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# Evaluation of too-big-to-fail reforms

## Summary Terms of Reference

## 1. Objective

**The evaluation will examine the extent to which too-big-to-fail (TBTF) reforms for systemically important banks (SIBs) that have been implemented to date are achieving their intended objectives**, and help identify any material unintended consequences that may have to be addressed, without compromising on the objectives of the reforms. In particular, the objectives of the evaluation are twofold:

1. **Assess whether the reforms for which implementation has been completed or is well underway are reducing the systemic and moral hazard risks associated with SIBs**. The evaluation will assess the extent to which implementation of TBTF reforms has reduced the moral hazard risks and externalities posed by these banks, and enhanced the ability of authorities to resolve them in an orderly manner and without exposing taxpayers to loss, while maintaining continuity of their vital economic functions.
2. **Examine broader effects (positive or negative) of the reforms on the financial system**. This involves analysis of the extent to which reform-induced changes in SIBs' structures and activities have impacted overall financial system resilience and structure, the functioning of financial markets, global financial integration (including issues related to market fragmentation), or the cost and availability of financing.

## 2. Relevance to financial stability

**The evaluation of TBTF reforms will cover a core area of post-crisis reforms relevant for financial stability**. In 2009, G20 Leaders called on the FSB to propose measures to address the systemic and moral hazard risks associated with systemically important financial institutions (SIFIs). The TBTF problem arises when the threatened failure of a SIFI – given its size, interconnectedness, complexity, cross-border activity or lack of substitutability – puts pressure on public authorities to bail it out using public funds to avoid financial instability and economic damage.

**In 2010, G20 Leaders endorsed the FSB framework for *Reducing the moral hazard posed by SIFIs***. The recommendations in that report stated that all FSB jurisdictions should put in place a policy framework to reduce the risks and externalities associated with domestic and global systemically important financial institutions in their jurisdictions.

**In 2011, the FSB further specified the details of the policy framework** in its report on *Policy Measures to Address Systemically Important Financial Institutions*. The FSB took stock of the progress made in implementing the framework and set out the further actions for the G20, the FSB and other international bodies in a report to the G20 on *Progress and Next Steps Towards Ending "Too-Big-To-Fail" (TBTF)* in September 2013.

**Implementation of TBTF reforms has progressed to a stage where an evaluation of their effects** – based on the July 2017 FSB *Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms* (Evaluation Framework) – **is becoming feasible.** The FSB, in cooperation with standard-setting bodies (SSBs), has monitored implementation of these reforms and has reported progress to the G20 on a regular basis since their adoption.[1] The evaluation offers a timely opportunity to assess the progress made by FSB members in response to the G20 call for this core reform although, with implementation still ongoing in some areas, a definitive assessment of the effects of these reforms will only be feasible over the longer term.

## 3. Tasks

**The evaluation will focus on the effects of TBTF reforms intended to reduce the probability and impact of failure of SIBs as follows:**

- (in terms of policies) requirements for additional loss absorbency through higher capital buffers and total loss-absorbing capacity (TLAC); recommendations for enhanced supervision and heightened supervisory expectations; and policies to put in place effective resolution regimes and resolution planning and to assess and improve the resolvability of firms' structures and operations. Other national/regional regulations that fall outside the scope of G20 reforms (e.g. structural banking reforms) will only be covered to the extent they are relevant for assessing the effects of G20 TBTF policies in particular FSB jurisdictions.
- (in terms of institutions) banks designated as G-SIBs by the FSB based on the BCBS methodology, and banks designated as D-SIBs by national authorities based on the agreed BCBS framework.[2] The analysis will include both G-SIBs and D-SIBs since they are subject to different levels of requirements. The evaluation will examine the implications of designation in terms of the policies applied to relevant banks in FSB jurisdictions. It will, however, not revisit the BCBS methodology and framework for assessing systemic importance of G-SIBs and D-SIBs respectively.

**The evaluation will analyse whether these reforms where they have been implemented:**

[1] See, for example, the November 2018 FSB *Fourth Annual Report on the Implementation and Effects of the G20 Financial Regulatory Reforms*. The report notes that implementation of higher loss absorbency as well as of reporting and disclosure requirements for G-SIBs is proceeding on a timely basis; that supervisory frameworks have improved and supervisory colleges have been established for almost all G-SIBs but that implementation of risk data aggregation and TLAC is still underway; and that substantial work remains in achieving effective resolution regimes and operationalising plans for SIBs.

[2] See the November 2011, July 2013 and July 2018 BCBS reports on the assessment methodology and higher loss absorbency requirement for G-SIBs, and the October 2012 *A framework for dealing with domestic systemically important banks*.

