

Resolution Strategy: Multiple Point of Entry

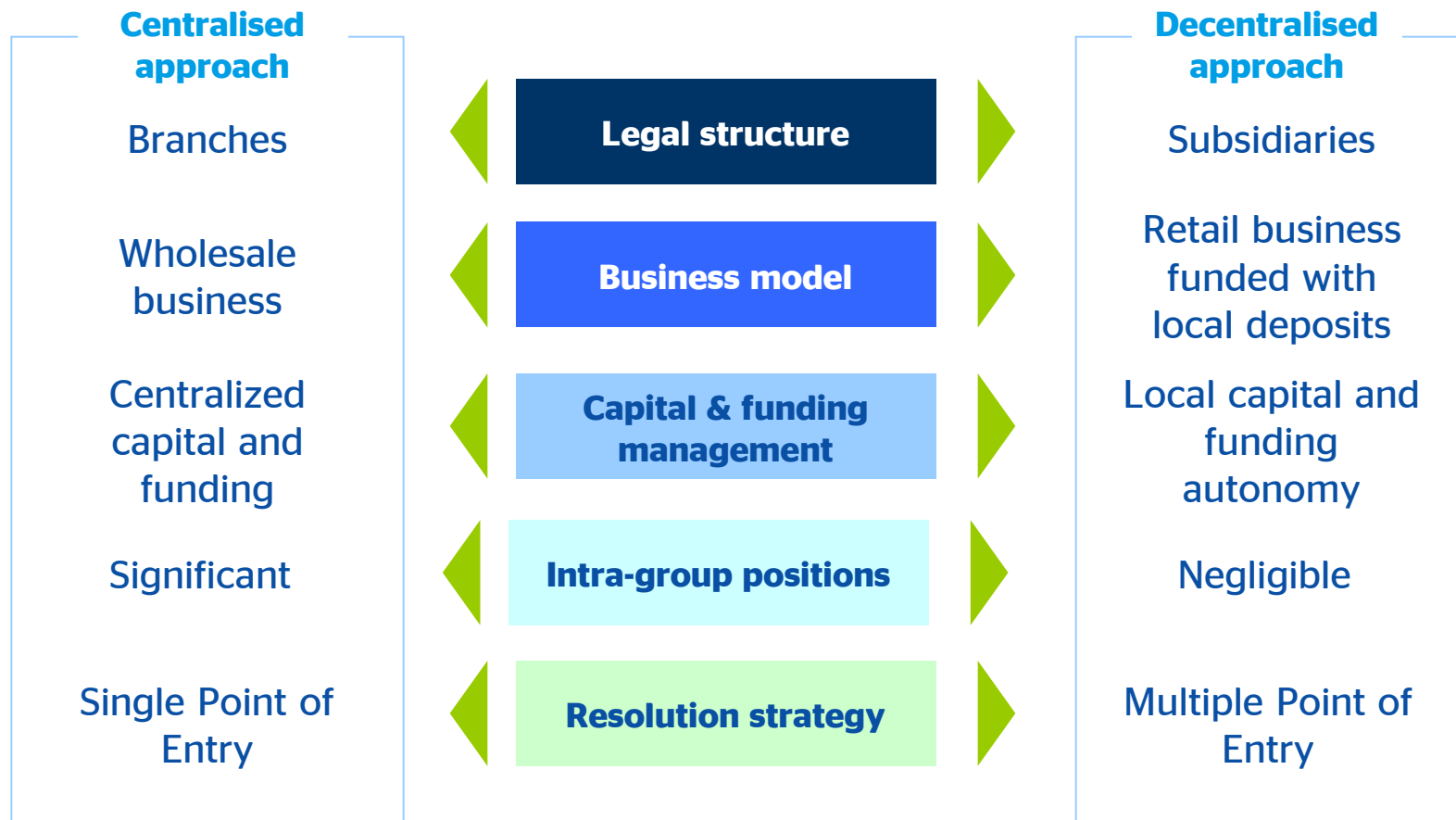
Santiago Fernández de Lis – Chief Economist Financial Systems and Regulation

