Enhancing Resolution Regimes: Applying the FSB Key Attributes

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Content

Bank Resolution: International Reform Agenda

- Global Financial Crisis and the Need for Reform
- Addressing "Too Big To Fail"
- FSB Key Attributes of Effective Resolution Regimes

Bank Resolution: Implementing the FSB Key Attributes

- Designing a Framework for Dealing with Failing Institutions
- Proportional Application of the Key Attributes
- Before Resolution: Resolution Authority; Recovery and Resolution Planning
- In Resolution: Resolution Powers and Tools; Legal Safeguards; Resolution Funding

Conclusions

Bank Resolution: International Reform Agenda

Global Financial Crisis Started International Reforms

The global financial crisis of 2008/09 identified weaknesses in regulatory frameworks

The international community (G-20, FSB, BCBS) responded with regulatory reforms:

- Basel III enhancements to supervisory regime
- FSB Key Attributes for Effective Resolution Regimes
- IADI Core Principles for Effective Deposit Insurance Systems

Full implementation of these reforms has been mixed:

- Some jurisdictions have adopted the new international standards and good practices
- Others are in the process of implementing them

Addressing “Too Big To Fail”

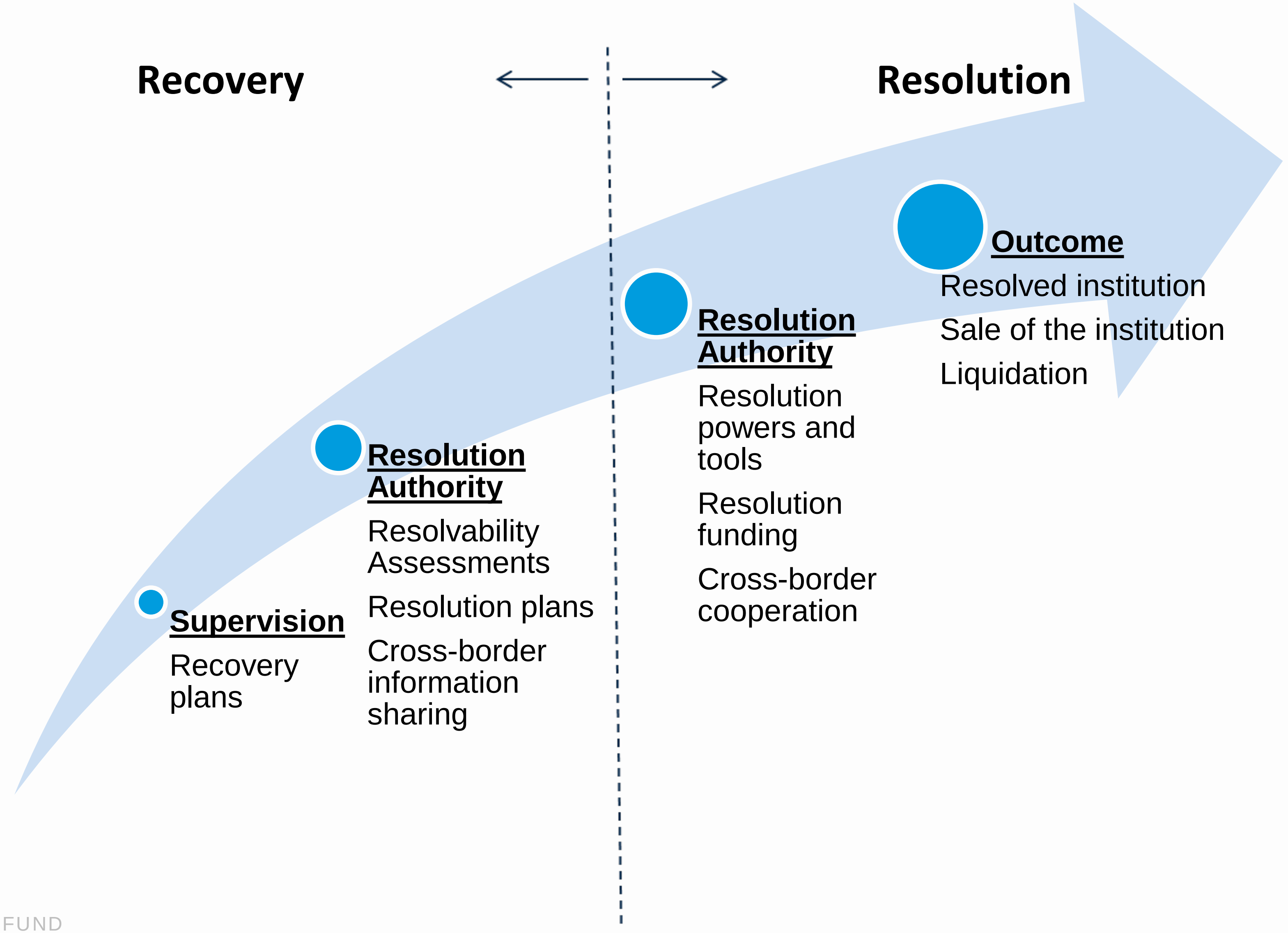
- Strengthening role and powers for the supervisory authorities (early intervention)
- Introduction of a special bank resolution law with appropriate powers and tools
- Preparation of recovery and resolution plans
- Enhancements in cross-border information exchange and cooperation
- Funding arrangements that protect public finances
    - Allocating losses to both shareholders and creditors (bail-in)
    - Use of deposit insurance fund for resolution
    - Mechanisms to levy the industry for resolution costs

