



International Centre for
Financial Regulation

Annual International Regulatory Summit

Regulation without Borders - G20 Ideals and National Interests

The Hilton, Amsterdam, Netherlands 8 – 9 November 2010

Session Bibliographies

Cross Border Crisis Resolution

9 November 2010**8:30 – 9:30****Cross Border Crisis Resolution**

“Develop resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard in the future.”

– G20 London, Washington and Pittsburgh, July 2010

Each financial crisis has its identifying factors. One of the key ones of the most recent crisis was the interconnectedness of financial firms, resulting in global ramifications of the failure of any systemically important financial institution. Mechanisms have been proposed for resolution of cross border institutions, but they vie with domestic bankruptcy codes and local practice. The panellists will address how to optimise cross border resolution in a multi-jurisdictional world.

Session Background and Points for Consideration

Banks are increasingly active in multiple jurisdictions and protocols exist for their supervision as going concerns differentiating between ‘home’ and ‘host’ supervisors. However, in distress, the interests of the home and host can diverge quite dramatically, as can the tools and legal structures that exist to protect depositors and creditors in these institutions in different jurisdictions. This was brought home in the recent financial crisis by the complications of working through cases such as Fortis, Lehman Brothers and Dexia. The recent crisis demonstrated the need for clearer and more consistent procedures for resolving institutions with operations in multiple jurisdictions. This panel will address the various proposals that exist for improved cross border crisis resolution and the likelihood of achieving consensus across key jurisdictions on this critical issue.

Questions which this session may consider include:

- Scope, Structure and Objective
 - What types of institutions should be included: banks, deposit takers, financial conglomerates, holding companies etc?
 - Which regulator should be in charge of cross border resolution? And what powers should it have?
 - What are the implications for the role of the national regulator should an “international framework” be adopted?
 - What are the necessary tools for resolution?
 - Does the new UK and EU supervisory structure improve information transfer for cross border crisis management?
 - How should/will burden sharing between the private and public sectors work?
- Harmonisation and conflicts
 - Cross border activity helped create a common market for financial services. However, there is no pan-European legal and administrative framework for wholesale bank insolvency. In the absence of EU level fiscal authority, the cost of resolution of failing institutions remains with national authorities. How can these conflicts be mitigated?
 - Should the 2001 Winding Up directive be extended to all EU subsidiaries? Or at the fully consolidated level? What about non-EU branches and subsidiaries?
 - Will there be sufficient change/adaptation in domestic legal systems to support recent ideas from the IMF and EU on resolution funds?

- How do the recommendations of the Cross-border Bank Resolution Group (CBRG) fit with domestic resolution mechanisms?

- Recovery and Resolution
 - How should the decision to intervene be determined? What about threshold conditions?
 - What happens when a bank is not systemic in its home country but is systemic in another jurisdiction? What happens when losses are unevenly distributed across countries?
 - Existing resolution methods are inadequate when considering large Systemically Important Financial Institutions (SIFIs). What should be the choice of a resolution approach and how should it be implemented?
 - Are there specific measures that need to be taken to resolve failing institutions? What issues arise amongst interested parties and how should they be tackled?
 - How should cross border crisis resolution be financed given the imperative to minimise taxpayer liability?

Bibliography:

The ICFR has prepared a core bibliography on works relating to reform of financial regulation. Many of the works in that bibliography have sections relevant to this topic.

Basel Committee on Banking Supervision (BCBS) (2010): *Report and Recommendations of the Cross-border Bank Resolution Group*

- **Link to the publication:** <http://www.bis.org/publ/bcbs169.pdf?noframes=1>

The Basel Committee's Cross-border Bank Resolution Group developed a set of recommendations that resulted from its stocktaking of legal and policy frameworks for cross border crises resolutions and its follow-up work to identify the lessons learned from the global financial crisis which began in 2007. This report lists the recommendations which were developed by the Cross-border Bank Resolution Group (CBRG) of the Basel Committee after being called upon by the G20 "to explore the feasibility of common standards and principles as guidance for acceptable practices for cross-border resolution schemes"¹, which could help to reduce the negative effects of uncoordinated national responses, including ring-fencing. Among other things, recommendations deal with effective national resolution powers, frameworks for a coordinated resolution of financial groups, convergence of national resolution measures, cross border effects of national resolution measures, reduction of complexity and interconnectedness of group structures and operations, and exit strategies in order to restore market discipline.

