Bailouts, Bail-ins, and Banking Industry Dynamics by April Meehl

Discussant: Dario Laudati

FMA annual conference 2025

October 23, 2025

Roadmap

1. Summary

2. Comments/Suggestions

Summary

- Theoretical macro-banking paper to study the general equilibrium effects of *resolution policies*: bail-ins vs. bailouts.

Summary

- Theoretical macro-banking paper to study the general equilibrium effects of *resolution policies*: bail-ins vs. bailouts.
- The model features: heterogeneous banks, a representative household, a perfectly competitive fringe of investors.

Summary

- Theoretical macro-banking paper to study the general equilibrium effects of *resolution policies*: bail-ins vs. bailouts.
- The model features: heterogeneous banks, a representative household, a perfectly competitive fringe of investors.
- Banks can *default* due to i.i.d. idiosyncratic risks hitting their loans portfolio $\Rightarrow$ If so, they can decide: Default vs. Bailout (or Bail-in, in the counterfactual).

Summary

- Theoretical macro-banking paper to study the general equilibrium effects of *resolution policies*: bail-ins vs. bailouts.
- The model features: heterogeneous banks, a representative household, a perfectly competitive fringe of investors.
- Banks can *default* due to i.i.d. idiosyncratic risks hitting their loans portfolio $\Rightarrow$ If so, they can decide: Default vs. Bailout (or Bail-in, in the counterfactual).
- Banks do **not** have agency over the riskiness of their loan portfolio, but they can buy *safe assets* provided by mutual funds, the investors, to act as insurance.

Summary

- Banks finance themselves through 4 sources: Net cash, capital injections, deposits, non-contingent debt.

  They can face i.i.d. shocks on **deposits** too.
  However, households are not cognizant that their actions affect repayment of deposits by the banks.

Summary

- Banks finance themselves through 4 sources: Net cash, capital injections, deposits, non-contingent debt.

  They can face i.i.d. shocks on **deposits** too.
  However, households are not cognizant that their actions affect repayment of deposits by the banks.

- If banks enter resolutions, **liquidation** gets them to liquidate at discount prices; **bail-outs** gives them cash to meet capital requirements.

  Bail-outs are based on banks' size to reproduce "too big to fail" dynamics.

Summary

- Banks finance themselves through 4 sources: Net cash, capital injections, deposits, non-contingent debt.

  They can face i.i.d. shocks on **deposits** too.
  However, households are not cognizant that their actions affect repayment of deposits by the banks.

- If banks enter resolutions, **liquidation** gets them to liquidate at discount prices; **bail-outs** gives them cash to meet capital requirements.

  Bail-outs are based on banks' size to reproduce "too big to fail" dynamics.

- **Bail-ins**: Take the Dodd-Frank Act resolution and see – if applied to the 1992-2006 – how that would have affected the equilibrium outcomes.

  All uninsured debt converted into cash. The banks only repay insured deposits.

Roadmap

1. Summary
2. Comments/Suggestions

Comments

- Important and policy-relevant question ⇒ Fully support this line of research: not enough work on it, and highly topical.
- The paper reads very well (only one typo!); theory is described in a precise way.
- At this stage, I would already considering it close to a top field journal like AEJ:Macro. My discussion will try to highlight points that can make this paper a contender for Top-5 Econ journals.

Comments/Suggestions

- **Off-equilibrium path**?

  It is fine to consider an equilibrium in which beliefs are internally consistent, but what happens if there is deviation / If bail-in funds are *not* enough?

  You don't link your paper to the **risk-shifting** literature, but that seems highly topical: What if banks do bet on the fact that even with bail-in funds, there is a positive probability they will be bailed-out?

Comments/Suggestions

- **Off-equilibrium path**?

  It is fine to consider an equilibrium in which beliefs are internally consistent, but what happens if there is deviation / If bail-in funds are *not* enough?

  You don't link your paper to the **risk-shifting** literature, but that seems highly topical: What if banks do bet on the fact that even with bail-in funds, there is a positive probability they will be bailed-out?

- Which brings me to: Banks do make decisions on who to lend to – that is key for the **moral hazard** properties you are implicitly addressing.

Comments/Suggestions

- **Off-equilibrium path**?

  It is fine to consider an equilibrium in which beliefs are internally consistent, but what happens if there is deviation / If bail-in funds are *not* enough?

  You don't link your paper to the **risk-shifting** literature, but that seems highly topical: What if banks do bet on the fact that even with bail-in funds, there is a positive probability they will be bailed-out?

- Which brings me to: Banks do make decisions on who to lend to – that is key for the **moral hazard** properties you are implicitly addressing.

- **Contagion.**
  - No bank runs, no networks amongst banks, no pass-through of shocks, no *fire sales*. But that is key to assess the robustness of bail-in policies!

Comments/Suggestions

- **Welfare - Banks' entry**.

  Very important for your welfare computations, but there is none of that. In fact, there has been massive exit/concentration in the U.S.. I would run the same model blocking entry altogether and see what happens.

- **Welfare - Lending/Investments**.

  It is unclear how lower lending affects capital accumulation, but that is key for your macroeconomic welfare computations, if you propose to reduce lending volumes (banks lobby on this point all the time).

Comments/Suggestions

- **Guessing the regulators policy rules**:
  - Banks want to grow with bailouts because they know regulators policy rule: *Size = Higher bailout probability*. Was that really so clear before 2006? Also, was that really why they grew so much? It seems both mechanical, and taken from an ex-post perspective.
  - Since you mention "banking industry dynamics" in the title, you can make this richer. The survival probability of banks is smaller if balance sheets are smaller (non-linear and closer to the boundary), and therefore there is an incentive to grow which engenders too much size $\Rightarrow$ Not mechanical anymore, endogenous, and potentially with different interesting results.
- **Investors**

  If you make them risky/defaultable, this can be your perfect set-up to show the effects of bail-ins when shadow banking is fragile.