Introduction

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This special issue of the *Journal of Banking Regulation* contains papers presented and inspired by a workshop entitled *Who Wants Big Banks?* which took place at the University of Ottawa in June 2013. The workshop was the third such event held under the auspices of the Banking Law Symposium. Financial support was provided by the Conference Board of Canada, the Centre for Commercial Law and Financial Regulation of the University of Reading, the University of Warwick Law School, the Centre for Commercial Law Studies of Queen Mary University of London, the Faculty of Law of the University of Ottawa and Patterson & LaBrosse Financial Consultants Ltd.

The global financial crisis, which surfaced in 2007 and whose aftermath continues to have major economic consequences and pose problems for the financial and fiscal authorities some 7 years later, has drawn attention to the systemic risks – national and international – posed by large and complex financial institutions, particularly banks. The Workshop's objective was to increase understanding in this area and hopefully thereby contribute to an improvement in public policy. To this end the focus was on regulatory, resolution, competition and governance issues as they relate to big banks.

Paul Jenkins provides a general context for the subsequent papers that set out the major concerns, as well as recommendations of policy-makers, practitioners, academics and others. He begins by exploring the reasons why the standard procedures for resolving or winding-up non-financial firms are not applied to large,

complex financial institutions, suggesting that these are centred on concerns about financial contagion and, by extension, economic stability. The international community has concentrated on reducing the probability of bank failures through enhanced regulation on the one hand and having credible resolution mechanisms in place on the other. Enhanced regulation has focussed on higher capital and liquidity standards, capital surcharges and stress testing; Jenkins argues that these, though welcome, are not a panacea for dealing with large complex institutions, nor is splitting a troubled bank into viable and non-viable parts via a bridge bank. He goes on to outline how bail-in could be used to resolve a large complex institution, with multiple subsidiaries, through either a top-down or a single-entry approach. Jenkins concludes with remarks on how best to avoid the building up of systemic risks in the first place. With respect to Canada, which weathered the financial crisis relatively well, he notes that while the means to do so already exist, that a body with a clear legislative mandate does not.

Bail-in, having the bank's liabilities (insured deposits apart) structured in such a way that risk is shifted back on to investors, is one possible policy response. Walter Engert and his colleagues at Office of the Superintendent of Financial Institutions (OSFI) outline the Agency's recent work on and plans for 'contingent capital', that is bank debt that would convert to equity when an adverse threshold is reached. They focus on last-stage or non-viability contingent capital (NVCC) as a means of facilitating bank

resolution, exposing providers of regulatory capital to risk, while reducing taxpayer exposure. Their rationale for concentrating on NVCC is that the design of the Canadian safety net, with its close coordination and cooperation among the various players helps to limit forbearance and that, moreover, OSFI already has a number of early intervention tools at its disposal. It was noted that NVCC is or can be consistent with corporate living wills and that NVCC can be designed to minimize the risk of an equity death spiral.

LaBrosse, Olivares-Caminal and Singh explore the contentious issue of dealing with distressed banks and the impact on sovereigns. They specifically look at the Financing Arrangements within the EU Bank Recovery and Resolution Directive. It reviews the creditability of a resolution and or deposit guarantee fund and some of the hurdles it is likely to experience during the short to medium term when member states will be building up funds and being sensitive to the fact that financial crises tend arise when you least expect them.

Roberta Karmel notes that in responding to the financial crisis the authorities, at least in the United States, have largely ignored competition issues, but that more recently there have been numerous calls, including from the financial community itself, for downsizing big banks and making Systemically Important Financial Institutions less complex. She gives a brief overview of how some US banks have grown to be so large. She submits that the 1920s experience of splitting up public utility holding companies, via the US *Public Utility Company Holding Act*, might provide some guidance for reducing the size and complexity of large banks, as well as reducing their political influence. She reasons that an antitrust approach may well be preferable to attempting to roll back the deregulation measures of the 1980s and 1990s and suggests that the *Dodd–Frank Act* is far from a cure-all.