European Commission (EC) (2010): *Overview of the Results of the Public Consultation on an EU Framework for Cross-border Crisis Management in the Banking Sector*

- **Link to the publication:** http://ec.europa.eu/internal_market/consultations/docs/2009/banking_crisis_management/replies_summary_en.pdf

The European Commission had issued a Communication in October 2009 to consult as widely as possible on a broad range of issues aimed at safeguarding financial stability and the continuity of banking services in a cross border banking crisis. The Communication set out questions on the tools that the Commission considered would be necessary for an EU crisis management framework. This is an overview of the responses from the consultation which concluded in January 2010. Most respondents argued that a "crisis management framework should ultimately cover all financial institutions, there was general agreement with the Commission's suggestion that it made sense to start in a first phase by focussing the framework on deposit taking institutions." There was general agreement with the "objectives listed in the Commission's Communication. In particular there appeared to be a high degree of consensus with respect to general objectives such as preserving financial stability, minimising cost to the taxpayer and protecting depositors." The overview goes onto detail the responses in the particular area of resolution tools that were suggested in the consultation.

Financial Stability Board (FSB) (2009): *Principles for Cross-border Cooperation on Crisis Management*

- **Link to the publication:** http://www.financialstabilityboard.org/publications/r_0904c.pdf

The objective of financial crisis management is to seek to prevent serious domestic or international financial instability that would have an adverse impact on the real economy. These "high-level principles for cross-border cooperation on crisis management have been developed and endorsed by the members of the

¹ Quotations in all the summaries are from the works summarised

Financial Stability Forum and include a commitment to cooperation between relevant authorities. They also commit national authorities from relevant countries to meet regularly alongside core colleges to consider together the specific issues and barriers to coordinated action that may arise in handling severe stress at specific firms, to share information where necessary and possible, and to ensure that firms develop adequate contingency plans.”

International Monetary Fund (IMF) (2010): *Crisis Management and Resolution for a European Banking System*

- **Link to the publication:** <http://www.imf.org/external/pubs/ft/wp/2010/wp1070.pdf>

This IMF working paper lays out an ambitious plan for a resolution authority for Europe. Such an authority would be armed with the mandate and the tools to deal cost-effectively with failing systemic cross-border banks. In addition, there is a plan to establish a European Deposit Insurance and Resolution Fund (EDIRF) that is pre-funded by the industry through deposit insurance premiums and systemic levies. The IMF accepts that these proposals will take a long time to be put in place and would require much by way of the harmonisation and coordination of national laws.

IMF (2010): *Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination*

- **Link to the publication:** <http://www.imf.org/external/np/pp/eng/2010/061110.pdf>

The approach advocated in this paper is the establishment of a pragmatic framework for enhanced coordination, which would be subscribed to by countries that are in a position to satisfy its elements. The framework, which would represent a significant step forward, would be evidenced by a non-binding understanding among participating national authorities. It would comprise four elements: (i) “countries would amend their laws so as to require national authorities to coordinate their resolution efforts with their counterparts in other jurisdictions to the maximum extent consistent with the interests of creditors and domestic financial stability”; (ii) the “enhanced coordination framework would only be applicable to those countries that have in place “core-coordination standards” relating to the design and application of resolution systems”; (iii) an “element of the enhanced coordination framework would be the specification of the principles that would guide the burden sharing process among cooperating authorities”; (iv) “countries that subscribe to the enhanced coordination framework would also agree to coordination procedures designed to enable resolution actions in the context of a crisis to be taken as quickly as possible and to have cross border effect.”

