

Recovery and Resolution Policy Unit

FSB reports on progress in reforming resolution regimens & resolution planning

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On 12 November, the Financial Stability Board (FSB) published a progress report to the G20 on the reform of resolution regimes and resolution planning for GSIBs. The report reviews what has been achieved so far and sets out further steps to fully implement the FSB Key Attributes¹. The FSB highlights that only a few jurisdictions already comply with all the principles of Key Attributes and that there is still substantial work to be done in the coming months. In that vein, the FSB establishes the following priorities for 2015 to ensure that all G-SIFIs are resolvable:

- Finalise the common international standard on total loss absorbing capacity (TLAC)
- Achieve the broad adoption of contractual recognition of temporary stays on early termination and cross-default rights in financial contracts and finalise FSB guidance on effective cross-border recognition
- Develop further guidance to support resolution planning by home and host authorities, in particular with regard to funding arrangements and operational continuity of core critical services
- Promote the full implementation of the FSB's requirements for resolution regimes and resolution planning beyond the banking sector

Overview

In the past few months, financial regulation of resolution has been making progress in providing the authorities with a series of instruments and competences to deal with banking crises in a preventive manner, protecting financial stability and minimising taxpayer exposure in the event of banking failures.

On the occasion of the G20 meeting next week in Brisbane, the FSB has published this progress report on resolution regimens that will be discussed at the meeting, focusing on the following four elements: i) progress in legislative reforms of resolution regimes, ii) adequacy of loss-absorbing capacity in resolution, iii) cross-border cooperation, iv) G-SIB resolution planning and resolvability assessments.

Progress in legislative reforms of resolution regimes

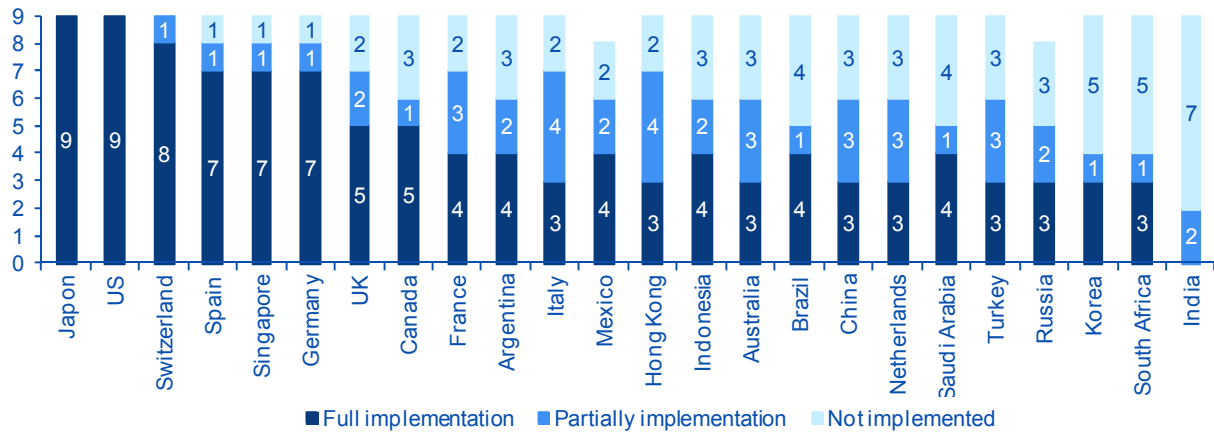
Although progress has been made recently by some G20 jurisdictions in undertaking legislative and regulatory reforms to transpose the FSB Key Attributes elements into local jurisdictions' regimes, only a few jurisdictions have resolution regimes in place that are fully or almost fully aligned with the Key Attributes (Japan, US, Switzerland and Spain). All other jurisdictions have regimens that are not aligned in certain key

1: Financial Stability Board (October 2011), Key Attributes of Effective Resolution Regimens for Financial Institutions.

areas. As shown Figure 1, the FSB has carried out a comparative analysis of the status of the implementation of certain elements of the Key Attributes in the FSB jurisdictions².