Recovery and Resolution Plan Workshop – Universidad de Navarra

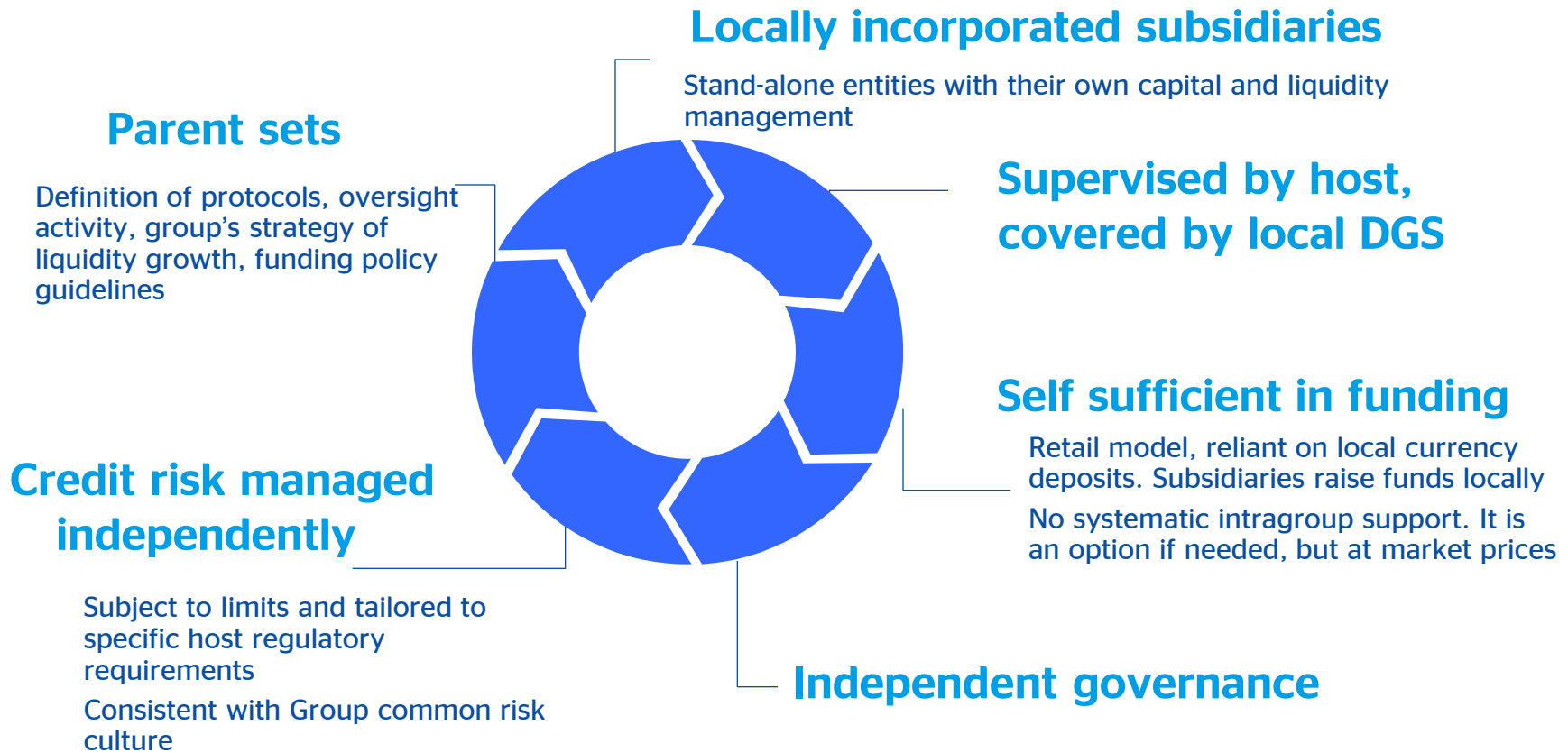
Madrid, 30 January 2015

A decorative graphic consisting of several horizontal stripes of varying shades of blue, ranging from a very light blue at the bottom to a dark blue at the top, positioned below the text.