UK HM Treasury (2009): *Establishing Resolution Arrangements for Investment Banks*

- **Link to the publication:** http://www.hm-treasury.gov.uk/d/consult_investmentbank161209.pdf

This consultation outlines a package of more than “30 policy initiatives designed to mitigate the impact of the failure of an investment firm.” These include the “development of resolution plans for firms, a set of special administration objectives and new responsibilities to be placed upon the board.” The aims of these proposals are: (i) to speed up the return of client money and assets; (ii) to address counterparty exposures to the firm; (iii) to ensure creditors are sufficiently protected.

Other Publications:

Brierley P (2009): *The UK Special Resolution Regime for Failing Banks in an International Context*

- **Link to the publication:** http://www.bankofengland.co.uk/publications/fsr/fs_paper05.pdf

This paper “seeks to place in an international context the UK Special Resolution Regime (SRR) for failing banks, which came into effect in February 2009 with the adoption of the Banking Act. The SRR’s key purpose is to enable an orderly resolution of a failing UK bank to be carried out in a manner preserving the public interest, particularly by maintaining financial stability, preserving confidence in the banking sector, and protecting both depositors and the taxpayer.” The paper shows that “the new SRR draws on and in several respects goes beyond best practice internationally.” Discussions within the paper include the key features and objectives of the SRR, drawbacks of using corporate insolvency law for banks, the resolution toolkit and, resolution of cross border banking groups. In conclusion, the paper states that the SRR is at the forefront of best practice internationally and this perhaps explains why other countries look up to the UK to reform their own approaches.

Claessens S, Herring R and Schoenmaker D (2010): *A Safer World Financial System: Improving the Resolution of Systemic Institutions*

- **Link to the publication:** <http://www.cepr.org/pubs/books/cepr/booklist.asp?cvno=P210>

In the context of a cross border resolution it can be difficult “to preserve national regulatory authority, foster cross-border financial integration and maintain global financial stability.” These issues create a difficult choice of decision and this according to the authors presents a “trilemma”. This report examines three approaches for the resolution of Systemically Important Financial Institutions (SIFIs) that address this trilemma. The report “favors a modified universal approach, which requires SIFIs to put in place better resolution plans; each country to adopt improved resolution rules; and countries to jointly adopt an enhanced set of rules governing cross-border resolutions. The integration of regulation, supervision and resolution policies should be enshrined in a new Concordat. With this approach, the authors hope, the world can move from the present situation in which national authorities ‘can’ to one in which they actually ‘will’ cooperate and thereby make the global financial system safer and more efficient.”

Ferreira E (2010): *Report with Recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector*

- **Link to the publication:**
<http://www.europarl.europa.eu/sidesSearch/search.do?type=REPORT&language=EN&term=7&author=28308>

Elisa Ferreira, a Portuguese Socialist MEP and member of the ECON, has recently written this report on EU crisis management proposing an EU Financial Stability Fund with ex ante contributions from systemic banks, as well as the formation of a ‘resolution’ unit within the European Banking Authority (EBA). In this report she outlines the need for a common crisis management framework that will cover different problems that need addressing. In primis it will try to limit spillovers, promote stability, avoid moral hazard and ensure respect and same creditors treatment. In order to help avoid further crises she proposes the appointment of a supervisor that will be called to operate when in need, and together with a set of mandatory resolution plans will help deal in a better and more structured way when facing a crisis.

Huertas T (2010): *The Road to Better Resolution: From Bail-out to Bail-in*

- **Link to the publication:** http://www.fsa.gov.uk/pubs/speeches/th_6sep10.pdf

“This paper outlines the path toward better resolution that should be taken for large, systemically important firms.” After the introduction of special resolution regimes for banks and the requirements that banks prepare living wills, foundations now needs to come to a “means of resolving large, complex cross-border banks. Bail-in offers the promise of such a solution, and this paper analyses how that promise might be fulfilled.” With its analysis of the estimation of probability of bail-outs the paper notes two points: (i) the estimation of the probability of bail-out is integral to credit analysis; (ii) changes in that probability can have significant effects

on the spreads that borrowers will have to pay. In what follows the paper makes some conclusions: (i) “If resolution is not a realistic option for large systemically important firms, then it must be questioned as to whether firms should be allowed to become so large or so complex that they become systemic”; (ii) corporate bankruptcy or insolvency procedures are inappropriate for banks and so it makes sense to impose a special resolution regime for them; (iii) none of the available methods of resolution is satisfactory for a large, systemically important bank; (iv) “bail-in of investor capital may provide a mechanism to resolve systemically important banks”. The paper then discusses the different aspects of how a bail-in would work and the two approaches to it viz. bail-in via write-down and bail-in via conversion.