- are effective in the sense of resulting in a perceived reduction in the probability and impact of failure of these institutions (e.g. as measured by estimates of implicit funding subsidies and assessments by national and international bodies of overall progress in their resolvability and adequacy of their loss absorbing capacity);
- are leading to changes in business models and risk profiles that reflect the internalisation of the negative systemic risk externalities they give rise to and whether the incentives remain aligned across different types of policies to address TBTF; and
- are impacting the overall functioning of the financial system and economy, both in terms of intended outcomes and of any material unintended consequences (whether positive or negative).

**The evaluation will cover all FSB jurisdictions and include, to the extent possible, cross-border and cross-sectoral effects from the implementation of TBTF policies for SIBs**. The analysis of G-SIBs will include assessments of both domestic and cross-border effects, including possible implications for host financial systems in FSB and (where possible) other jurisdictions. The analysis of D-SIBs will include assessments of TBTF policies in FSB jurisdictions consistent with the SIFI Framework. These analyses will also examine the interactions and possible spillovers (including in terms of interconnectedness) of TBTF policies on other sectors – insurance and central counterparties – while recognising that implementation is not far enough advanced to assess the reforms targeting these sectors.

## 4. Process

**The evaluation team will take stock of relevant existing work before conducting its own analysis.** The starting point is to set out the reforms' original objectives and the primary issues that they intend to address. The evaluation will then take stock of the literature and existing work by the FSB and its member institutions, and identify data and possible indicators to assess progress with these objectives; establish post-crisis trends based on such indicators and descriptive statistics; identify transmission channels through which the reforms are operating; and analyse the effects by conducting empirical and other analyses.

- The stocktake will comprise a review of relevant FSB, SSB and other official sector reports; analytical work by authorities in FSB jurisdictions and by the private sector and academia; and an overview of industry and regulatory data that could potentially be used in the analysis.
- Various approaches will be used to ensure that the evidence on the effects of TBTF reforms underpinning the evaluation is comprehensive and robust.[3] These include: (i) qualitative analyses (e.g. of credit rating agency expectations of government support, of changes in SIB structures and behavioural responses, and of the state of readiness of resolution regimes and improvements to the resolvability of SIBs); (ii) indicators and descriptive statistics (e.g. market prices and balance sheet indicators to assess implicit subsidies as perceived by market participants and adjustments in

[3] The need to use various approaches also stems from the lack of SIB failures in recent years, which would have provided actual tests of the effectiveness of new policy frameworks.

SIB structures, activities and risk profiles); and (iii) quantitative/empirical analyses (e.g. event studies to assess the impact from the introduction of TBTF reforms on market prices and SIB behaviour, econometric analysis to investigate for a causal link between the reforms and relevant dimensions of interest).[4]

**The evaluation will utilise a broad range of information sources**. As much as possible, work will be based on data that is already available (public, vendor and supervisory data).

**Academic advisors will be involved in the work throughout the process.** They will assist the group in the design of methodological approaches, data collection and use, empirical and other analyses, and interpretation of the findings. This involves providing input on analytical issues, reviewing draft report write-ups, and participating in team meetings and calls.

**Stakeholder outreach will be an important aspect of the evaluation**. The FSB will engage with relevant stakeholders (market participants, academics, civil society etc.) through: (i) a call for public feedback on the effects of TBTF reforms; (ii) participation of stakeholders in selected evaluation group meetings as appropriate; (iii) two workshops to exchange views about the literature on this topic, analytical approaches and data that can be used, and issues to explore in the evaluation; and (iv) public consultation on the draft report.

## 5. Expected final deliverable

**The FSB will prepare a public evaluation report.** The report will describe the motivation, objectives, scope and approach of this exercise; describe relevant reforms, their implementation status and possible transmission channels; summarise the main findings from the qualitative and quantitative analyses across building blocks; and provide an overall assessment of the effects of TBTF reforms. The report will include Annexes on the literature review and bibliography, data sources and design of the empirical analysis, and other relevant issues. The draft report will be issued for public consultation before it is finalised.

**The results of the evaluation may contain findings for consideration by the appropriate bodies. They will not contain any specific policy recommendations**. If their findings warrant, the SSBs and the FSB may recommend that a standard or policy in their respective areas of responsibility be considered for amendment, in accordance with their established policy development processes. The final responsibility for deciding whether and how to amend a particular standard or policy remains with the body that is responsible for issuing that standard or policy. The FSB and SSBs will cooperate closely to ensure work is carried out in a coordinated and effective manner, consistent with the G20's mandate to the FSB.

## 6. Term

**The evaluation will be completed once the final report is published by the end of 2020.** The draft report is expected to be issued for public consultation in June 2020. The final report, incorporating feedback from the public consultation, will be published in late 2020.

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4 See the *Assessment of the macroeconomic impact of higher loss absorbency for global systemically important banks* by the Macroeconomic Assessment Group (October 2011) and the *Summary of Findings from the TLAC Impact Assessment Studies* by the FSB (November 2015).