Overseas structure of global banks



The Decentralised Subsidiary Model



Decentralised subsidiary model characteristics

Features

Self-standing subsidiaries: independent risk assessment

Natural firewalls due to absence of interconnections

Accountability & transparency

Straight forward resolution

Development of local financial systems

At the cost of

Lower economies of scale

Lower capital and funding management optimization

Strong resilience and limited systemic risk

Experiences with crisis in home and host countries

Firewalls between different parts of the group work in both directions

Crisis in **host** country: Argentina 2001

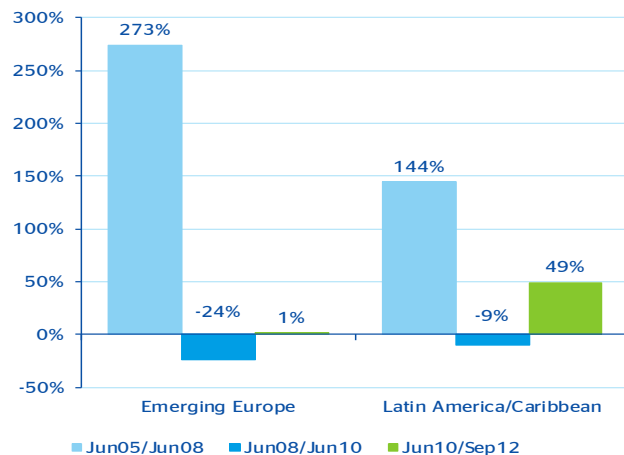
Crisis in **home** country: Eurozone sovereign crisis 2010-2012

Spanish banks stayed in Argentina (long term orientation), but having the option to leave strengthened their position

No evidence of contagion of liquidity problems in home to hosts

Changes in external loans of BIS-reporting banks to the bank sector

Source: BBVA Research based on BIS International Banking Statistics (Table 7)



**Latam:* Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru, Venezuela
***Emerging Europe:* Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania

Foreign banks in Latam smoothed both the bubble and the bust, as compared to Emerging Europe

The new resolution framework's challenges

G-20 commitment in 2011

*“The new resolution framework should set out the responsibilities, instruments and powers to enable authorities to resolve failing financial firms in an **orderly manner**, by **protecting critical functions** and **without exposing the taxpayer to the risk of loss**”.*

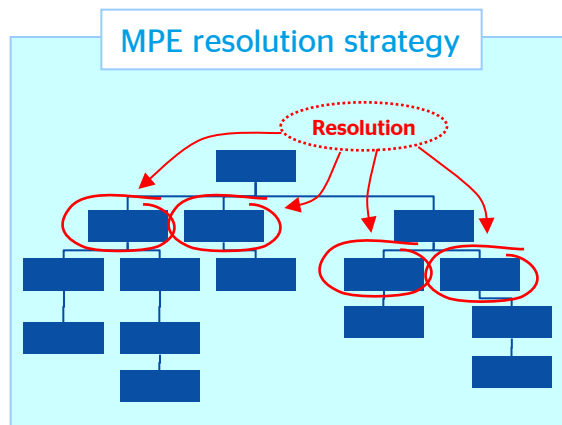
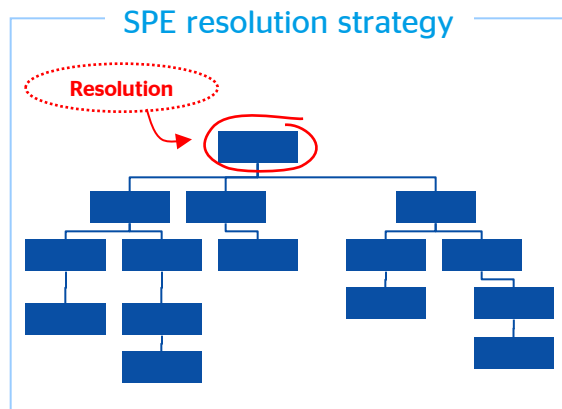
Global banks need to be viable, albeit resolvable

Financial models: enough loss-absorbing liabilities (Loss-Absorbing Capacity - LAC)

