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RESOLVING G-SIFIS: CROSS-BORDER ISSUES

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Workshop "SIFIs: Identification and Regulatory Challenges"
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Agenda

1. Lessons from the financial crisis: even worse globally

2. Controlling for the region: SA is not Europe (nor the US)

3. Cross-border issues on G-SIFIs: papers needed

Lessons from the financial crisis

- o Stronger and more effective consolidated supervision
- o The ability to wind down major financial institutions in an orderly manner
  - ✓ No bank should be "too big to fail"
  - ✓ Keep the taxpayer out
- ➢ **Globally, these challenges are amplified**

Controlling for the region

- Heterogeneous institutions
  - ✓ The model of supervision
  - ✓ Regulatory perimeter
- The market
  - ✓ Few G-SIFIs
  - ✓ Mostly host
  - ✓ Increasing non banking credit
  - ✓ Economic groups (conglomerates)
- The low development effect
  - ✓ Low (and heterogeneous) financial inclusion
  - ✓ Vested interest groups
  - ✓ Low negotiation power
- History matters: the 1982 crisis
  - ✓ Doing the homework: microprudential policy
  - ✓ Low complexity and narrow shadow banking?

G-SIFIs in the region

	Chile	Perú	Colombia
BBVA	7.1	23.7	9.3
Citibank	18.7	1.6	2.5
Deutsche	0.0	-	-
HSBC	0.2	1.7	0.6
JP Morgan	0.0	-	0.0
Santander	18.9	1.0	-

Loans market share (%) – October 2012.

Doing the homework

- A corollary from the financial crisis would be the need for macroprudential policies. But the Great Recession was mainly the result of a poor assessment of individual risk.

- A well known microprudential policy issue: lightly regulated non-banking institutions combining highly leverage and short maturity funding → **inadequate risk management**. As a matter of fact, Citibank, Bear Stearns, Lehman, Merrill, UBS, AIG collapsed; BUT JP Morgan Chase, Goldman, Morgan Stanley, Deutsche, credit Suisse, Met Life remained quite healthy.

- Any cross-border supervision, to be effective, must focus in the areas of risk management control functions, risk data aggregation capabilities, risk governance, and internal controls.

Recommendations: easier said than done

Develop common cross-border tools. National authorities should have appropriate tools to address all types of financial institutions in difficulty so that an orderly resolution can be achieved. These tools might be legal, regulatory or something else. We should continue to align state's resolution schemes and work toward common guidelines for initiating insolvency proceedings, determining location of main proceedings and the treatment of creditors. As this is not likely to happen overnight, we also need to identify internationally coordinated temporary solutions, such as MoU.

Increase depth and frequency of communication. Schedule regular meetings among the key players involved (government, regulatory and industry) with a focus on planning for crises, identifying barriers to coordinated action, and improving information sharing. In a financial crisis, the health of a financial institution can deteriorate rapidly and having an open line of communication that allows for early and decisive action can be critical. Each entity involved should have a clear understanding of their respective responsibilities.

Require SIFIs to develop "living wills." Each SIFI should prepare and maintain a contingency plan for authorities to use in a wind-down scenario. These plans should contemplate a period of severe financial distress and contain information such as a map of its businesses and legal entities, obligations and liabilities for each entity and who the counterparty is, which parties would be involved in an orderly wind-down (authorities, regulators, attorneys, advisors, etc.), identify information systems, locations, etc.

Papers needed

- SIFIs: Definition? How small is small? Public trust in LDC more (or less?) sensitive to bad news.
- The US-UK model to resolve G-SIFIs: top down strategy - public fund; more capital in LDC?
- Complex problems require complex solutions. But in financial regulation, **less may be more**. Rules vs. discretion.
  - ✓ A challenge of cross-border regulation is strong resistance in the host country to help the home country. Having a rule-based approach should help to partially obviate this problem.
  - ✓ Countries must coordinate the timing of regulatory changes. That need for synchronization creates political challenges that further strengthen the political economy argument in favor of simple regulatory rules based on observable criteria.
  - ✓ The monetary policy: simple rules are desirable when policymakers face uncertainty about the structure of the economy and the source of economic shocks. This conclusion may apply to cross-border regulation and supervision as well.

Papers needed

- Two issues: cross-border cooperation and resolution of G-SIFIs
  - ✓ Strengthened national resolution regimes
  - ✓ Cross-border cooperation arrangements in the form of bilateral or multilateral institution-specific cooperation agreements
  - ✓ Improved resolution planning by firms and authorities based on *ex ante* resolvability assessments
  - ✓ Measures to remove obstacles to resolution arising from fragmented information systems, intra-group transactions, reliance on service providers and the provision of global payment services.

Papers needed

1. Statutory mandates to foster cross-border cooperation, coordination and information exchange:

- ✓ How should a statutory duty to cooperate with home and host authorities be framed?
- ✓ What criteria should be relevant to the duty to cooperate?
- ✓ Which authorities will need to be parties to the Institution-specific Cross-border Cooperation Agreements for them to be effective?

Papers needed

2**. Lack of adequate tools for cross-border resolution:**

- ✓ ***Multiple Trigger Points****:* Can the host pull the trigger regardless of the home supervisors, and without regard to the value of the overall enterprise? Can the act of initiation be coordinated?
- ✓ ***Consistency of Coverage****: have* regulators consistent powers to address distressed institutions with different types of legal entities?
- ✓ ***Legal Entity vs. Group Interest****:* Will the objective of local supervisors be to maximize outcomes for entities (or investors) in their jurisdiction or to seek an overall value maximizing outcome?
- ✓ ***Branches****:* How will branches be treated for purposes of No Creditor Worse Off Than In Liquidation calculations; When local interests diverge from global interest in a resolution?
- ✓ ***Funding via Multiple Entities****:* Many SIFIs issue debt from multiple entities and under different governing laws. The actions of a resolution authority in one jurisdiction may not naturally bind in a foreign jurisdiction.

Summarizing

- The questions are clear, the answers not yet
- Recommendations: easier said than done
- **Papers needed**

- On the time being, rules?
- In financial regulation, **less is more?**
  - LPB?
  - Much higher capital requirements?

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