Crisis resolution in financial institutions and countries

Lars Nyberg, EFA Conference, 2011

Evolution of the crisis

- July 2007: US housing market and toxic assets in the financial system
- September 2008: Lehman and the liquidity crisis
- 2009: Sharp fall in demand and production in the developed economies (credit crunch)
- Spring 2010: Greece and the European sovereign debt crisis.
- Summer 2011: Investors lose confidence in the EU (and US) political process for crisis resolution

Loss of confidence

- In the EMU area:
  - Several last minute agreements
  - Non credible statements (”Greece will make it”)
  - No political solution in sight
- In the US:
  - Internal fight in Congress prevents a credible handling of the budget deficit

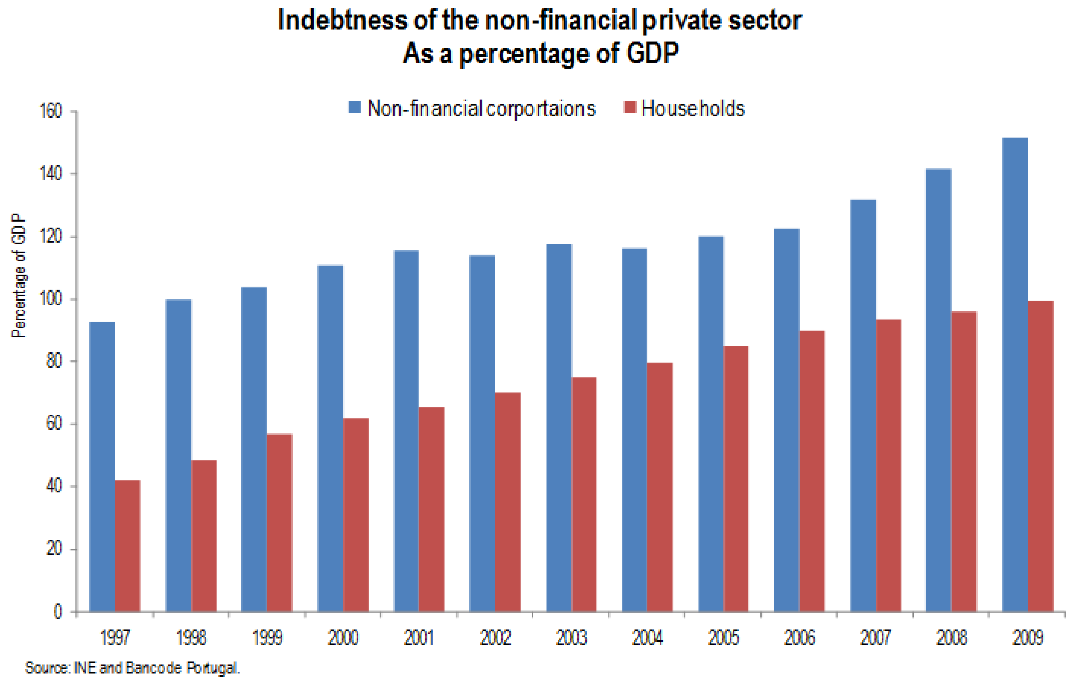
The political side of the crisis

- ”Chicken race” may be necessary
  - To minimise moral hazard (Greece etc)
  - To maximise public support domestically (Germany)
- Investors may understand this – but there is still a great risk of the process failing
- The crisis management process is an increasing risk to financial stability

Not only *sovereign* debt…

High indebtedness in Portugal

The indebtedness of the private sector has increased significantly, in line with the new regime of permanently lower and more stable interest rates



