11th High Level Meeting on Global Banking Standards and Supervisory Priorities in the Americas

Resolving Large Banks. Advances and Remaining Roadblocks.

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I. The former TBTF problem

- Diagnosis
  - Too much size, complexity, interconnectedness, ...
  - Systemic risk; non-substitutability; ...
  - Implicit (and, when necessary, explicit) public support = taxpayer money at risk

- Treatment
  - Regulation: much higher capital requirements (quantity and quality); G-SIBs category; TLAC; structural reforms?
  - Supervision: more intensive; more intrusive; more discretional supervisory powers
  - Resolution: shareholders and junior bondholders money at risk (first)

II. Not TBTF entities

1. If assets < liabilities ⇨ go out of business
    - Fairness across sectors
    - Level playing field within entities
    - Level playing field within investors
2. Large banks ≠ TBTF
    - The importance of being resolvable
    - Business model vs. Resolvability assessment
3. Resolution
    - Neither liquidation nor resurrection
    - But, more important: prevention scheme and early intervention measures

III. Resolving banks and business model

- Regulation must be neutral with business and organizational model: SPE and MPE

- From the point of view of resolution, MPE shows undisputed advantages:
  - Financial independents units
  - Not parent company financial or liquidity dependence
  - No contagion

- Agreed that not all business models allow for MPE

IV. Recovery & Resolution plans

- Recovery plan
  - Relevant: “*know your structure*”
  - Internal preparedness
  - Identify critical functions and core business lines
  - Credibility of recovery options

- Resolution plan
  - First thing: better not try !!
  - Increases resilience, supports prevention and allows early actions

- Avoiding bankruptcy

- and, also, planning the exit:

  No corporation is eternal (Average life: 50 years)

V. Myths around resolution

- No taxpayers money
  - Systemic crisis: whatever it takes to stay afloat
  - Someone has to pay the bill
    - OK shareholders / bonds holders
    - OK no guaranteed depositors
    - Investment funds & Pension funds (savers, retirees, …)
    - and finally taxpayers.
    - It is about distribution of burden

- Resolution weekend
  - A weekend to have a plan,
  - but execution takes months

- Individual vs. Systemic crisis

VI. Advances ...

- Regulatory and institutional framework
  - Identification G-SIBs and D-SIBs
  - Capital surcharges (buffer)
  - Living wills
  - Regulation
    - FSB: *Key Attributes* ; TLAC
    - EU: BRRD and national transpositions
  - Institutional framework
    - EU: Resolution authorities
    - Eurozone: Single Resolution Mechanism & Single Resolution Fund

VII. … and remaining ... roadblocks?

- Recognition of MPE: knowing characteristics and building specific requirements (no fit at all, SPE & MPE)
- Translation of TLAC to legal frameworks
  - EU: pending complete MREL regulation and TLAC compatibility
  - Breach treatment
- Absorbing capacity of non-equity instruments
  - Conversion trigger
  - Priority order
  - International recognition of bail-in clauses
  - Disclosure
- Completing and, more important, running of resolution plans (not to say practical execution)
- Resolution colleges

VIII. Conclussion

- Nowadays, large banks are safer and less likely to fail
  - Tier 1 capital ratio SIFIs > 2 times 2009 [(1)]
  - Basel III risks-adjusted capital level SIFIs ≈ until 7 times Basel II [(2)]
- But markets do not believe in it, and reduced riskiness is not translated into lower required return on stock
- For economic reasons:
  - Low interest rate environment
  - Flat yield curve
  - Increased competition from shadow banking and fintechs
- But for regulatory changes too [(3)]

It is pending the assessment of effects of new regulation in the market's confidence and in the banks' franchise value

(1) M. Carney; (2) J. Caruana; (3) N. Sarin and L.H. Summers

Thank you very much