Hüpkens E (2003): *Insolvency – Why a Special Regime for Banks?*

- **Link to the publication:** <http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/hupkes.pdf>

This paper reviews some of the common arguments put forward “for and against a special bank insolvency regime”. It also discusses the features that “distinguish bank insolvency rules from general insolvency rules”. Finally, it also considers areas in which special rules appear most necessary. The paper begins with the debate about why banks should be accorded special treatment in insolvency and outlines the reasons banks receive special treatment and considers whether general insolvency law works for banks. The paper then considers the nature of the suitability of special rules for banks by segregating insolvency into three stages: pre-insolvency stage, insolvency phase and, the liquidation phase. In conclusion, the paper states that, “in the interest of preserving financial stability, banks warrant special treatment. Bank insolvencies are different from others, and require special rules. The extent to which such rules are needed depends on the infrastructural circumstances in each country, in particular the interplay between banking and insolvency law, and the flexibility of the judicial system.”

Lastra RM and Wihlborg C (2009): *Law and Economics of Crisis Resolution in Cross-border Banking*

- **Link to the publication:** http://feweb.uvt.nl/pdf/2009/LSE_Special_Paper_PCA.pdf#page=97

This paper presents some of the issues and legal principles at stake in cross border resolution of banking crises. The authors “emphasise the need for credible “Prompt Corrective Action” procedures for banks approaching distress, and separate insolvency law for banks as prerequisites for effective market discipline and competition. Proposals with more or less direct involvement on the EU level while retaining essential elements of national responsibility are discussed and developed.” This paper is organised as follows: section 2 presents the “case for and the design of a *lex specialis* for bank insolvency as distinct from general corporate insolvency law.” Section 3 provides an overview of legal procedures governing cross border insolvency and approaches to dealing with bank insolvency in Europe and the implications for market discipline are discussed in section 4. Section 5 details proposals for next steps while “reconciling the international perspective, national authority and strengthening market discipline.” Lastly, section 6 details alternative proposals.

Schoenmaker D (2010): *A Safer World Financial System: Improving the Resolution of Systemic Institutions*

- **Link to publication:** <http://www.voxeu.org/index.php?q=node/5281>

Financial reform legislation is finally being put in place in the US and EU in response to the global financial crisis. The need to integrate resolution becomes obvious once one considers the endgames for both financial institutions and regulators. Schoenmaker argues that the direct costs of resolution have been borne by domestic taxpayers, and that insolvencies and bankruptcies are dealt with by national courts and resolution agencies derive their powers from national legislation. In the report he addresses this situation as a “financial trilemma”; the three policy objectives (preserving national autonomy, fostering cross-border banking, and maintaining global financial stability) are not always mutually consistent. Solutions to the trilemma are to be

found in giving up some fiscal and legal sovereignty, or putting restrictions on cross border banking in the event of crises.

SUERF and Centre for European Policy Studies (CEPS) (2010): *Crisis Management at Cross-Roads: Challenges Facing Cross-border Financial Institutions at the EU Level*

- **Link to the publication:** <http://www.suerf.org/download/studies/study20101.pdf>

The papers in this report are based on contributions at the conference on “Crisis management at cross-roads” organised by SUERF, CEPS and the Belgian Financial Forum. Some of the many topics that this report deals with are: (i) the crisis management options such as recovery and resolution plans, contingent capital and resolution and support operations; (ii) impact of the liquidity crisis using the case study of Dexia; (iii) crisis management and improving cross-border bank resolution in the EU; (iv) proposals for the reform of deposit guarantee schemes in Europe. Chapter 8 provides a summary of the conference contributions addressing the “limits of the ‘lender of the last resort’, ‘too big to fail’ and, ‘too big to save these’” and chapter 9 draws on the conference contributions by addressing “Deposit guarantee schemes: How to re-establish clients’ confidence.”

