BANK FOR INTERNATIONAL SETTLEMENTS

Crisis management framework: what remains to be done?

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Welcoming remarks at the FSI-IADI conference on "crisis management, resolution and deposit insurance: what's next and how to prepare"

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Introduction

It is a great pleasure to welcome you to this FSI-IADI Conference on Crisis Management, Resolution and Deposit Insurance.

First, I wish to express my appreciation to IADI for our collaboration in organising this conference. The FSI has worked with IADI on a range of joint activities over a number of years, and it is a productive partnership. It is a pleasure to co-host this event with IADI President, Katsunori Mikuniya.

This is the ninth joint FSI-IADI Conference, and we are delighted that it continues to attract great support. You, the participants, represent more than 90 institutions from some 70 countries. This breadth and diversity is a testament to the continuing relevance of crisis management as a topic for international discussion.

The countries you represent range from well-developed markets that are home to large, complex financial institutions, to smaller jurisdictions that may be host to foreign banks, and potentially exposed to harmful impacts in the event of their failure. Effective crisis management poses different challenges depending on the size of a country's banks and the nature of its markets.

Since the inception of the FSI-IADI conferences in 2009, we have striven to design programmes that engage with those challenges. This means not only covering the latest developments in crisis management, but also doing so in a way that reflects the perspectives and concerns of home and host countries.

This year we have chosen a practical emphasis, with a focus on ensuring that supervisors, resolution authorities and deposit insurers – and the firms for which we are responsible – are ready for future risks or crises. This includes the issues of (1) what resolvability means for systemic banks and insurers; (2) adapting resolution regimes for different types of banking market; and (3) ensuring our crisis management frameworks and resolution plans remain robust and effective in the face of emerging risks.

[1] I am grateful to Ruth Walters for her helpful comments and to Christina Paavola for her useful support. The views expressed are my own and do not necessarily reflect those of the BIS.

The progress so far

In the decade since the Great Financial Crisis, we have made tangible progress towards resolvability for the largest banks.

The Financial Stability Board's *Key Attributes* were developed to address the problem of institutions that, because of their size, interconnectedness and critical role in the financial system, cannot be adequately dealt with through ordinary insolvency. This standard outlines the core tools, powers and arrangements that resolution regimes should have to enable authorities to manage the failure of such firms in an orderly way that maintains the firm's critical functions, while ensuring that shareholders and unsecured creditors bear an appropriate share of the losses.

The bail-in tool is core to making this objective feasible for large and complex banks. The TLAC standard, adopted by the FSB in 2014, and the 2018 principles on bail-in execution, are in turn critical in ensuring that bail-in is feasible and credible.

In practical terms, resolution strategies and operational resolution plans, based on bail-in, are now in place for all G-SIBs, and planning is coordinated among home and material host jurisdictions in crisis management groups.

The implementation challenges

However, the work is not complete. The most recent FSB Resolution Progress Report, published in November 2018, indicates that more than half of the G20 jurisdictions do not have the full set of bank resolution tools specified by the *Key Attributes*. Indeed, as at last November, almost 60% of those jurisdictions did not have statutory bail-in powers and one third did not have powers to establish a bridge bank, although a number had reforms in train that will address these gaps.

The FSB's Review of the Technical Implementation of the TLAC Standard, published in July, concludes that while there has been steady and significant progress by both authorities and G-SIBs, the framework is not yet fully implemented. In particular, much work remains to ensure that loss absorbency is distributed appropriately around the group in a way that gives sufficient confidence to host authorities, without unduly trapping resources and increasing risks of market fragmentation.

Similarly, the recent FSB's Thematic Peer Review on Resolution Planning found that while progress has been substantial, important technical and operational aspects remain to be addressed to make sure that resolution plans can be executed as intended. This includes effective arrangements for the provision of temporary liquidity for a banking group that operates in multiple jurisdictions.

Work is ongoing on these issues in the FSB as a matter of priority, and will no doubt be discussed over the course of these two days.

The management of the failure of smaller banks

The Peer Review also reports that, in most FSB jurisdictions, resolution planning to date has largely concentrated on G-SIBs and D-SIBs. For understandable reasons, smaller banks have not been the focus of international attention in the same way.

Nevertheless, the question of the design of effective regimes for managing smaller bank failures is important and gaining increasing attention.

First, it is by no means clear that bail-in is an appropriate tool for smaller banks with little experience of tapping capital markets in the way that would be necessary to issue sufficient amounts of bail-in-able liabilities. I have previously spoken about the issue of a "middle class" of institutions that might have a local or regionally systemic impact in failure. Such retail-focused banks are mainly funded by capital and deposits, and may not easily satisfy, within their current business models, the LAC requirements that would be required for resolution.

Second, in many jurisdictions, smaller banks that do not meet thresholds for the use of special resolution powers are subject to an ordinary corporate insolvency regime. This may not provide suitable tools for dealing with the public interest considerations that may arise in the insolvency of any bank, irrespective of whether it is systemic.

Last October, we published an *FSI Insights* paper that considered approaches to managing failure of non-systemic banks. The paper reviews bank-specific insolvency regimes in 12 jurisdictions, and discusses features that address the special nature of banking. These features include (1) specific depositor protection objectives; (2) grounds for opening of proceedings that better reflect the causes and timing of bank failure; (3) an expanded role for administrative authorities and a reduced procedural role for creditors; and, (4) in some cases, a wider range of tools.

Building on that work, last month we published another *FSI Insights* paper on the role of deposit insurance in bank failure management. Deposit insurance is a fundamental element of an effective bank crisis management framework. In its most basic form – a deposit insurer with a paybox mandate – depositor protection contributes to financial stability by reducing the risk of depositor runs.

But where the mandate allows the funds to be used for purposes other than payout, this can support alternatives to liquidation for banks that do not meet the threshold conditions for the use of resolution powers.

The paper is based on information provided in response to a survey by around 50 IADI members – and we are very grateful to IADI and members for this valuable assistance. It shows a wide range of approaches to the use of deposit insurance funds to support measures within resolution or insolvency that maintain access to insured deposits, or to prevent the failure of a member bank. These include purchase and assumption and bridge bank transactions, or provision of capital or liquidity. The paper also reviews the safeguards that may circumscribe the use of deposit insurance funds, including least cost principles and governance requirements. Within such constraints, the ability of deposit insurers to fund alternative measures can increase options for managing bank failures. This may be especially relevant for medium-sized or non-systemic banks, in which deposits may be the main form of loss absorbency.

We note that these considerations are gaining prominence in the policy arena. In the European Union, a promising debate is gaining momentum on the eventual creation of an FDIC-like authority backed by a harmonised insolvency regime for banks that do not meet the thresholds for resolution. Moreover, improvements to bank insolvency regimes along the lines suggested may help strengthen crisis management frameworks in emerging market economies where the nature of the local financial system does not support the smooth application of international standards designed for large, complex institutions.

Let me stop here and wish you a fruitful conference.

Thank you.

Reference

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