After the Storm:
The Future Face of Europe's Financial System
Working Session 4

Crisis resolution: Where we stand and how to improve it?

Eva Hüpkes

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Many challenges

The wind-down of a large cross-border institution is complex

- Legal form does not follow function
- Asymmetries of exposures across jurisdictions
- Multiple (conflicting) proceedings and competencies
- Asset grab
- Existing resolution tools do not work when markets are not functioning
- Practical constraints (need for speed, time zones)

Work of the Basel Committee

- Creation of a working group on the resolution of cross-border banks (CBRG) in December 2007
- Mandate to
  - Take stock of differences in national practices in banking crisis resolution
  - Identify areas where differences in national practices hamper optimal responses to crises
  - Prepare a menu of options for addressing the problems
- Update in the light of the crisis

Key conclusions

(1) Existing resolution arrangements are **not designed to resolve cross-border failures of complex financial institutions**.

(2) Existing resolution arrangements are **entity-centric** and do not provide for a coordinated resolution of financial groups, not even on a national level.

(3) Measures **focused on the preservation of domestic interests** impede effective cross-border solutions.

(1) Inadequacy of existing tools

- Need for speed - “bridge bank” or “purchase and assumption” operations do not work cross-border
- Policy and legal obstacles hinder cross-border mergers and acquisitions
- Close-out practices may disrupt public/private restructuring.
- Differences in set-off rules and treatment of financial contracts in insolvency

(2) No framework for financial groups

- Misalignment of supervisory and crisis resolution frameworks
- National frameworks (corporate, regulatory, insolvency) are entity-centric and sector-specific.
- Diversity of national crisis resolution arrangements
  - Intervention thresholds
  - Intervention tools
  - Priorities and client asset protections
- Constrained access to information in a crisis

(3) Domestic objectives dominate

- National solutions have prevailed - the 2008 MoU has not been effective.
- The resolution of failing firms remains a domestic competence.
- Fiscal support is provided on a national basis.
- Recapitalizations and restructurings are guided by the objective to preserve critical functions in domestic financial systems

Solutions for the EU?

(1) Strengthen resolution capabilities

(2) Establish frameworks for resolving financial groups

(3) Exploit the dynamics of burden sharing

Solutions for the EU?

(1) Strengthen resolution capabilities

- A centralized solution (“European FDIC”) or a decentralized solution (convergence of intervention powers)?
- Powers to preserve critical functions (bridge banks, etc.)
- Strengthen risk mitigants (set-off, netting, CCPs, etc.)

Solutions for the EU?

(2) **Establish frameworks for resolving financial groups**

- Extend existing rules to all types of financial institutions, including holding structures and investment firms
- Provide for a coordinated framework for resolving financial groups

Solutions for the EU?

(3) Understand the dynamics of burden sharing

- In the absence of an ex ante burden there is a de facto allocation of the burden
  - Group structures (branches vs. subsidiaries)
  - Priorities in insolvency
  - Location of claims
  - National propensity to bail out systemic banks
- Impact of group structures and business operations on burden allocation