Legal entity structures: clear and feasible mapping of interdependences

Operating model: operational continuity of shared services

Decentralised Model & MPE resolution scheme



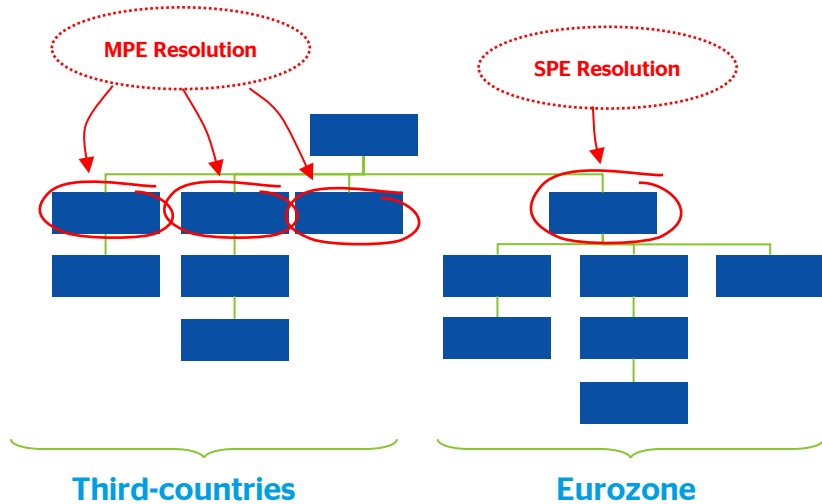
Multiple-Point-of-Entry

Point-of-entry	Subsidiary - failure individual subsidiaries
Resolution powers	Host authority - subsidiary
Authority role	Home - Coordinator & local executor Host - Executor (local)
Losses / bail-in	Local losses - parent voluntary support
LAC (*) placed to third investors	LAC at individual level
Legal structure	Subsidiary
Operational services	Operational subsidiarization: Decentralized or centralized

(*) LAC - Loss absorbcency capacity

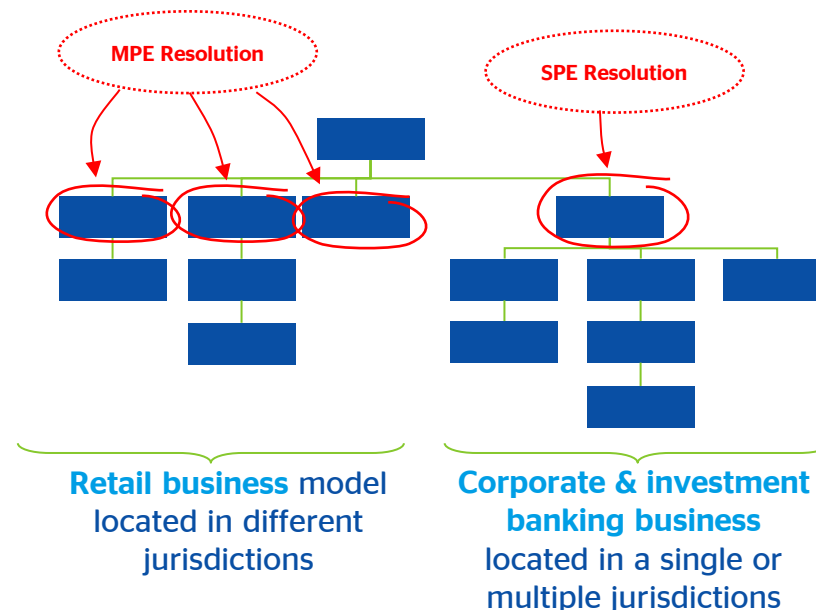
A hybrid scheme is possible

Based on geographical segmentation



- Single supervision (SSM)
- Single resolution framework (BRRD)
- Single resolution authority (SRM)
- Single resolution fund (SRF)

Based on business model



This could be a consequence of ring-fence measures

The TLAC is the complement to the bail-in

Banks need to have sufficient resources to **absorb losses in resolution** to avoid the need for a bail-out with public funds

An adequate amount of TLAC should facilitate the implementation of a resolution strategy with a **recapitalization at a level** that promotes **market confidence** and meets going-concern regulatory **capital requirements**



Protecting taxpayers



Protecting critical functions

Illustrative example (*)

Pre-resolution bank

Good assets	Equity
Bad assets	Subordinated debt
	Senior debt
	Deposits
	Other liabilities

Liquidation bank

Bad assets	Equity
	Subordinated debt

Bridge bank

Good assets	New equity (bail-in senior debt)
	Deposits
	Other liabilities

(*) Illustrative example which combines a bridge bank & bail-in resolution strategy