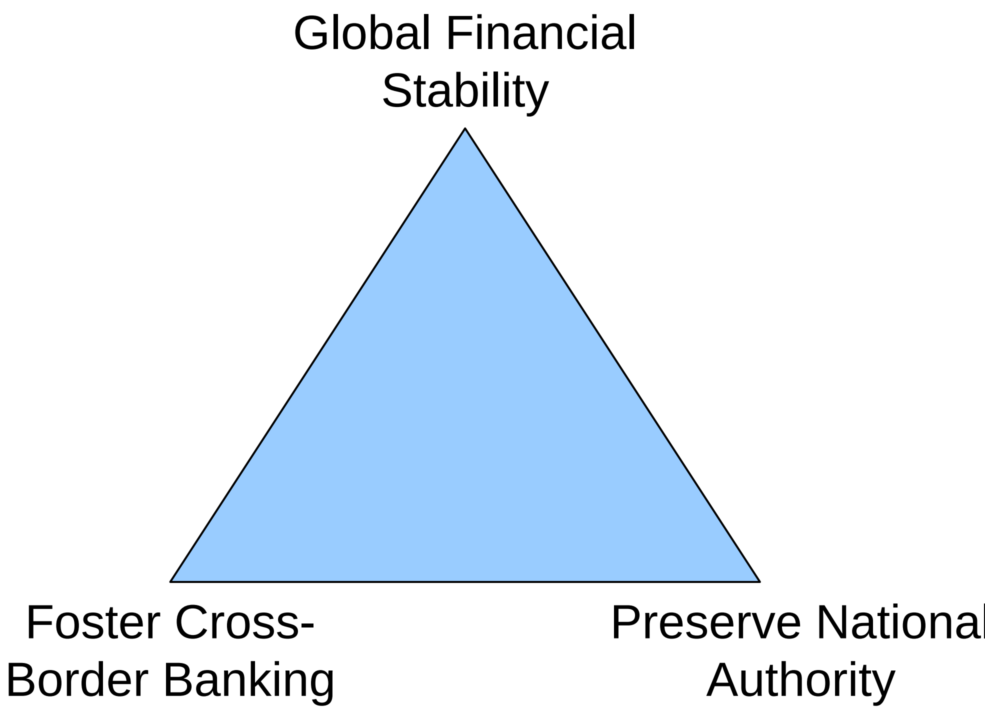
Sovereign-bank loop

- Problems in banking sector can cause problems for sovereigns (Ireland)
- Problems in sovereigns can cause problems for banking sector (Greece, Portugal)

- Breaking the loop requires abiltity to resolve banks in orderly manner without using state funds

Cross-border bank regulation

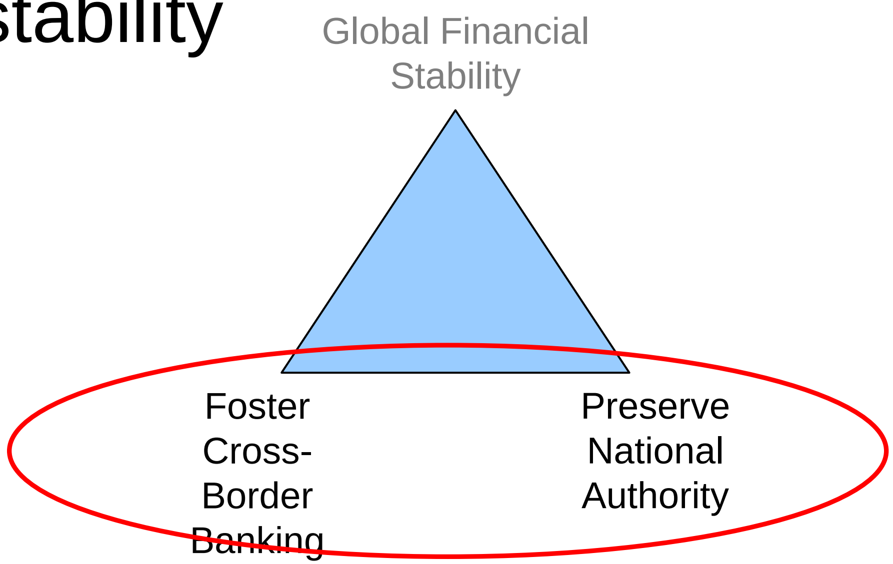
- Dirk Schoenmaker's triangle of policy objectives:



Only 2 of the 3 policy objectives can be achieved!

