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To Be Bailed Out or To Be Left to Fail? A Dynamic Competing Risks Hazard Analysis

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Highlights

- We construct a dynamic competing risks hazard model.
- We explore the joint probability of a distressed bank to fail or to be bailed out.
- Distress is analysed based on a broad range of bank-level and environmental factors.
- The determinants of bank failures largely differ from those of bailouts.
- Our model outperforms the commonly used logit model in terms of forecasting power.

Abstract

During the global financial crisis, a large number of banks worldwide either failed or received financial aid thus inflicting substantial losses on the system. We contribute to the early warning literature by constructing a dynamic competing risks hazard model that explores the joint determination of the probability of a distressed bank to face a licence withdrawal or to be bailed out. The underlying patterns of distress are analysed based on a broad range of bank-level and environmental factors. We find that institutions with inadequate capital, illiquid and risky assets, poor management, low levels of earnings and high sensitivity to market conditions have a higher probability to go bankrupt. Bailed out banks, on the other hand, face both capital and

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