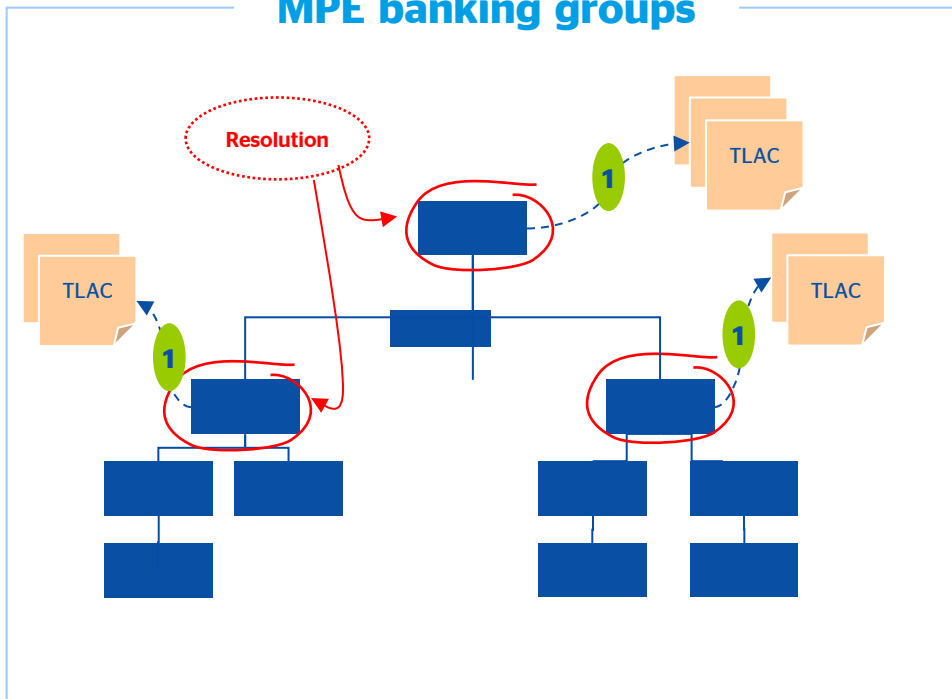
In MPE, TLAC should be placed in each point of entry

TLAC placement principle



The appropriate allocation of TLAC will be determined by the **preferred resolution strategy**: at parent level under an SPE scheme and at subsidiary level under an MPE scheme.

MPE banking groups



TLAC should be required at individual but not at consolidated level

The individual TLAC should be based on the local resolution regime established by the host authority

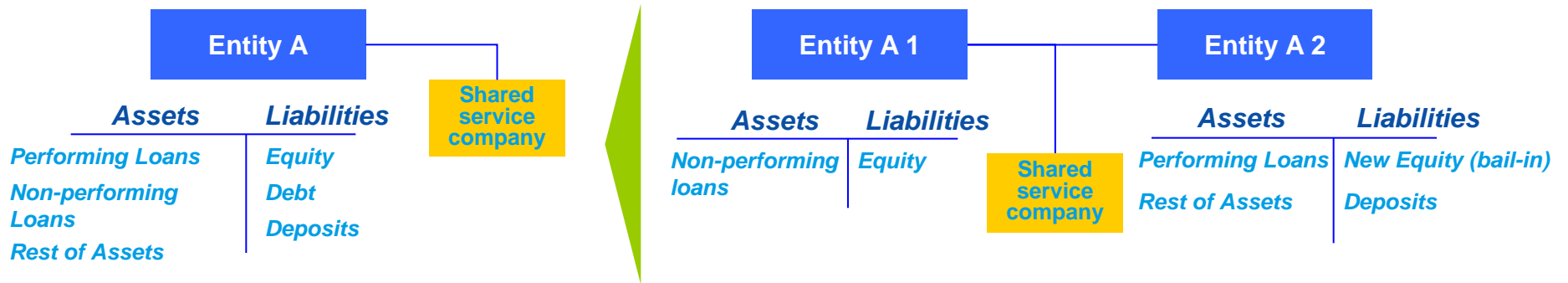
The individual TLAC requirement should have similar features to local entities ensuring the level-playing field

Operational continuity is a key resolution issue

Effective operational subsidiarisation

*“...this entails the provision of critical shared services or functions out of adequately capitalised **separate legal entities that are dedicated to service provision** (FSB July 2013)*

For example, operational subsidiarisation helps to maintain critical functions in both, the good- and the bad-bank when authorities apply a bridge-bank resolution strategy