Pre-crisis policy objectives

- Pre-crisis, focus was on fostering cross-border banking and preserving national authority
- Cross-border banking was allowed to boom without the necessary evolution of policies to protect global financial stability



Changing the policy focus

- To enhance focus on protecting global FS, need to develop policies that:
  - Reduce national authority – eg burden sharing, international macroprudential or resolution authority; or
  - Restrict cross-border banking – eg increasing capital requirements on cross-border banks

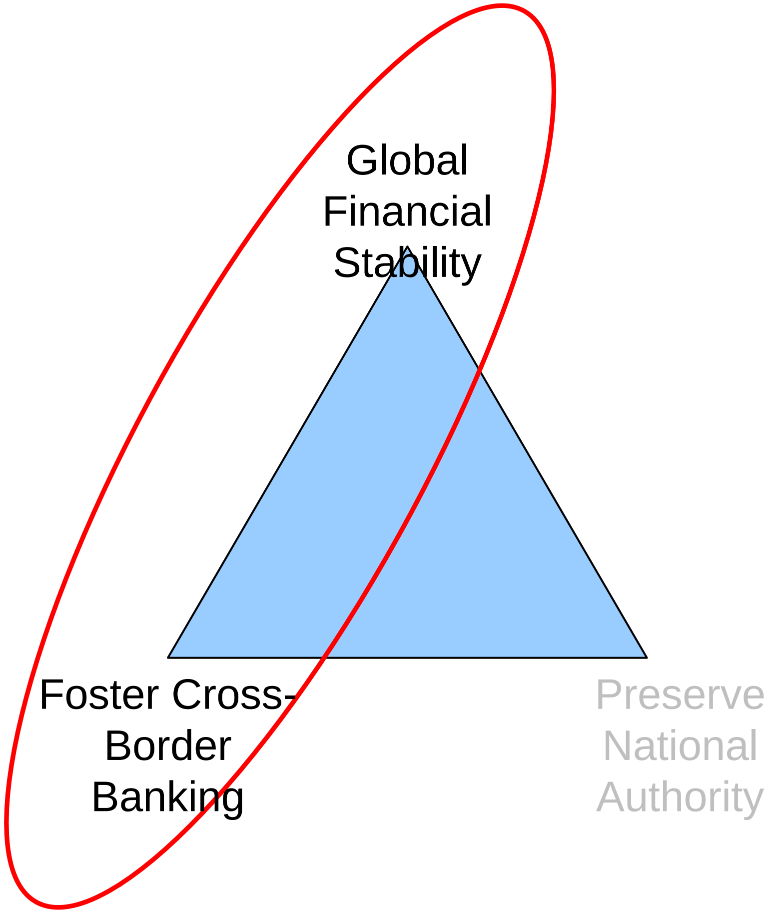
Resolving cross-border banks

- Three broad approaches:
  - Universialism
  - Territoriality
  - Modified universialism

- Territoriality is default option, unless modified unviersialism can be made to work

Universialism

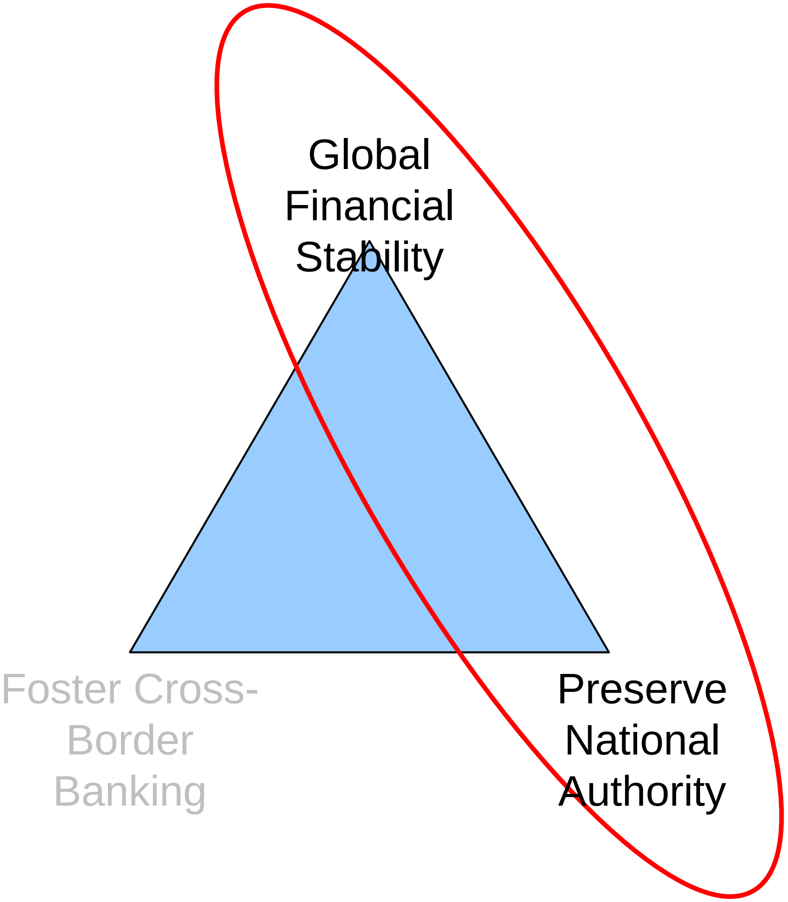
- Requires countries to give up a degree of national authority
- Supra-national supervision / resolution authority
- Agreement on burden-sharing



