

# Bailouts, Bail-ins, and Banking Industry Dynamics

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  - ▶ **This Paper: Resolution policies also impact small banks and differentially influence big banks.**

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- Adapted Hopenhayn firm dynamics model with bailout/bail-ins
- Benchmark: Banking industry pre-GFC with size-dependent probability of bailout
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- Counterfactual: Bail-in policy instead of bailout

## Key Channels

- **Uninsured debt with risk-sensitive interest rates**
  - ▶ Extensive literature documenting “Too Big to Fail” subsidy on debt borrowed by big banks
  - ▶ Solve for endogenous interest rates based on bailout/bail-in policy

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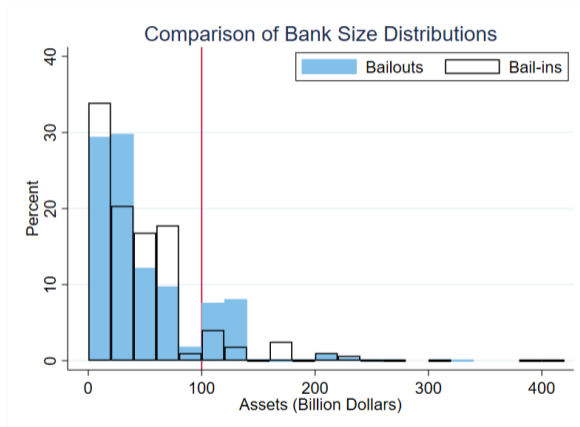
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- **Key Intuition:**
  - ▶ Bailouts subsidize uninsured debt for large banks, particularly riskier banks.
  - ▶ Bail-ins reduce this subsidy.
  - ▶ This raises funding costs for riskier banks and weakens incentives to grow just to become too-big-to-fail.

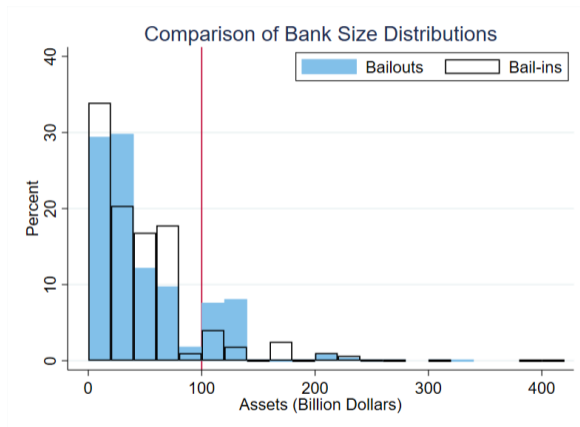
## Fewer big banks exist and fewer fail

- Share of big banks decreases by 42%



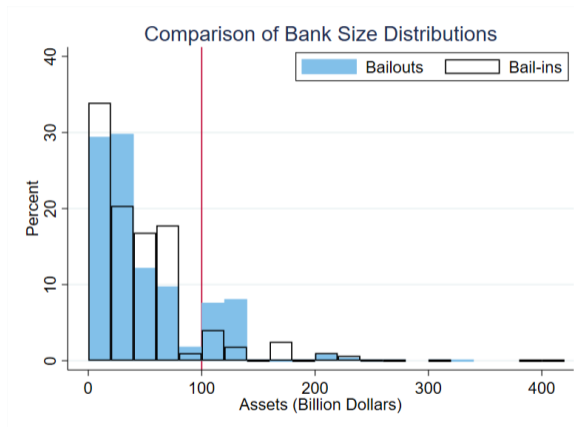
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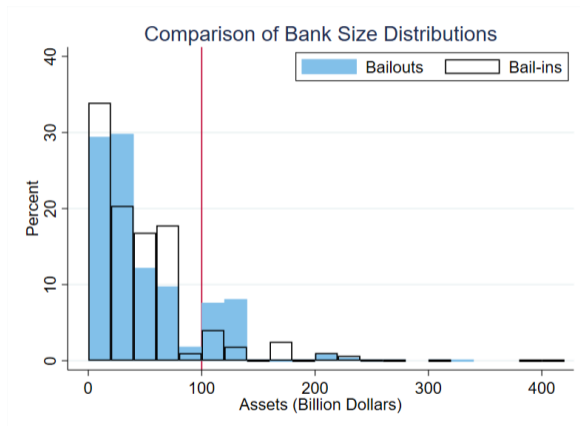
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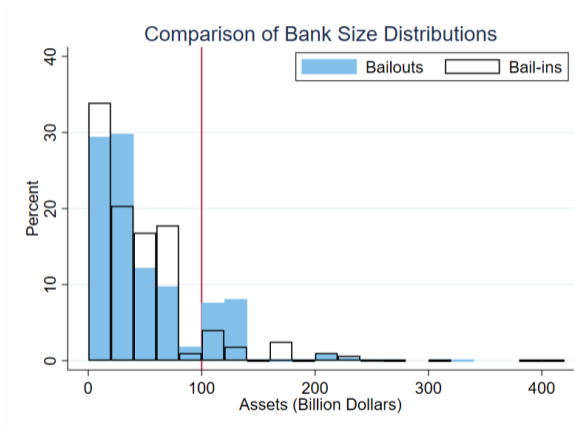
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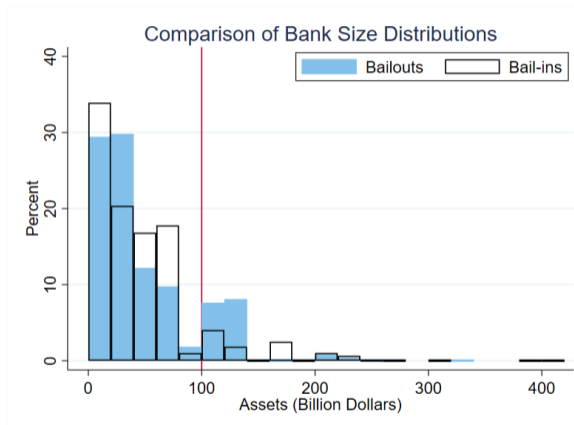
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- Bail-ins reduce risky lending by riskier banks, but still encourages it by less risky banks



# Conclusion

- Bail-ins achieve their goal of reducing big bank failure
- Banks are less incentivized to grow large and share of big banks ↓ 42%
- Avg prob of a big bank failing ↓ by 65%
  - ▶ Ex-ante riskier banks stay smaller due to fewer size incentives
- More banks enter, and aggregate lending ↓ by 3%