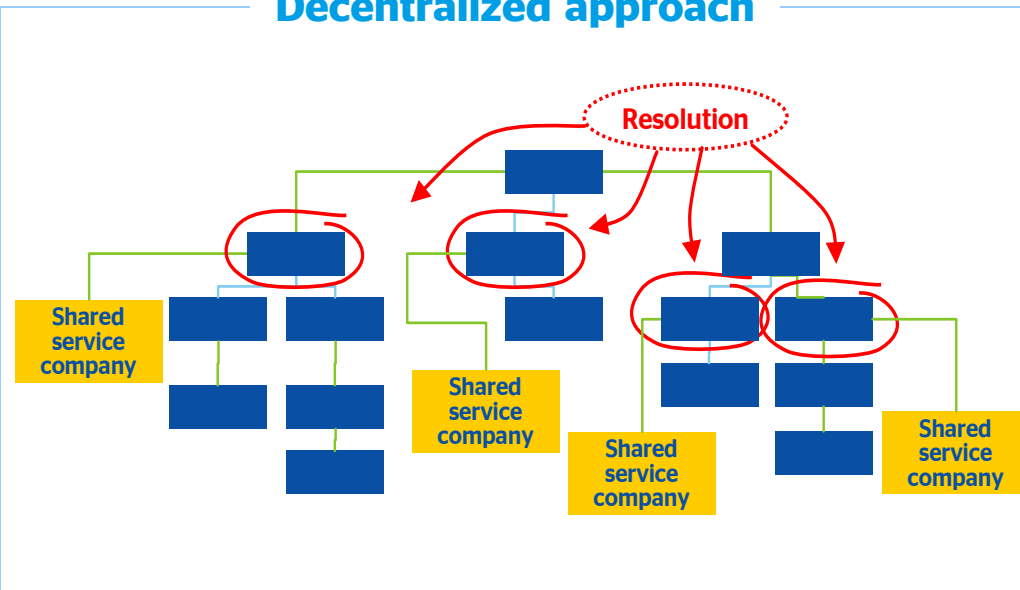


Maintaining shared services in or for a particular entity when the bank or another part of the group fails is the main objective of the operational subsidiarisation.

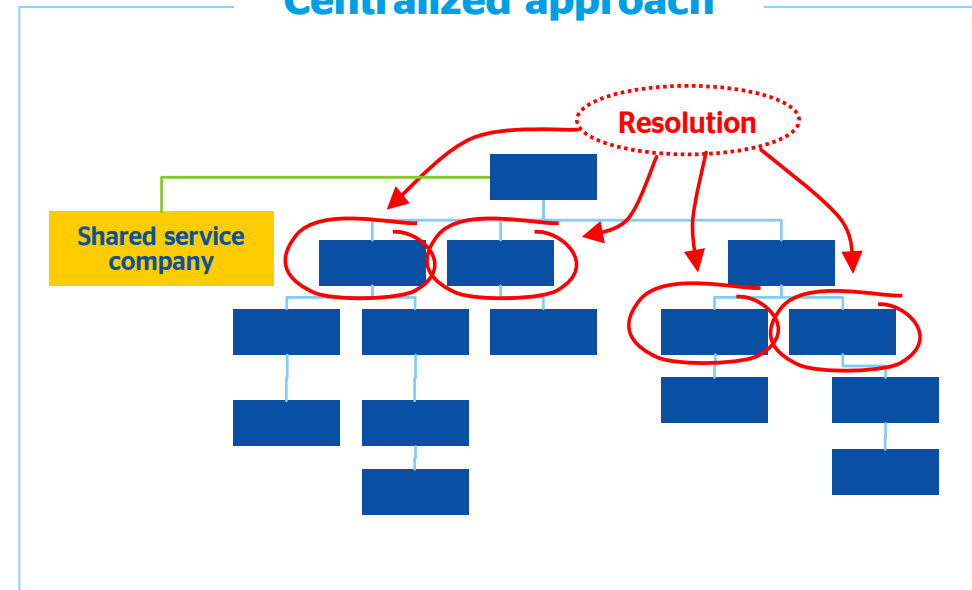
Removing resolution obstacles

Operational subsidiarization in an MPE

Decentralized approach



Centralized approach



Less efficient

More efficient

Decentralised scheme

Centralised + subsidiary scheme

Centralised + branch scheme

Easier MPE resolution

Complex MPE resolution

Conclusions

- 1** There is no unique foreign bank business paradigm. **Resolution strategy should be aligned with business model**
- 2** **MPE is appropriate for global decentralized retail banks**, funded with deposits, supervised by the host authorities and with no systematic intragroup positions
- 3** SPE and MPE are extreme models, in practice **many banks' strategies would be hybrid**
- 4** **The TLAC in MPE** should be based on the local regime established by the host authority with similar characteristics to the local entities
- 5** The **operational subsidiarization in the MPE** model could be organized under two schemes: centralized and decentralized

The MPE model is consistent with progress towards banking union and the Eurozone ultimately becoming a single jurisdiction

DISCLAIMER

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.