Territoriality

- Requires restriction on global financial integration

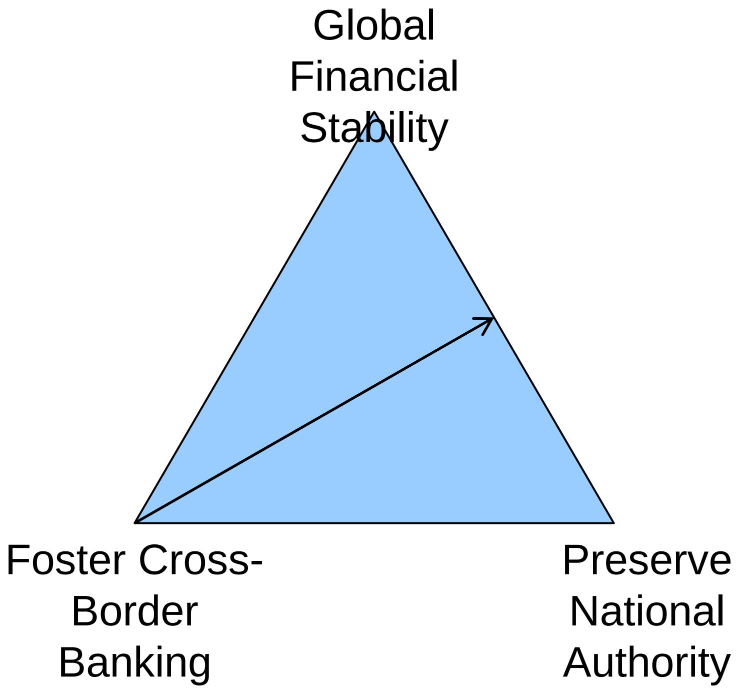
- National supervisors requiring subsiduarisation
- Ring-fencing assets



Modified Universialism

- Intermediate approach

- Greater convergence of resolution regimes
- Concordat on crisis management and incentives for cooperation?



So, what is being done?

- Development of *national* regimes that can resolve domestic banks (US, UK, European Commission)
- Development of tools to resolve large, complex financial institutions (LCFI:s), *national and cross border*
- Burden sharing still too hot a subject

LCFIs

- The basic question: Should we allow banks that we cannot resolve?
- Recovery and Resolution Plans (RRPs) may be a way forward
- In theory, perfect RRPs should make sure that there are no burdens to share
- But there is still a long way to go….

RRPs

- Institution / group specific plans for SIFIs
- Countries currently developing RRPs

