Cross-Border Bank Supervision and Resolution: The Home-Host Dilemma for Significant-Material Subsidiaries from a ‘Small’ Host State Perspective

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The EU Banking Union
A Rising Expectations Gap?

• The impact of the global financial crisis led to unprecedented reforms at the European Union level with a raft of legal reforms and the adoption of the Banking Union with the centralisation of banking supervision, resolution and the moves towards a common deposit guarantee scheme.

• The talk today asks whether the awareness and requirements now associated with a cross border bank supervision and resolution opens a new expectations gap.

• It asks whether the incentives still serve the home state as the group supervisor and group resolution authority to the detriment of some host states.
Reciprocal Cooperation and Coordination on the level of Macro & Micro-Prudential Supervision – CRR and CRD IV

Aligning Incentives

- Home
- Host

- Regulation
- Supervision
- Resolution
- Crisis Management / Containment

- Home
- Host
The EU Banking Union
A Rising Expectations Gap?

• This can be explored at two levels the first level is the centralised administrative level/decision making built around the Banking Union and the other the instruments of micro-prudential supervision the CRR and CRD IV.

• The set of countries is rather unique in that they are Eurozone, Non-Participating Member States and Third Country states at the border of the European Union.

• The gaps prevent the small host state of a significant subsidiary from preparing properly for supervision, resolution and crisis management due to the unwillingness of the consolidated supervisor sharing important information and data about the group as a whole.
The Banking Union: A Pure Eurozone Perspective

• The ECB role for significant banks arguably minimises the home and host dilemma for a pure Eurozone bank. The role of the ECB as the ‘consolidated supervisor’ on behalf of the ‘home authority’ and the supervisor for branches and subsidiaries as ‘host-home’ arguably minimises the incentives on the micro prudential level to act purely in the interests of either the home or host.

• The introduction of Joint Supervisory Teams and the Supervisory Review and Evaluation Process (SREP) are likely to lead to limited or no asymmetry of information between the home and host with centralised decision-making and the way of managing information and data for a pure Eurozone bank.

• The need for Supervisory Colleges for a pure Eurozone bank is possibly limited, if not eliminated, minimising coordination and cooperation between the home and host for the purposes of information sharing.
Significant and Less Significant Banks – Regional Eurozone Perspective

• The coherency of the approach from macro-prudential oversight to micro-prudential oversight needs to be addressed.

• The threshold of most significant banks is set relatively high based on asset size more than 30 Billion; ratio of total assets and GDP is more than 20%; or one of the three largest banks; directly assisted by the ESM; or Based on cross border activities the credit institution has total assets exceeding 5 billion and its cross-border activities in a participating member state exceeds 20% of its total assets or the liabilities in a participating member state exceeds 20% of total liabilities.

• In the Eurozone 127 credit institutions groups are classified as significant banks and their approximately 1200 group entities and so representing 85% of the assets of the Eurozone.
Number and Category of Significant Banks

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of Significant Banks</th>
<th>Size</th>
<th>Total Assets above 20% of GDP</th>
<th>3 largest credit Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td>2</td>
<td></td>
<td></td>
<td>2</td>
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<tr>
<td>Latvia</td>
<td>2</td>
<td></td>
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<tr>
<td>Lithuania</td>
<td>3</td>
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<tr>
<td>Slovenia</td>
<td>3</td>
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<td>3</td>
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<tr>
<td>Slovakia</td>
<td>3</td>
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<td>3</td>
</tr>
</tbody>
</table>
Number of Significant Banks in Comparison to Less Significant Banks

Estonia  Latvia  Lithuania  Slovenia  Slovakia

Number of Significant Banks  Number of Less Significant Bank
CRD IV and CRR

- CRD IV and CRR enable either the consolidated supervisor or the other competent authority the discretion to decide whether a subsidiary is ‘significant’ for the purposes of cross border supervision.

- A Macro-prudential Perspective: A small member state can on the basis of classifying a subsidiary as significant it can decide that it’s a O-SII – a domestically important institution. (See EBA Guidelines) On the basis of this decision it can require the O-SII to comply with capital buffers.

- A Micro-prudential Perspective: Technically subsidiaries will be included in consolidated supervision regardless of size. However, the amount of information and data the consolidated supervisor is expected to share with the competent authority of subsidiary is couched in a lot of discretion which enables it to limit the type and quality based on size and importance of the subsidiary to the group and also location in a third country.

- At the same time, there is no doubt some states would cooperate and seek to coordinate more proactively than others due to concerns of systemic risk being more likely to be transmitted between them.
The Form Foreign Banks Take in the Region

<table>
<thead>
<tr>
<th>Country</th>
<th># of foreign subsidiaries</th>
<th># of foreign branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>15</td>
<td>10</td>
</tr>
<tr>
<td>Estonia</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Croatia</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Hungary</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Lithuania</td>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>Latvia</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>Poland</td>
<td>30</td>
<td>25</td>
</tr>
<tr>
<td>Romania</td>
<td>10</td>
<td>7</td>
</tr>
<tr>
<td>Slovenia</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Slovakia</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>Albania</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Kosovo</td>
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<td>2</td>
</tr>
<tr>
<td>Macedonia</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Montenegro</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Serbia</td>
<td>20</td>
<td>15</td>
</tr>
</tbody>
</table>
The proportion of Foreign Banks to Domestic Banks
Share of Domestic and Foreign Bank Assets

