Quantifying the "Too-Big-to-Fail" Subsidy Value for Large Australian Banks: A Pitch

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1. Introduction

This pitch letter is based on the template developed by Faff (2014) with regard to a research topic in applied finance discipline. I am recently a Master of Research student in applied finance at Macquarie University, Sydney, Australia. I am totally new in academic research and my first-year study is concentrate on research methods. This year give me a great chance to find out what I really interested and can achieve during my master's degree. In this year, I grasp plenty of journal articles in different research areas. On September 2014, I attend a seminar hold by a lecture in my own university. The discussion about large banks being "too-big-to-fail" is raised in this seminar. While before this seminar, I was struggling if I should choose another topic, which needs to employ very complex and advanced econometric models that I need to learn from the beginning. I decide to talk to the lecture that delivers the seminar. And he recommends one paper, which is about the "too-big-to-fail" subsidy he talked about in the seminar. I find this topic is very interesting and decided to start my own research in this area. In the meantime, I had the great honor to have him as my supervisor. That's where I start my pitch.

It is really a "non-linear" progress to complete the pitch. As a novice pitchee, the knowledge I had accumulated is limited to the subjects I completed in my coursework study. In order to broader my knowledge in the banking sector research, I started to read high quality journals and textbooks about financial institutions and this regarded "too-big-to-fail" issue. At that time, I was at the top level of the "cocktail glass" proposed by Faff (2014). In the meanwhile, the first consideration came up with the data that I needed in my own research. It takes me more than one month to find out and filter the data, and fortunately this problem is solved in terms of the database the university subscribed. When I finished collecting the data, I am confident that I can approach this pitch after all.

The remainder of this letter is organized as follows. Section 2 will present a brief explanation on my pitch template. Section 3 is my personal reflections on the pitching research. And Section 4 concludes this letter.

2. Explanation on my pitch template

The completed pitch relates to the topic of "too-big-to-fail" subsidy is displayed in Table 1. In order to measure the "too-big-to-fail" subsidy, it is essential to find out "how much funding advantage the four big banks enjoy in their previous issuance", which is the key research question. The first identified key paper is Santos (2014), which is recommended by my supervisor. Santos (2014) is the most critical paper to my pitch and it is nominated for constituting the motivation of the underlying research. This study uses American corporate bond market data to demonstrate the existence of "too-big-to-fail" subsidy. It recognizes the market notion of "too-big-to-fail" that the government of a number of countries, including Australia, would intervene to protect the large banks from failure. These large banks are viewed as systemically important that their failure will cause significant economy disruption. The investors' expectation of government intervene create implicit subsidy for these large banks, which is the funding advantage the large banks enjoy when gathering funding. These benefit the large banks enjoy give them competitive advantages over the other smaller banks and give these large banks incentive to take more risks. Noss and Sowerbutts (2012) propose two different models to measure the implicit subsidy and criticize on these models. Ueda and Mauro (2013) applied the rating-based approach by employing support ratings, which reflect the external assessment of the default probability of the debts. It gives specific statistical evidence to demonstrate the "too-big-to-fail" subsidy the systemic important institutions enjoy.

These key papers highlighted the concerns of the "too-big-to-fail" perception as a credible threat to market functioning in industry. Even there are no prudentially regulated institutions in Australia experienced a disorderly failure; Murray Financial System Inquiry (FSI) (2014) expresses the requirement to resolve these institutions without government support. To reduce perceptions that the government would intervene to prevent banking failures, FSI recommends three significant policy actions. Firstly, banks should be required to strengthen their capital adequacy and reduce the likelihood of future crises. Secondly, it is necessary to build a leverage ratio adopted as a backstop to prevent banks against risks in the risk-basked capital requirements. Lastly, developing a sufficient loss absorbing and recapitalization framework can help facilitate the orderly resolution of Australian banks and

minimize taxpayer support. By measuring the value of the too-big-to-fail subsidy for Australian banks, my research will demonstrate the benefit of these policy recommendations. This proposed research would apply the size-based approach and employ Australian primary bond market data from 1990 to 2014 to look at the spread on bonds between the four big banks and the other smaller banks. The reason funding cost is chosen because it is a risk-sensitive measure of what investors charge banks to borrow. The bond market data are collected from Bloomberg, which include their yield at origination, issue date, maturity data and credit ratings. And by employing SAS in terms of panel data regression modeling will be the tools to analyze the data. Australian market is special when compare with the other markets as there is no explicit guarantees before the global financial crisis. Thus, comparisons between implicit subsidies before global financial crisis and after will also be conducted to test the robustness of the results.

3. Personal Reflection

After complete this pitch, I feel like how to choose the right topic and be aware of the significant and contribution of this study within a particular area is the major obstacle at the beginning. When I read the literatures and selecting the main papers to rely on, I am thinking how can I contribute to the knowledge and what is a really significant contribution at all. When looking back on the time I sift through the papers, I only read the abstracts and choose papers focus on this topic and consider if I can start my own research in the light of these few papers. Just like Faff (2014) talk in the paper, I used to mistakenly believe that doing the same kind of study in different country will contribute to the knowledge. Then I go back to my supervisor with my question about the contribution of my proposed research. His feedback let me take a further step and start spend time to read current papers related to my research topic and read textbooks to supply my knowledge base. The weekly meetings with my supervisor really help me to sort the logic of my proposed research and find out what I can start working on and where I am going to head all along. Sometimes, maybe one sentence he said will save me whole week of working. These progress in the early phase developing my pitch is what I realize the most significant success in my study until now.