Figure 1

Status of Implementation of Specific Aspects of Bank Resolution Regimes by FSB Jurisdictions



Source: BBVA Research

In this context, the FSB has identified several gaps in relation to the Key Attributes related to:

- Resolution powers to write down and convert unsecured creditor claims to the extent necessary to absorb losses of a firm in resolution (20 jurisdiction have partial implementation)
- Restrictions on early termination rights (19 jurisdictions have not implemented or partly implemented)
- Cross-border cooperation (19 jurisdiction have not implemented mechanisms to give prompt effect to foreign resolution actions)

Nevertheless, the report remarks that the national transposition of the BRRD in Europe, due for the end of 2014, will represent a good example of progress for G-20 jurisdictions that are members of the European Union.

Adequacy of Total Loss-Absorbing Capacity in resolution (TLAC)

For the FSB, the adequacy of Total Loss-Absorbing Capacity (TLAC) in resolution is one of the remaining outstanding issues to be addressed on the FSB’s agenda to remove the systemic and moral hazard risks associated with G-SIFIs, as it is the necessary complement to the bail-in tool to ensure that any banking rescue will have to be supported in the first instance by shareholders and private creditors instead of tax payers.

On 10 November 2014, the FSB released for public consultation a set of draft principles on TLAC³ of G-SIBs in resolution and an accompanying draft term-sheet. The consultation will be under consultation until 2

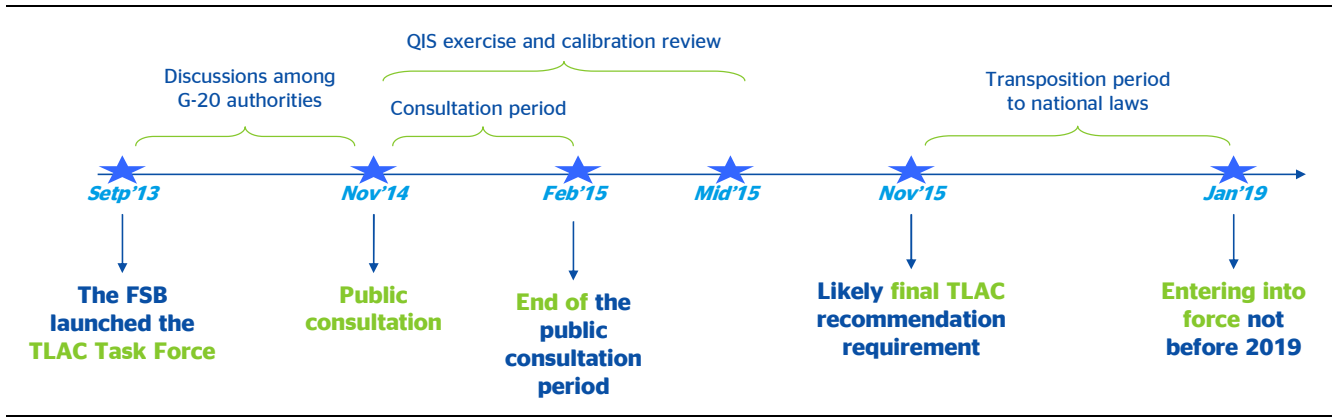
2 The specific aspects of bank resolution regimes are the following: i) Existence of resolution regime and administrative resolution authority, ii) Resolution powers, iii) Power to impose temporary stay on early termination rights, iv) Resolution powers in relation to branches, v) Mechanisms to give prompt effect to foreign resolution actions, vi) Non-discriminatory treatment of creditors, vii) Information sharing for resolution purposes and confidentiality protections, viii) Recovery and resolution planning for systemic firms, ix) Powers to require changes to improve firms’ resolvability. In Mexico and Russia, the requirements of resolution powers in relation to branches do not apply.