Art Wilmarth provides a detailed analysis of the risks of being too big to manage and regulate with his case study of Citigroup and its subsequent need for the state to provide it with

taxpayer support during the 2007–2009 financial crisis. The move towards financial conglomeration in the 1990s was an agenda universally advocated on the basis of big was better and strong, and wielded improved economies of scale. Wilmarth provides a critical assessment of that position. He questions to some extent whether institutions such as these lend themselves to be managed or supervised effectively when their size and complexity can lead to unintended risks being concealed from their view, until it is too late.

Larry Wall begins by noting that while in compliance with the Basel capital standards a number of banks nevertheless have found themselves in difficulty. He provides a detailed comparison of stress testing with the Basel capital ratios, arguing that neither is a panacea, and that both are likely to remain as components of the supervisory tool-kit as they complement each other as indicators of capital adequacy. He expresses some concern that institutions could game the system, that is make portfolio adjustments so as to be technically in compliance, but not in compliance with the intent of neither the Basel ratios nor stress testing requirements.

David Longworth emphasizes that an important underlying strength of the Canadian system of financial supervision and regulation is its emphasis on principles as well as rules. Accordingly, senior bank management are expected to have a clear understanding of the principles underlying the rules, which helps minimize *pro forma* conformity – a concern raised by Larry Wall. The Canadian authorities have traditionally placed emphasis on capital regulation and Canadian banks have high capital ratios by international standards. The 5-year sunset clause in legislation for federally regulated financial institutions provides a built-in opportunity for the authorities to make regulatory adjustments to meet emerging prudential concerns.

Patrick Leblond notes that in the wake of a sovereign debt crisis, which was itself preceded by a banking crisis, the European Union (EU) is in the process of creating a banking union for

the euro area. An integrated financial framework is considered necessary in some quarters for completing Europe's economic and monetary union. But is this the case? He argues that a banking union in Europe may not be necessary for the euro's survival and functioning, but it is likely to be helpful in reducing tensions inherent in the system. Without an effective banking union, financial integration is costlier and puts excessive pressure for financial stability on the shoulders of the European Central Bank.

Albert Foer and Don Allen Resnikoff echo Roberta Karmel's comment that the US Department of Justice should have a more important role in examining bank mergers, even during periods of financial stress. They argue that this has been the case in the EU. They submit that many of the issues under consideration in the recently formed Financial Stability Oversight Council have competition implications and that the Antitrust Division of the Department of Justice should be a voting member on that body.

Ioannis Kokkoris outlines the EU's approach to reconciling competition and financial stability considerations. He argues that from a long-term perspective competition policy and financial stability have a common goal – a well-functioning and efficient financial system, but that in a financial crisis stability issues have to take precedent.

P.M. Vasudev and Dirana Rodriguez Guerrero provide an analysis of corporate governance issues in the context of the LIBOR scandal. They propose that fraud coupled with poor judgement were at the heart of the matter

and that, given this, adjusting or introducing new corporate governance rules would be of minor effect. They submit that the permissive financial regulatory environment of the time, including the rapid evolution of derivative markets, as well as regulatory forbearance also were factors in the debacle.

In addition to the papers included in this special issue, the workshop benefited from remarks delivered by: Gordon Thiessen, former Governor of the Bank of Canada; Clyde Goodlet, a former Advisor at the Bank of Canada; Jason Allen and Timothy Lane, Bank of Canada; David Walker and Michele Bourque, Canada Deposit Insurance Corporation; Paul Darby and Michael Burt, the Conference Board of Canada; Patrick Grady, Global Economics Ltd.; Gary H. Stern, former President of the Federal Reserve Bank of Minneapolis and now of Stern Partners LLC; Costanza Russo, Queen Mary, University of London and Jean Pierre Sabourin, Malaysia Deposit Insurance Corporation. Workshop details can be found at www.bankingsymposium.org.

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