

FinSAC Annual International Conference 17-18 May 2022

Session 4 - Hoping for the best, preparing for the worst: bank resolution

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## Options for testing

Full scale CSE

Focused scenario

Walkthrough

**Process Test** 

**Structured Training** 

Focused on decision making and communication. Likely to involve multiple injects and require exercise of judgement. May involve multiple authorities, including cross-border.

More focused on execution materials and procedures that support decision making.

A presentation of steps through recorded procedures and execution materials, rather than a scenario-based simulation

A **test focused narrowly** on templates and available knowledge management tools

A **structured & deep dive presentation** of resolution topics

### Crisis Simulation Exercises

6 countries

members

11 authorities

~30 project team

Early July 2022

#### LATAM - Banco São Francisco

Broad scope: early intervention, triggering and implementing resolution

6 countries

10 authorities

~15 project team members

~40 senior officials

~70 support staff

**CSE** conducted **March 2021** 

#### FICTIONAL ENTITY

- Banco São Francisco (BSF) is a large, multinational bank headquartered in Brazil
- Subsidiaries of systemic relevance in Chile, Uruguay and Paraguay, a large subsidiary in Colombia, and 49% ownership of systemic bank in Argentina
- Significant exposure to infrastructure project in Iguaçu
- BSF failure driven by:
- Growing NPLs and poor asset quality
- Liquidity issues accentuated by bank runs

#### **APAC - APB group**

Narrower scope focused on design of resolution strategy

#### **FICTIONAL ENTITY**

- APB is a leading global bank
- · The bank has grouped its APAC material subsidiaries under an intermediate holding company headquartered in Hong Kong
- Strong digital offering and an innovative approach to data analysis
- APB's subsidiaries failure driven by:
- Growing NPLs and poor asset quality
- Bankruptcy of a large corporation
- Liquidity issues
- Trading losses

Uncertainty regarding APB.

**Deposit outflows** 

#### **Africa - Cape bank**

Expected broad scope: early intervention to resolution / insolvency

8 countries. including CMA (monetary union

11 authorities

~20 project team members

Q1 2023

#### Banking sector stress



BSF under strain attempts to sell

Bank runs severely affecting BSF



Leak to media of BSF

resolution

Sharp increase in NPLs. ThaiCorp's bankruptcy



**AQR** results reveal poor asset quality



APB in resolution

Alternative strategies to complement resolution

**Operational continuity** problems with ServCo

Chilean subsidiary

Stress test

BSF in

Protest delay Iguaçu Dam expansion. Economic

outlook worsens

## Design of Cross-Border CSEs



# CLARITY ON OBJECTIVES AND SCOPE



- Agree in advance what CSE will test
- Do not be over-ambitious!
- Tailor scope of exercise to agreed objectives

#### **FOLLOW-UP PROCESS**

- How will lessons learnt be identified?
- What is the follow-up process?
- Institutional buy-in for that process



#### **PARTICIPATION**

- Seniority of participants
  - Objectives and materials need to be aligned with seniority
  - Key question involvement of Finance Ministries

#### **SCENARIO AND MATERIALS**

- Undue complexity
   undermines effectiveness –
   simple is better
- Focus materials on what you want to test
- A decision-menu can help build materials
- How dynamic?

### The Latin American CSE



### **Failure of fictional South American** banking group (BSF)

#### Three rounds

Keeping the ailing bank afloat in distress, assessing viability



Deciding resolution strategy and tools, pulling the trigger



Implementing the resolution: weighing up alternative offers



### Selected Findings

| Resolution Mandates and Powers                    | <ul> <li>Some frameworks focussed predominantly on liquidation</li> <li>Gaps in resolution tools, eg limited bail-in powers, lack of clarity re bridge bank</li> <li>May not be sufficient to deal with the failure of a systemic bank</li> </ul>      |
|---|--|
| Resolution planning and resolvability assessments | <ul> <li>Not yet carried out in most participating countries</li> <li>Factors such as operational continuity not sufficiently considered</li> <li>Authorities' readiness and capabilities could be improved through protocols, playbooks</li> </ul>    |
| Funding in resolution                             | <ul> <li>Lack of clear frameworks for liquidity provision in resolution</li> <li>Heavy reliance on deposit insurance funds, and caps on funds available</li> <li>Resort to public funding without clear frameworks or recovery arrangements</li> </ul> |
| Domestic coordination                             | <ul> <li>Arrangements for coordination unclear in some countries</li> <li>Lack of formal arrangements for timely provision of information to deposit insurer</li> </ul>  |
| Cross-border cooperation                          | <ul> <li>Existing arrangements have supervisory focus</li> <li>Obstacles to implementation of a group solution: funding, tools, mandates</li> </ul>  |

## Follow-Up Actions



New legislation to address identified gaps in framework

Develop requirements and procedures for recovery and resolution planning



Update MoUs between domestic authorities to incorporate crisis management and formalise ELA process



Expand internal handbooks to include detailed procedures for communication and decision-making



Develop cooperation agreements between authorities in the region

### What did we learn?

| Topic   | Lessons  |
|---|--|
| Exercise preparation Be clear about objectives Do not underestimate time and resources required | <ul> <li>Agree in advance what CSE is intended to test, and be realistic about the scope</li> <li>The local knowledge of Project Team (PT) members is essential to ensure that material is relevant for their own authorities</li> <li>Dry-runs are crucial, and should be carried out at least a month before exercise to give time to adjust material</li> </ul>   |
| CSE narrative Ensure all authorities are engaged but avoid excessive complexity                 | <ul> <li>Keep it as simple as possible, while ensuring materials are realistic and relevant to authorities</li> <li>Encourage cross-border discussions through information asymmetries and intra-group dependencies</li> <li>Start a resolution-focussed exercise close to point of failure, and provide enough time to discuss resolution options</li> </ul>  |
| Exercise format Be as dynamic and adaptable as possible   | <ul> <li>Increase the relevance of role-players to foster dynamism of exercise and ensure they are well-briefed</li> <li>Quantitative materials should be simple and relevant to the decisions required</li> <li>Shorter sessions in a virtual exercise allows material to be adapted between rounds</li> </ul>  |
| Execution and reporting Effective operations team (OT) and well-briefed observers               | <ul> <li>Ensure that the OT has sufficient capacity to exercise full control and oversight of activities, and to act as key stakeholders to shape the exercise (e.g. Minister of Finance, investors or potential purchasers)</li> <li>Involve PT members in conduct of CSE (role players, observers)</li> <li>Ensure observers have clear instructions and are familiar with the legal framework of the country they are overseeing</li> </ul> |

## THANK YOU!

Cross-border crisis simulation exercise in South America (bis.org)