3: <http://www.financialstabilityboard.org/2014/11/fsb-consults-on-proposal-for-a-common-international-standard-on-total-loss-absorbing-capacity-tlac-for-global-systemic-banks/>

February 2015 and is likely to be approved by the next G20 2015 summit in Turkey. In parallel with the consultation period, the FSB will carry out a comprehensive Quantitative Assessment Study (QIS) in collaboration with the Bank Committee on Banking Supervision, to assess the optimal Pillar 1 minimum TLAC requirement. Thus, the FSB will finalise the draft principles and draft term sheet in 2015 and will undertake further work with the BCBS to specify the disclosure requirements under the Basel III framework.

Figure 2

The FSB's TLAC calendar



Source: BBVA Research

Addressing obstacles to cross-border cooperation

The FSB is aware that cross-border cooperation is a necessary element in enhancing trust and confidence between the home and relevant host authorities when carrying out a resolution process of cross-border banks.

The report identifies uncertainties about the cross-border effectiveness of resolution measures and obstacles to cross-border information-sharing as important impediments to cross-border resolution. The FSB is working on cooperation challenges and has issued different consultation documents

- on the cross-border recognition of resolution actions, covering both statutory recognition frameworks and possible contractual arrangements to support recognition; and
- on cooperation and information-sharing with host authorities not represented on CMGs that covers the process for identifying non-CMG host jurisdictions; criteria for assessing the systemic nature of a G-SIFI's presence in a non-CMG host jurisdiction; cooperation and information-sharing arrangements with a non-CMG host jurisdiction; and classes of information to be shared between home authorities and non-CMG host jurisdictions that will be finalised in 2015.

G-SIB resolution planning and resolvability assessments

The FSB shows that most home authorities of G-SIBs are working on developing high-level resolution strategies and on their first operational resolution plans detailing how those strategies might be implemented, these high-level strategies have also been discussed with host authorities participating in the CMGs during 2014. As a conclusion, the "single point of entry" (SPE) strategy seems to be the preferred approach of the most G-SIBs at this stage. Of 27 G-SIB, only HSBC, Banco Santander and BBVA have been adopted a Multiple Point of Entry (MPE) strategy, which paradoxically poses fewer cross-border issues in resolution.

The report also points out that most home authorities are in the final stages of developing firm-specific cross-border cooperation agreements (COAG) with authorities represented on CMGs. However, as of **the date of release of this report, only one COAG (an MPE bank) has been signed** by members of a CMG for a G-SIB.

With respect to **the Resolvability Assessment Process (RAP⁴)**, the FSB highlights that the first RAP is expected to be completed for all G-SIBs by mid-2015. Nevertheless, home authorities of 10 G-SIBs have already reported results from their RAP to the FSB Chair. Those results show that good progress has been made in resolution planning. However, authorities identified a number of factors and circumstances affecting the resolvability of firms and reported material legal, operational and financial barriers to the feasibility and credibility of their resolution

Next steps in the global resolution agenda

The FSB establishes that there is still substantial work to be done. For this reason it will continue monitoring implementation of the Key Attributes to support implementation across all financial sectors, including for financial market infrastructures, insurers and firms that hold client assets and will continue to work on the main challenges to developing an effective resolution regime for financial institutions. Figure 3 summarises the action and timelines that the FSB expects in each on the topic of the resolution regime.

4: The objective of Resolvability Assessment Process (RAP) is to promote adequate and consistent reporting on the resolvability of each G-SIFI and help determine what should be done to address material recurring issues with respect to resolvability.

Figure 3

FSB summary of actions and timelines

I. Legislative and institutional reforms to implement the Key Attributes

Action	Responsible	Completed by
2015 implementation monitoring using standardised templates to cover resolution regimes for all financial sectors	FSB	Mid-2015
Report on plans to implement the <i>Key Attributes</i> for FMI, insurers and firms holding client assets, including resolution planning for all such firms that could be systemic in the event of failure	FSB Members	End-2015
Finalise the Key Attributes Assessment Methodology for use in IMF and World Bank assessments	FSB, IMF, World Bank	End-2015
Conduct workshops with RCGs to further understanding of how the Key Attributes apply in emerging markets and to domestically and regionally systemic financial firms in emerging market jurisdictions	FSB, RCGs	2015
Focused thematic peer review of resolution powers for banks, including recovery and resolution planning requirements	FSB members	End-2015

