morgan Stanley (USA) State Street (USA) Royal Bank of Canada (Canada)	Bank of China (China) China Construction Bank (China) Industrial and Commercial Bank of China (China) Agricultural Bank of China (China) Mizuho FG (Japan) Sumitomo Mitsui FG (Japan) Mitsubishi UFJ FG (Japan)

Source: Financial Stability Board, 2017

In 2018, the list of global systemically important banks comprised 29 banks around the world as follows (Table no. 3): 13 banks from Europe (4 banks from France, 3 banks from the UK, 2 banks from Switzerland, 1 bank from Netherlands, 1 bank from Spain, 1 bank from Italy, 1 bank from Germany), 9 banks from North America (8 banks from the USA, 1 bank from Canada), and 7 banks from Asia (4 banks from China, 3 banks from Japan). In other words, the USA occupied the first place with 27.58%, followed by France and China, each of them with 13.79%.

Table no. 3. Global systemically important banks in 2018

Europe	North America	Asia
BNP Paribas (France) Société Générale (France) Groupe BPCE (France) Groupe Crédit Agricole (France) HSBC (UK) Barclays (UK) Standard Chartered (UK) Credit Suisse (Switzerland) UBS (Switzerland) ING Bank (Netherlands) Santander (Spain) Unicredit Group (Italy) Deutsche Bank (Germany)	JP Morgan Chase (USA) Citigroup (USA) Bank of America (USA) Goldman Sachs (USA) Wells Fargo (USA) Bank of New York Mellon (USA) Morgan Stanley (USA) State Street (USA) Royal Bank of Canada (Canada)	Bank of China (China) China Construction Bank (China) Industrial and Commercial Bank of China (China) Agricultural Bank of China (China) Mizuho FG (Japan) Sumitomo Mitsui FG (Japan) Mitsubishi UFJ FG (Japan)

Source: Financial Stability Board, 2018

The period 2011-2018 witnessed some changes in the composition of the list of global systemically important banks. The changes were the following:

- The total number of global systemically important banks slightly increased from 29 banks in 2011 to 30 banks in 2017, and decreased to 29 banks in 2018.
- All banks are located in Europe, North America and Asia.
- The majority of global systemically important banks were US banks. In fact, there were the same 8 US banks in this period, namely: JP Morgan Chase, Citigroup, Bank of America, Goldman Sachs, Wells Fargo, Bank of New York Mellon, Morgan Stanley, and State Street.
- The share of US banks remained almost the same. It attained the peak in 2011 (28.57%) and slightly decreased in 2018 (27.58%). The banks from UK, France and China were other important financial institutions worldwide.
- The Chinese banks have increasingly become major players in the global banking system. Last year, the Industrial and Commercial Bank of China was the world's largest bank by assets (4009.26 $bn), followed by China Construction Bank, Agricultural Bank of China, and Bank of China (Statista, 2018).

5. Conclusions

The financial impact of globalization and the global financial crises are among the major factors that led to the emergence of the TBTF concept. This is why several measures were designed and implemented at the global level in order to address this topic.

The paper demonstrated that the TBTF concept represents an important topic in the global banking system. Also, it showed that there are several global systemically important banks located in Europe, North America and Asia.

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