CHALLENGES CONFRONTING BANK RESOLUTION

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Key legal aspects of bank resolution

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Outline

- Conditions for resolution
  - *ensure decisive intervention in addressing the Too Big To Fail problem, while avoiding unnecessary intrusion on private property rights*
- Resolution policy
  - *deal with the impossible trinity of bank resolution, as it is critical to enhance market discipline and solve the sovereign-banking nexus without giving birth to contagion within the financial sector or to bank-corporate feedback loop*
- Crisis communication
  - *find a way on how to communicate effectively to avoid disproportionate reactions in the financial market whenever resolution actions are taken*

Background

- We are at what political scientists call a "critical juncture" – that rare time when a window of opportunity opens to fundamentally change institutions (Sabine Lautenschläger, 2013).
- There is no alternative to submitting well-informed investors to the disciplines of capitalism – failure as well as success. We cannot afford to have banking, so central to the allocation of capital in market economies, semi socialised (Paul Tucker, 2013).

Ensure decisive intervention without unnecessary intrusion on private property rights

- Resolution is based on an **up-front judgment of the scale of expected losses.**
  - Stress tests appear to become a valuation tool in this respect.
  - Is such a mechanism compatible with the provisions on likely to incur losses ?
- The use of resolution tools is subject to the **public interest pre-condition** on financial stability.
  - How to identify systemically important institutions?
  - Should their list be publically available?

The impossible trinity of bank resolution

- We cannot have the following three objectives targeted at once:
  - Exclude certain senior liabilities from bail-in;
  - Respect no creditor worse off principle and avoid material funding costs increases;
  - Avoid contributions by resolution fund.
- How to **strike a balance between predictability and flexibility** to ensure that the imposition of losses on senior creditors does not itself cause systemic distress through contagion?
- How to enhance market discipline and solve the sovereign-banking nexus **without giving birth to a bank-corporate feedback loop**?

The impossible trinity of bank resolution (cont.)

- Addressing these challenges puts forwards the following trilemma:
  - **Exemptions – MREL – Resolution Funds.**
- One should not miss to take into account the **non-contractual liabilities** that might emerge following legal challenges against resolution measures.

Crisis communication is undoubtedly a hot issue for policy makers

- There is a clear gap in terms of **financial/resolution literacy** that has to be filled in.
  - *Disproportionate reactions could emerge*, triggering indirect contagion within the financial sector.
- The uncertainty surrounding the use of *ad hoc* solutions, as we all saw recently in some cases, has shown the importance of establishing a **comprehensive communication framework to underpin the resolution of banks.**
  - Without detailed communication planning, *public statements are often taken late and in an improvised way.*

Final remarks

- The resolution framework must be absolutely watertight.
  - Not only because resolution actions will invariably be followed by lawsuits, but also because predictability is needed to avoid excessive market volatility, bank runs and/or overpricing of risk.
  - Striking a sound balance between the conflicting objectives of harmonisation and flexible rulemaking is particularly challenging.
- An effective resolution framework can only be a **complement**, and **not a replacement** for market discipline and supervisory vigilance.

Thank you for your attention!

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