II. Adequacy of loss-absorbing capacity in resolution

Conduct of impact assessments comprising a Quantitative Impact Study (QIS), micro- and macro-economic impact assessments, market survey, and review of loss and recapitalisation histories	FSB, BCBS, BIS	Second half of 2015
Finalise principles on loss-absorbing and recapitalisation capacity of G-SIBs in resolution and Total Loss-Absorbing Capacity (TLAC) term sheet	FSB	End-2015
Further work to specify disclosure requirements under Basel III	FSB, BCBS	2015-2016

III. Cross-border cooperation

Adherence to the ISDA Protocol by the G-SIBs and other financial institutions that are the largest OTC dealers	G-SIBs	November 2014
Development of proposals to address cross-border close-out risks in other financial contracts and products	FSB	End-2015
Adoption of supervisory measures or other actions to promote adoption by relevant institutions with significant volumes of cross-border financial trading activity	FSB Members	End-2015
Finalise guidance on cross-border recognition of resolution actions, including on elements of statutory recognition regimes and contractual recognition clauses	FSB	End-2015
Finalise guidance on cooperation and information sharing with host authorities not represented on CMGs	FSB	End-2015

IV. G-SIB resolution planning and resolvability

Conclude first RAP for all G-SIBs	G-SIB CMGs	Mid-2015
Develop draft guidance on measures that support operational continuity in resolution for funding of firms in resolution	FSB	End-2015
Develop draft guiding principles consistent with Key Attribute 6 to support implementation of the preferred resolution strategies of G-SIBs. Conduct further analysis on the information needed by authorities to more accurately estimate, within the resolution planning process, a G-SIB's potential funding needs in resolution	FSB	End-2015

V. G-SII Recovery and Resolution Planning

Finalise guidance on the identification of critical functions and critical shared services in the insurance sector	FSB with participation of IAIS	Mid-2015
Report on the development of resolution strategies and plans for all G-SIIs	G-SII CMGs	End-2015
Develop a proposal for draft guidance on the development of effective resolution strategies for G-SII	FSB with participation of IAIS	End-2015
Report on results of Resolvability Assessment Process (RAP)	G-SII CMGs	End-2016

VI. Resolution of Financial Market Infrastructures

Report on the status of CMGs or equivalent arrangements for systemically-important FMIs, and the development of resolution strategies and plans	FSB Members	End-2015
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Source: BBVA Research

Assessment

- Since the FSB's Key Attributes was published in 2011, being the first milestone in defining a new global crisis management regime to resolve failing systemically important financial institutions, a great deal of work has been done by policy-makers around the globe in dealing with failed banks, particularly in Europe and the US.
- While major initial legislative reforms have already been undertaken by both Atlantic regions, it is clear that implementation of the FSB's recommendations is still at an early stage in other regions such as LatAm and Asia, either from a home or host perspective. This is not surprising as these are "new" international standards, and the reforms needed to implement them may involve significant legislative changes that will take time, and regional priorities differ. Global regulators need to work on improving these frameworks but must also take into account the specifics of each jurisdiction.
- Nevertheless, from a cross-border resolution standpoint, a key challenge for regulators related to global banking groups is to develop a consistent solution that relies on a variety of legal regimes and overcomes all reluctance among the authorities involved. The effectiveness of a cross-border resolution regime will be limited unless it is immediately accepted as legally binding and operationally effective by all parties, and national authorities act collectively in a coordinated and predictable way. Solving cross-border issues is the FSB's main challenge.
- The progress made in the design of a resolution framework has been positive and is moving in the right direction. But what is needed now is not complacency, but to keep working towards the development of an efficient and credible global framework.
- Finally, it is important to extend all the elements of the FSB resolution regime to G-SIIs and Financial Market Infrastructures (FMIs) to ensure that they are resolvable in a credible and feasible way.

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