The adorable Mickey proposed by Faff (2014) is an effective approach to tell what are the most important elements in my proposed research. It is simple but represent the new knowledge that will contribute to the literature. It is appealing when presenting my proposal no matter in presentations or written papers. Figure 1 presents the Mickey Mouse in the context of my pitch.

From doing this pitch, I find out it is a great effective way to sort and organize my ideas and help me to start my proposed research without waste time. It is difficult for me as a new pitchee to make the first version of the pitch perfect. It is necessary to update the pitch time by time and do not afraid to talk about your idea with the senior academics. You will grow and gain valuable feedback from different aspects. In the next pitch, I would dedicate time to read and supply my knowledge and be more patient to refine the research question.

4. Conclusion

The pitch letter presents a brief commentary for my proposed research about the "too-big-to-fail" subsidy for large Australian banks. This pitch presented here is following the pitch template proposed by Faff (2014) and I find it very effective and helpful leading me organizes my research ideas. Applying the pitch template avoid wasting times and point to direction directly without distractions. As a novice, I am aware that this is just a beginning in my career. There will be various challenges in the future and waiting for me to beat them with prudential but enthusiasm.
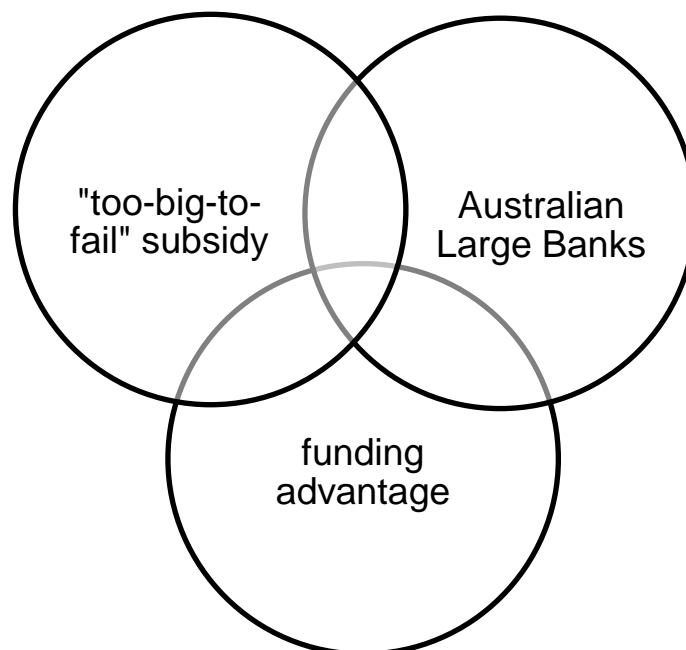
Figure 1: Mickey Mouse

Table1: Pitch Template on "Too-Big-to-Fail" Subsidy Topic

(A) Working Title	Measuring "too-big-to-fail" subsidies of large Australian banks
(B)Basic Research Question	How much implicit subsidies that the large Australian banks enjoy in the perception of "too-big-to-fail"?
(C) Key Papers	Noss, J & Sowerbutts, R 2012, 'The implicit subsidy of banks', Bank of England Financial Stability Paper, No. 15. Santos, J 2014, 'Evidence from the bond market on banks' "too-big-to-fail" subsidy', Economic Policy Review, vol. 20, no. 2, pp. 1-11. Ueda, K & Weder di Mauro, B 2013, 'Quantifying structural subsidy values for systemically important financial institutions', Journal of Banking & Finance, vol. 37, no. 10, pp. 3830-3842.
(D) Motivation/Puzzle	The idea of "too-big-to-fail" has long been recognized as a market notion that the government of a number of countries, including Australia, would intervene to protect the large banks from failure. The investors' expectation of government intervene create implicit subsidy for these large banks, which is the funding advantage the large banks enjoy when gathering funding. These benefit the large banks enjoy give them competitive advantages over the other smaller banks and give these large banks incentive to take more risks.
THREE	
(E) Idea?	In order to demonstrate the "too-big-to-fail" subsidy, it is essential to find out how many funding advantage the four big banks enjoy in their previous issuance. The reason funding cost is chosen because it is a risk-sensitive measure of what investors charge banks to borrow.
(F)Data?	**(1) Setting:** Australia; **Unit of analysis**: corporate bonds issued by four big banks and other smaller banks; **Sampling:** primary market; **Focus**: Spread at origination **(2) Expected sample size**: Panel data; **Sample Period**: 1990-2014 **(3) Data source**: Bloomberg **(4) Data collection**: mostly automatic, manual adjusted after.
(G)Tools?	Panel data regression model approach; Software: SAS
TWO	
(H) What's New?	There is no literature using bond yield spread to quantify the subsidy. In the meantime, Australian market is special because there is no explicit guarantee before the GFC.
(I) So What?	As the Australian Government already propose to reduce the too-big-to-fail perceptions within market participants and take steps to control on banks' failure without government support, this proposed research would help the federal financial regulators to made progress to reform and enhance the existing regulation standards for large banks related to capital, liquidity and risk management.
ONE	
(J)Contribution?	Contribute to the knowledge by demonstrates the necessary of adjustment for capital requirement and banking regulations.
(K)Other Considerations	Collaboration: - Idea: yes, feedback for adjustment the original propose - Data: yes - Tools: yes

References

Faff, RW 2014, 'Pitching Research', <http://ssrn.com/abstract=2462059>

Noss, J & Sowerbutts, R 2012, 'The implicit subsidy of banks', *Bank of England Financial Stability Paper*, no. 15.

Santos, J 2014, 'Evidence from the bond market on banks' "too-big-to-fail" subsidy', *Economic Policy Review*, vol. 20, no. 2, pp. 1-11.

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