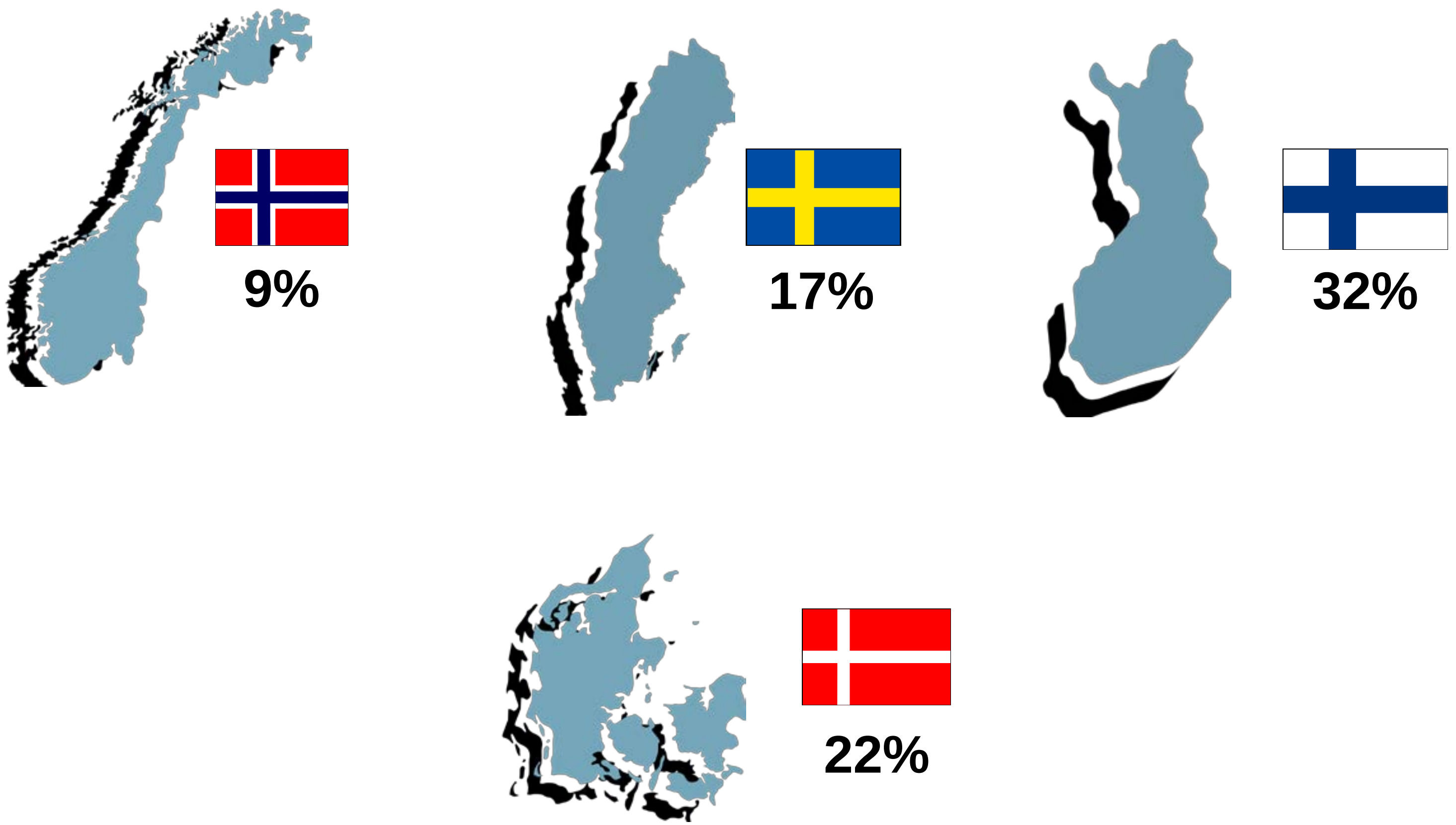
- *Recovery plans* serve as guide for distressed banks when still under control of management
- Includes plans to conserve capital & liquidity, divest businesses, restructure liabilities, etc
- Written by banks, reviewed by supervisor

RRPs

- *Resolution plans* guide authorities on how to resolve banks if recovery fails
- Includes identification of systemic activities, legal & business structure, cross-border issues, vital IT systems, etc
- Written by authorities (home and host), banks provide info

- Supervisory sanctions if RRPs not credible?

Nordea: Market share of household deposits



Improved cooperation

- General framework for cooperation eg Nordic MoU
  - Crisis Management Groups
    - Share information to help determine systemic importance and solvency position of banks
    - Enable discussion and coordination of measures
    - Coordinate media handling
    - Prepare for burden sharing discussions
  - But not legally-binding

Summary

- The debt crisis is largely political – and there are no credible solutions in sight
- Financial integration will move backwards if we do not accept less national authority
- Good progress on domestic bank resolution but cross-border issues remain
- Large, cross-border banks provide big challenges
- Burden sharing between countries is still too hot an issue to discuss
- Cooperation agreements (linked to RRPs or MoUs) may be a step forward