Speeches:

Huertas T (2010): *Living Wills: How Can the Concept be Implemented?* Delivered at the Wharton School of Management, University of Pennsylvania

- **Link to the publication:** http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/0212_th.shtml

This is a speech by Thomas Huertas the Director for Banking at the UK Financial Services Authority (FSA) and Vice Chairman of the Committee of European Banking Supervisors (CEBS). This speech outlines how living wills can be implemented, which are officially known as “recovery and resolution plans”. Conceptually, “living wills recovery plans should make it less likely that a bank will require intervention, and resolution plans should lower the impact on society, if intervention is required.” The speech discusses the different aspects of recovery and resolution plans which could be, raising additional capital and liquidity, sale of a business, early equity injection, setting up a bridge bank and share transfers. The speech then casts some light on the pros and cons of choosing among different resolution methods and the informational requirements for a resolution to be successful. In order to make a decision on the type of a plan there has to be a framework to make that decision and conceptually, “there is consensus that the choice of resolution method should be based on some type of cost-benefit test.” This framework is workable when it comes to resolution of a local institution but that framework becomes more complex when a financial institution is active in more than one jurisdiction. In conclusion, according to the speech, “recovery plans are well within the scope of banks to design and implement... resolution plans are more difficult. But they are an important form of contingency planning.”

Lipsky J (2010): *Towards an International Framework for Cross Border Resolution*, Delivered at the ECB and its Watchers Conference XII

- **Link to the publication:** <http://www.imf.org/external/np/speeches/2010/070910.htm>

This is a speech by John Lipsky the First Deputy Managing Director for the IMF. The speaker starts off with an observation that it is understood well, “even under an optimal system of supervision and regulation, some financial institutions will fail.” In this context, there is another issue that deserves renewed attention, regarding “how we can better prepare to deal with the insolvency of a systemically important financial institution that operates in multiple national jurisdictions.” The speech discussed the issues involved in cross border crisis resolution, and then proposes and explains an alternative framework developed by the IMF to deal with cross border failures.

Tarullo D (2010): *Toward an Effective Resolution Regime for Large Financial Institutions*, Delivered at the Symposium on Building the Financial System of the 21st Century

- **Link to the publication:** <http://www.federalreserve.gov/newsevents/speech/tarullo20100318a.htm>

This is a speech by Daniel Tarullo, Member of the Federal Reserve Board of Governors. The crisis has focused attention on the special problems created by the failure of a large, internationally active financial firm. In his remarks he elaborates on “the relationship between resolution regimes and an effective overall system of financial regulation and supervision, both in the international and domestic spheres.” In concluding his speech the Governor remarks that, “resolution mechanisms must be understood not as silver bullets, but as critical pieces of a broader agenda directed at systemic risk and the too-big-to-fail problem.”

Tucker P (2010): *Resolution of Large and Complex Financial Institutions: The Big Issues*, Delivered at the European Commission Conference on Crisis Management

- **Link to the publication:**
<http://www.bankofengland.co.uk/publications/speeches/2010/speech431.pdf>

This is a speech by Paul Tucker the Deputy Governor for Financial Stability at the Bank of England. The challenge for any resolution mechanism is the continuation of financial intermediation while making sure that taxpayers are not on the hook for any bailouts. In light of this a resolution mechanism must have the following objectives in mind: (i) to avoid a “disorderly disruption to the provision of financial services in the economy”; (ii) put market discipline back into the system without support from the public sector. The speech advocates for a “super-special resolution” regime which would allow for rapid imposition of haircuts on uninsured creditors while noting the advantages of a “going-concern” over a “gone-concern” approach. The second half of the speech sketches why the problem of cross border resolution arises, which is due to the fact that countries may either have a territorial approach or a pure universalistic approach. The speech then explores a middle ground between the two approaches which would involve “host authorities choosing to defer to and cooperate with a resolution brought by the home country authorities” given that certain conditions hold.