FSB Key Attributes of Effective Resolution Regimes (KAs)

The FSB KAs were adopted in 2011 by the Financial Stability Board (FSB) to assist G20 jurisdictions to strengthen their resolution frameworks

- Non-binding set of principles - a new international standard for resolution of financial institutions
- Implementation is monitored by FSB peer reviews
- Assessed by the IMF in the context of FSAPs
- Used as a guidance to provide Technical Assistance by the IMF

FSB Key Attributes Enhance Supervision and Resolution Process of a Failing Bank



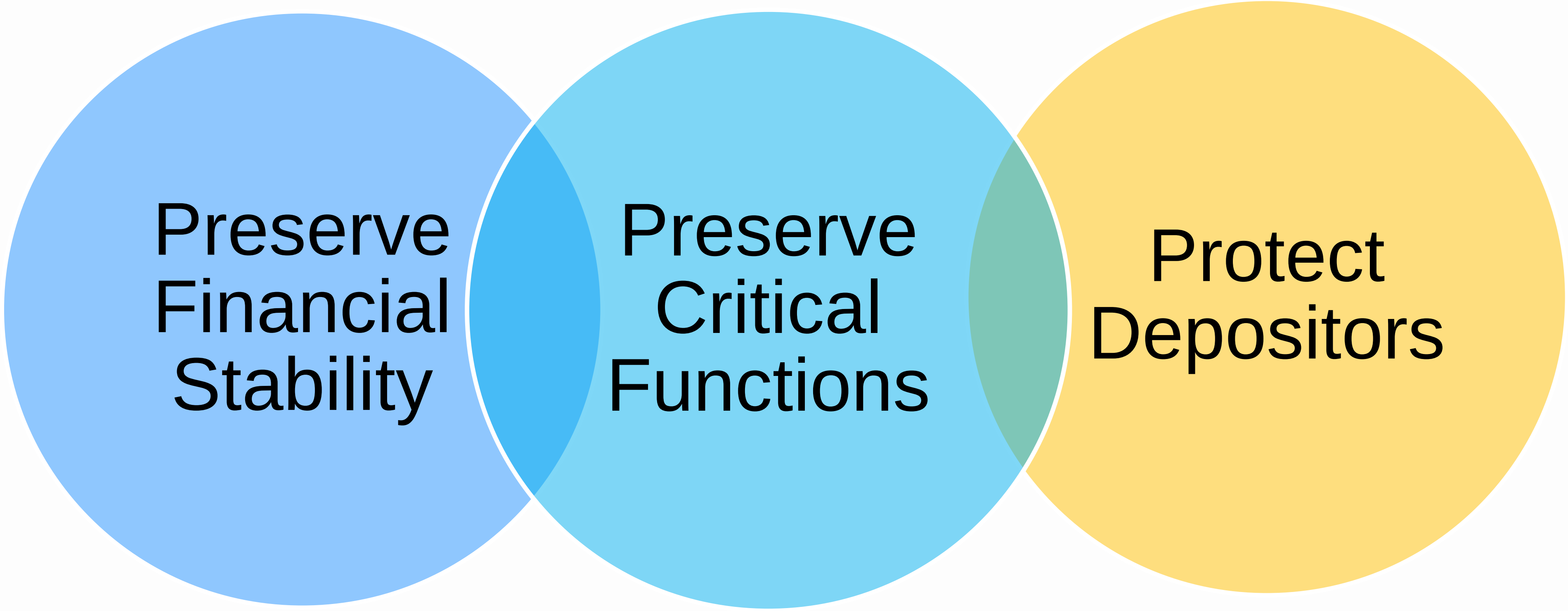
Bank Resolution: Implementing the FSB KAs

