

Louis Kasekende: Financial stability – restructuring and resolution of financial institutions

Speech by Dr Louis Kasekende, Deputy Governor of the Bank of Uganda, at the Bank of Uganda–Deutsche Bundesbank seminar on “Financial stability – restructuring and resolution of financial institutions”, Kampala, 3 July 2013.

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Distinguished Guests

Good morning ladies and gentlemen.

On behalf of Bank of Uganda, I wish to formally welcome you all to this seminar with the underlying theme “*Financial Stability – Restructuring and Resolution of Financial Institutions*”.

This seminar is occurring under the Bank of Uganda and the Deutsche Bundesbank technical cooperation. The main objective is to strengthen the Resolution framework for dealing with banks and financial conglomerates. This initiative emerged from the recommendations of the IMF Regional Crisis Preparedness Mission of February 2011 and the FSAP Mission of August 2011. Both these missions recommended that Bank of Uganda reviews the Bank Resolution framework and in addition, ensure that it conforms to the Financial Stability Board’s (FSB) guideline on *Key Attributes of Effective Resolution Regimes for Financial Institutions*.

At the Seoul Summit on 11–12 November 2010, the G20 Leaders endorsed the FSB policy framework for reducing the moral hazard of systemically important financial institutions (SIFIs). This framework called for action in five areas, of which a key area was to make improvements to resolution regimes so that any financial institution, whatever its size and complexity, can be resolved without disruption to the financial system. The Key Attributes of Effective Resolution regimes for Financial Institutions outline the policy framework to meet this objective. These key attributes have been identified by the Financial Stability Board (FSB) jointly with its members including the IMF, World Bank and the standard-setting bodies.

The purpose of an effective resolution regime is to make possible the resolution of financial institutions without severe system-wide disruption. Such a resolution regime needs to take into account the taxpayers, and minimize the losses to them, while protecting vital economic functions. It should employ mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation. Finally, the resolution regime should provide for timely and early entry into resolution before a firm is balance-sheet insolvent and before all equity has been fully depleted. These attributes set out the responsibilities, instruments and powers that national regimes should have to resolve failing financial institutions, some of which may be systemically important financial institutions (SIFIs).

Any financial institution that may be systemically significant or critical if it fails should be subject to a resolution regime and to this effect, the FSB Key Attributes help to address one of the key themes of “too-big-to-fail” in global finance by making it possible to resolve any financial institution in an orderly manner, regardless of the size and complexity of the financial institution.

Two key themes emerge in this overarching area of resolution of SIFIs; one, resolution authority, powers and hierarchy of stakeholders and two; the detailed mechanisms for resolution such as the collateralization, safeguards and funding of firms in resolution.

For resolution to be feasible, the authorities should have the required legal powers and the operational capacity to apply them in order to ensure the continuity of functions that are

significant to the economy. The mechanisms employed in resolving problematic firms should follow the “Respect of creditor hierarchy” and “no creditors worse off than in liquidation” principle’ as laid down in the FSB Key Attributes. In other words, resolution powers should be exercised in a way that respects the hierarchy of claims while providing flexibility to depart from the general principle of equal treatment of creditors of the same class. In particular, equity should absorb losses first, and no loss should be imposed on senior debt holders until subordinated debt has been written-off entirely. Creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the firm under the applicable insolvency regime. Directors and officers of the firm under resolution should be protected in law, for instance, from law suits by shareholders or creditors for actions taken when complying with decisions of the resolution authority. I hope that the first training session this morning on the institutional framework within the EU and the sharing session on Thursday about the German Bank Restructuring Act will shed light on some of these issues.

Second key issue is that there is a need to put in place pre-determined methods of resolution, sources of funding and identified assets acceptable as collateral against such emergency funding in a crisis. Most importantly, authorities should have statutory or other policies in place so that authorities are not constrained to rely on public ownership or bail-out funds as a means of resolving firms. Therefore, in support of the preparations of recovery and resolution plans and the effective implementation of resolution measures in a crisis, a framework should be developed in advance. As they say, *it is already too late to dig a well when you are thirsty*. These are some of key issues which have prompted international best practices in the area of resolution regimes, and we are looking forward to understanding these from the historical examples and restructuring case studies that will be shared during the training seminar.

The G20 and the FSB are calling on countries to undertake the reforms necessary to implement these standards. In Uganda, this will require cooperation amongst authorities, that is, among the Bank of Uganda, the Ministry of Finance, Planning and Economic Development, the Insurance Regulatory Authority and the Capital Markets Authority, to review business structures, legal powers, policies and operations to improve recovery and resolution planning as well as the mechanisms employed in resolution of firms. Therefore, as a capstone, I am glad that the participants will also have the opportunity to do some hands-on decision making in the group exercises at the end of each day.

Over the course of the next three days, the team from Deutsche Bundesbank which includes Mr. Peter Spicka and Mr. Martin Pontzen, with their wealth of experience will be taking us a step further towards these areas. I believe that the seminar will be enriching as they share their experience in Europe on relevant areas including the analytical tools for macroprudential supervision. Of particular importance will be the section where the seminar goes into the details of international and European initiatives for developing efficient resolution frameworks for financial institutions and explains fundamental features of the German Bank Restructuring Act.

I hope that this seminar, bringing all the players in the financial sector together, will help to facilitate sharing of ideas and experience and will promote the development of an effective framework for the restructuring and resolution of financial institutions, especially SIFIs so as to safeguard financial stability in Uganda. I am very grateful for the opportunity to have addressed you this morning. Thank you very much.