Observations on Bank Resolution Practices

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Background

- Recognized conflict between what is expected from host countries and their influence on decision making
- Gaps between the existing principles of resolution and their practical implementation
- Furthermore, the proposed Directive on Resolution raises many questions – not least for Emerging Europe
- So does the Banking Union…

Emerging European countries

- Financial sector generally bank (rather than market) oriented
- Banks offer traditional (conservative) banking service
- Dependent on long term savings from abroad…
- …channelled by branches or subsidiaries of big European groups…
- …which are often systemic in host countries
- Branches and subsidiaries get their funding largely through parent banks

Subsidiaries and branches are usually small in relation to their parents - sometimes of little interest to home supervisors

Supervision and resolution

- Cross-border banking has become a lot more important than expected.
- Host countries are expected to participate in the resolution of cross-border banks…
- …but their ability to influence supervision in normal times is limited and dependant on decisions by home supervisors
- MoUs that try to handle this may not work under stressed conditions

If host countries are to participate as expected in resolution procedures, they must be assured adequate influence in the decision-making in the normal non-crisis work of the supervisory colleges. And this influence must have an EU legal backing

Host countries in colleges

- Host countries must have an appropriate role in college work
  - Adequate sharing of information
  - Part in resolution college discussions
  - Part of the RRP procedure
- Partly a question of implementing EBA procedures

The right of host countries to obtain relevant and timely information and to participate in the work and decision making of supervisory and resolution colleges should be strengthened in the legal framework – and implemented in practice

Host responsibility

- Incentives in home and host countries not aligned
- And the new directive on resolution shifts more power to home authorities (e.g. RRPs)….
- …while host country authorities are still responsible for financial stability in their domestic economies
- Mediation runs into similar problems. And necessary host country decisions may be delayed

Host countries must have a clear say in matters affecting their domestic financial stability. If the role of the EBA as a binding mediator is to be generally respected, the interest of host countries, whether EZ or not, must be properly recognized in the EBA mandate and voting structure

Intra-group support

- The Commission proposal provides a much improved basis for discussing the issue of ring-fencing
- Safeguards are given to the transferring country…
- …but the mismatch between decision power and responsibility for local financial stability is still there

Further attention must be given to potential conflicts of interest between home and host if the proposal on intra-group support shall work as intended. A ”comply or explain” procedure may be worth consideration

Temporary state ownership

- RRPs and the directive on resolution should minimize the need for public money – but will not eliminate it
- How will the risk of taking over a cross border bank be shared by home and hosts? Ex-ante agreements on ex-post sharing of risk, as decided by the Ecofin, should complement the directive
- Can legal support be added?
- The Banking Union, when fully implemented, will address the burden sharing issue for EZ countries. But non-EZ and non-EU countries with sizable cross-border banking need to participate for the system to work. And implementation will take time

Important issues of burden sharing are not handled in the Directive and need further attention. Ex ante agreements preparing principles and procedures for ex post burden sharing should be set up for cross-border banks as decided by the Ecofin in 2010

Resolution tools

- A number of new tools suggested by the Commission
- Bonds to bail in may not be possible to issue in weak financial markets
- Could the minimum level be adjusted to the business idea of deposit funded banks with low risk?

The regulations concerning bail-in need to be further developed to account for conditions in small and yet undeveloped domestic capital markets.

In summary:

- Emerging European countries need access to foreign savings – and they often rely on foreign banks to provide this
- Dependence on parent funding add complications in crisis management and resolution
- If host countries are to participate in resolution they must be given a better say in supervision
- In resolution, home and host may have conflicting interest. But home authorities have the right to take final decisions while the responsibility for local financial stability remains with the host. An unacceptable mismatch
- The problem of temporary state ownership must be addressed