- Bulgaria
- Czech Republic
- Estonia
- Croatia
- Hungary
- Lithuania
- Latvia
- Poland
- Romania
- Slovenia
- Slovakia
- Albania
- Bosnia and Herzegovina
- Kosovo
- Macedonia
- Montenegro
- Serbia

BG  CZ  EE  HR  HU  LT  LV  PL  RO  SI  SK  AL  BH  KO  MK  ME  RS

Share of Domestic bank assets
Share of foreign bank assets
The Home Country of Foreign Banks Located in the Region

- Austria
- Italy
- France
- Hungary
- Greece
- Belgium
- Germany
- Sweden
- Russia
Information Sharing: Group vs Periphery Perspective

• The risk of the home and host forbearing on sharing of information will ultimately mean the home and host state during periods of crisis or loss of confidence are likely to act in their own self interest due to the asymmetry of information and unwillingness to reach a consensus.

• The importance of information sharing to improve supervisory decisions is crucial to ensure cross border financial stability and market integrity.

• Information sharing needs to be at two levels during the supervisory process, governing the banks as going concerns and, secondly, during periods of distress.

• Host State supplies information and data to the home state and the home state responds to ad hoc requests from host state for information?
Information Sharing: Group vs Periphery Perspective

• The competent authority of the parent entity is expected to receive the data to comply with consolidation requirements.

• How should we interpret timeliness of information sharing? Fulfil requests: on the day, in a week, a month or three months? Risk of Forbearing

• The risk of the home and host state forbearing on the sharing of information will ultimately mean the home and host state, during periods of crisis or loss of confidence, are likely in resolution to act in their own interests rather than the collective interests of the group as whole.

Consolidated Supervision - One Way Traffic when it comes to Small Hosts?

• The purpose of consolidated supervision is to ensure activities undertaken by way of subsidiaries and branches do not undermine the stability of the parent entity or the group as whole.

• The counter balance to this is the authority of the host to be able intervene if risks at the group parent level materialise and put at risk entities within the host state.

• Need for a framework to ensure states are consistent in their approach in terms of information sharing with others to prevent alignment of interests to simply preserve their own self-interest.

• At the same time, there is no doubt some states would cooperate and seek to coordinate more proactively than others due to concerns of systemic risk being more likely to be transmitted between them.
Supervisory College – Membership: Group vs Periphery Perspective

• A central plank to improve cooperation and supervision of cross border banks is the introduction of supervisory colleges.

• The membership of supervisory colleges is divided into members and observers. The former group have significantly more of role within the supervisory colleges than the observers of the supervisory colleges.

• The information and data sharing they can expect and how they can engage in decision making differs significantly. For example, the lack of inclusion of such small hosts to produce recovery plans and resolution plans.

• For the purposes of consolidated supervision: the decision about who can join the supervisory college is the responsibility of the consolidated supervisor.
Resolution College – Membership: Group vs Periphery Perpsective

• The rationale of such colleges is necessary to ensure an appropriate platform for consultation between the respective authorities both at the point of resolution as well as crisis prevention level and crisis management level.

• The lead taken by the group resolution authority to invite members and observers provides the group resolution authority a significant amount of discretion exists to invite members and observers that are aligned with their interests.

• The consideration of the recovery and resolution plans is the first matter. Those plans will be an important basis to assess the resolvability of groups and possible impediments to cross-border orderly resolution.

• The assessment of resolvability needs to specifically incorporate the extent to which such institutions can be effectively supervised as well as the credibility of the resolution plans and assessing the likely impediments that could hinder the process.

• TLAC and MREL Requirements: The Sharing of Information will be important to build up the appropriate levels of Loss Absorbing Capacity to safeguard critical functions such as credit in the economy.
Significant Branches and Subsidiaries: Aligning the Correct Incentives for Home-Hosts?

- The authorities need to ensure the decision-making strands at the Macro-Micro prudential levels connect to formulate a coherent policy framework both at the crisis prevention and crisis management levels.

- If the macroprudential authority of a state sets buffers for O/SII - D-SIB then it should mean enhanced supervision and resolution arrangements between the home and the host in the interests of the state where the entity is incorporated regardless of the size of the subsidiary relative to the group.
Significant Branches and Subsidiaries: Aligning the Correct Incentives for Home-Hosts?

• The policy argument that those entities at the periphery are narrow and therefore not a systemic threat is a one sided stemming from the argument that the entity is not systemic from the consolidated supervisors point of view and therefore should be dealt with by placing it in to insolvency/administration.

• The risk of the home and host state forbearing on the sharing of information will ultimately mean the home and host state, during periods of crisis or loss of confidence, are likely in resolution to act in their own interests rather than the collective interests of the group as whole.
Resolvability of Narrow Bank – Critical Financial Services

• Moving to a one-size-fits all approach with the introduction of a Single Point of Entry Model is not likely to capture all subsidiaries. A formal policy needs to be introduced to enable Multiple Point of Entry Model along side it.

• Is the periphery a one size fits all set of banks that are narrow and do not offer critical financial functions? Y/N

• The Recovery and Resolution Planning process needs to take in to consideration the rights of member states to prepare ex ante for a MPE model along side proposed SPE model[s].

• The Resolution options should be determined by the respective member state in line with the critical functions the institution provides in their markets namely credit finance and so should not necessarily mean insolvency.
Thank you!

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