Designing a Framework for Dealing with Failing Institutions

Jurisdictions need a special resolution framework for systemic and non-systemic institutions

- A strong legal framework is needed because:
  - Resolution interferes with shareholder and creditor rights and
  - to ensure sound governance and accountability
- Resolution should be triggered early (before insolvency → non-viability)
- Decisions must be taken and implemented swiftly to prevent contagion
- Least costly resolution options should be chosen
- The need for government financial support is minimized

Resolution: Objectives



Proportional Application of the KAs

KAs were written for global systemically important financial institutions

KAs should be implemented in a proportionate manner and take into account:

- the complexity and systemic importance of the banks to which the resolution regimes applies
- the size, structure and complexity of the jurisdiction's banking system

KAs have to be adapted to country needs where there are no G-SIBs as there is no "one size fits its all" for resolution frameworks

KAs can be used to design resolution frameworks for Domestic-SIBs and non-systemic banks

Before Resolution: Designate a Bank Resolution Authority

The KAs call for a dedicated **resolution authority**

- **Operational** independence (staff & resources) is necessary for any resolution agency to fulfill the tasks assigned to it (resolution planning, execution of resolution powers) and to exercise its powers without undue influence. Such a specialized authority should have **sound governance and transparent processes.**
- The institutional location of the resolution authority (central bank, separate entity, deposit insurer) will depend on the size of the banking sector and authorities' institutional capacity
  - A small banking sector with few failures only may need a resolution unit in the central bank
  - A complex banking sector may benefit from a separate resolution institution
    - If in the central bank, dedicated reporting lines are needed
    - If institutionally independent, strong coordination arrangements are needed

Before Resolution: Recovery Plans

Recovery plans ensure preparedness of banks and supervisors to deal with crises situations

- Mechanism within which banks can establish and maintain the capacity to restore their financial soundness in the face of capital or liquidity shocks
- Recovery plans fall under the responsibility of bank's senior management
- The supervisor will outline its expectations for the plans and review the plans
- All banks should write recovery plans; taking into account proportionality

Before Resolution: Resolvability Assessments and Resolution Plans

Resolvability assessments and resolution plans allow the resolution authority to be prepared to resolve a bank with its resolution toolkit without facing any obstacles

- **Resolvability assessment** done by the resolution authority should identify potential impediments to execution of the resolution actions and the use of the relevant resolution powers
- **Resolution plans** identify resolution options and outlining implementation mechanisms for failed banks
- Both fall under the responsibility of the resolution authority
- The resolution authority should have the power to require banks to implement changes to their operations and structure as necessary for implementing effective resolution strategies
- At least, D-SIBs should be subject to resolution planning

Before Resolution: Cross-border cooperation and coordination

Certain KAs on cross-border cooperation (KA 8-9 on Crisis Management Groups, Cross-border Cooperation Agreements) only apply to G-SIBs

For D-SIBs with material cross-border operations there is a need for appropriate cooperation and coordination between home and host countries

- There should be a **cross-border coordination forum** with a specific mandate to deal with cross-border RRPs
- Existing cross-border supervisory bodies often do not cover resolution issues but could be expanded to cover, for example, recovery and resolution planning

In Resolution: Resolution Powers

The resolution framework should include powers to

- **replace the management and appoint an administrator** to manage the failing bank
- **override shareholder and creditor rights** to approve a merger, increase capital, sell or transfer assets
- **temporarily suspended payments** (careful when limiting access to deposits and obligations under deposit insurance framework!)
- **ensure continuity of essential services and functions** by other companies of the same group

In Resolution: Resolution Tools

Purchase and Assumption Transactions (P&A)