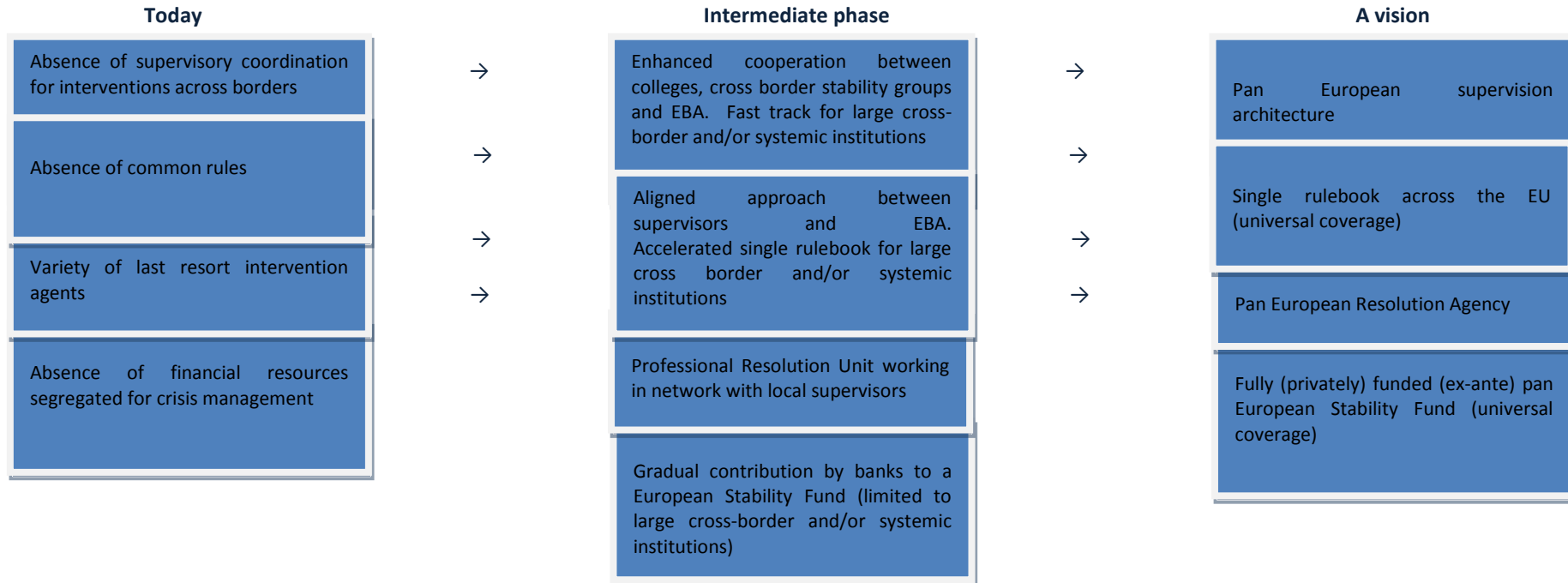
Website Articles:

Bair S (2009): *Remarks by FDIC Chairman Sheila Bair at the Institute of International Bankers Conference*

- **Link to the publication:** <http://www.fdic.gov/news/news/speeches/archives/2009/spnov1009.html>

In order to end the “too big to fail” there is the need of an effective mechanism to close large, financial intermediaries when they get into trouble. This speech addresses the need to address the root cause of the crisis by eliminating the belief that the government will always support large, interconnected financial firms. In order to do this the FDIC process for banks might be useful. The resolution scheme is composed mainly of three features: the insurer itself must have ready access to funding, the ability to recycle valuable banking relationships and assets from the failed bank back, and to provide continuity for the capital markets

THE ROADMAP (Source: Elisa Ferreira, March 2010; An EU Framework for Cross-Border Crisis Management in the Banking Sector)



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