- Requires the existence of another bank willing to acquire part of the business of a failed bank
- Resolution agency packages good assets with deposits, which are transferred to the acquirer
- The transfer should be able to be accomplished without the consent of shareholders or creditors
- Deposit insurance fund should be allowed contributing to P&A under least-cost rule
- Remaining part of the bank is liquidated; shareholder/creditors bear losses in liquidation
  - *Pro: Performing assets keep their value; insured depositors keep access to their deposits*
  - *Contra: Might not work with a big, complex bank (e.g. small market; competition concerns; timing)*

In Resolution: Choose Resolution Tools (continued)

Bridge Bank

- A temporary public bank that acquires the assets and liabilities of a failed bank if no private acquirer can be found
  - *Useful for more complex banks; when under time constraint or no (suitable) private buyer*
  - *Who is the owner and who runs the bridge bank? Regulatory requirements (capital)??*
  - *Bridge should not become a "permanent bank"*

Asset Management Company

- Transfer of non-performing assets to a special vehicle which liquidates the assets
  - *While mentioned in the KA, not necessary a "resolution" tool; needs to be combined with other resolution tools; high fiscal costs; governance issues.*

In Resolution: Resolution Tools (continued)

Bail-in can be a useful tool to preserve a large, complex bank in going-concern when other resolution powers (e.g. bridge bank power) would not be sufficient and a closure is not an option

Bail-in

- Statutory bail-in by the resolution authority (opposite to a contractual conversion (CoCo Bonds))
- Scope of liabilities subject to bail-in: TLAC, but not DIS insured deposits

Characteristics of bail-in powers

- Converts creditors to shareholders
- Provides bank capital
- But does not provide liquidity or a new business plan/model or deal with legacy issues

In Resolution: Resolution Tools (continued)

Implementation challenges

- Requirements for banks to hold bail-inable liabilities (TLAC)
- Valuation of assets in a crisis might be difficult
- Determination of the financial “hole” to fill by bail in
- Concerns about contagion when bailing in (who is bailed in?)
- Legal challenges of bailed-in creditors
- “Fit & proper” shareholders as a result of the bail-in?

In Resolution: Resolution Tools (continued)

Nationalization as a last resort when

- Necessary for financial stability;
- Private funding exhausted;
- Shareholders written down, unsecured/uninsured creditors bailed-in;
- It is coupled with an ex post cost recovery mechanism

Resolution: Legal Safeguards

“No creditor worse off”: No creditor or shareholder should be left worse off than if the bank had been wound up/liquidated under bankruptcy law to safeguard property rights (often protected under the constitution)

Legal protection of the resolution authority’s staff is important to ensure it can fulfil its mandate

Legal review should be ex-post and courts should not have the ability to reverse resolution actions once implemented; only compensation should be awarded if the resolution authority overstepped its powers

Resolution: How to Pay for Bank Resolution?

Resolution may need some funding, but the use of public funds should be limited

- Before any (external) funding, **shareholders and creditors** should bear first losses
- The **use of the deposit insurance fund** for a transfer of deposits in resolution should be allowed. Its use need to be clear and transparent and limited to the cost it would have incurred in a liquidation (least-cost test)
- A **special resolution fund** might not always be a feasible option (e.g. small banking sector with low profitability)
- There should be a mechanism to recover public funds **from the industry ex-post**

Conclusions

KAs as a blueprint for resolution frameworks

Resolution regimes for all sorts of banks can be strengthened by incorporating the KAs

- Setting up a resolution authority
- Enhancing resolution tools
- Strengthen cross-border cooperation

KAs should be implemented in a proportionate manner

- Take into account the complexity and systemic importance of the banks
- Not all powers are needed or suitable for each resolution
- How to ensure sufficient resolution funding?

Implementation Challenges

Institutional Architecture

- Establishing a resolution authority and building capacity
- Operationalizing resolution tools and powers (incl. least cost test, valuations, “no creditor worse off” test)
- Ensure funding of resolution measures

Information exchange, cooperation and coordination

- Strengthening information exchange and coordination within the domestic safety net
- Removing legal obstacles for information sharing (especially cross-border)
- Establishment of cross-border information exchange and coordination for resolution purposes

Supervision and contingency planning

- Operationalizing recovery and resolution planning
- Perform resolvability assessments

Thank you