Preparing for the adoption of resolution plans from the host country perspective: the Polish experience

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Globalized (too-big-to-fail) institutions – GSIFIs are highly interconnected.

Operating the group as a single business although many parts of the business will be separately incorporated and subject to the principle of separate legal personality.

Complicated corporate structures.

Local laws have local reach

There is no global treaty or a global burden sharing arrangement
Why work on resolution in the host country (Poland)?

- There are banks that aspire to be D-SIFIs or at least systemically important,
- About 60% of sector assets controlled by foreign banking groups,
- Resolution is the most efficient way of restructuring a failing bank,
- Efficient resolution requires an enhanced institutional framework.
Drawing up and approval of Recovery and Resolution Plans for systemic banks by both home and host authorities is an important tool in cross-border supervision and resolution of banks.

A map of corporate structures and distribution of assets and liabilities around the group have to be regularly updated, and early indication as to the location of the most risky operations of the group should be delivered to all involved authorities.

Conflicts of interest may exist and trust may be lost if, for instance, a parent bank and home supervisor have incentives not to disclose or formulate the recovery plans together with the host supervisors.

On the other hand RRPs gain in credibility if they are discussed and approved by all countries where the relevant bank plays a systemic role.

(admittedly this problem will probably not arise at least in MoUs between developed country regulators)
Resolution Plans – trust is crucial

- In the absence of legally binding bilateral / multilateral burden sharing arrangements, the effectiveness of plans could be severely tested under conditions of crisis.

- In crisis situations, capital or liquidity or both are usually in short supply – or thought to be, so there might arise the threat of cross-border spillover from regulatory / supervisory actions.

- Host countries may feel the need to restrict the operations of bank subsidiaries under their jurisdiction, particularly if these subsidiaries are of systemic importance.

- There needs to be an agreement ex ante about the practical tools in crisis management, such as limiting dividend payments, requiring more capital (locally or by a parent), raising liquidity requirements etc. and certainty that such an agreement will be adhered to.
### Territorial vs Universal Approach

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<th>Territorial</th>
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<td>Each national jurisdiction applies its own law which governs insolvency proceedings for entities, operations, and assets of the insolvent firm located in that jurisdiction.</td>
<td>Resolutions of insolvencies based on a common law (with the legal framework of the country where the home entity is established). Under this option, the decisions of the resolution authority in the home country jurisdiction are extended to branches, other operations and assets of insolvent firms in other jurisdictions.</td>
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<td>This protects national sovereignty and authority, but the costs of the process would be covered by cross-border banking partners.</td>
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Recognizes the strong possibility of ring-fencing in a crisis and helps ensure that home and host countries and financial institutions focus on resiliency within national borders (where they can try to align their toolbox in context of improving their legal systems).

Such an approach may require certain discrete changes to national laws and resolution frameworks to create a more complementary legal framework that facilitates financial stability and continuity of key financial functions across borders. This approach aims at improving, inter alia, the ability of different national authorities to facilitate continuity in critical cross-border operations.
Ring-fencing seems to be the only ‘bullet proof’ solution

But...

- It harms cross-border banking,
- Retrenchment into national borders (ring-fencing measures and substantial cutbacks in cross border activities) carry high economic costs and risks,
- It strains the relations between home and host authorities, especially in countries like those in emerging Europe, where foreign banks typically dominate local banking systems,
- It destroys group synergies and economies of scale.

Contemporary resolution strategies for cross-border groups are considered to be broadly based around two ‘stylised’ approaches, Single Point of Entry (SPE) and Multiple Points of Entry (MPE).
Single point of entry (SPE)

- Parent company absorbs potential losses within the group by up-streaming losses,
- Operations of particular subsidiaries preserved on a going concern basis by down-streaming capital,
- Loss absorbing capacity at group level,
- Resolution powers applied at the level of the parent company.

Multiple point of entry (MPE)

- Higher degree of financial separation of group entities,
- Sufficient loss absorbing capacity available at the level of each entry point,
- Resolution powers applied where the problem has arisen.
### Advantages and potential impediments

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<td>Operations of particular subsidiaries preserved on a going concern basis,</td>
<td>Problem solved at point where it arose,</td>
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<td>Strong incentives for host jurisdictions to refrain from taking independent action and rely on group resolution strategy,</td>
<td>No obstacles resulting from legal and regulatory differences between jurisdictions involved,</td>
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<td>Possible lower average cost of financing the bail-inable debt,</td>
<td>Coordination challenge,</td>
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<td>More complex – losses passed up, capital and liquidity down-streamed – <strong>possible obstacles resulting from legal, regulatory, accounting and tax requirements,</strong></td>
<td>Lack of strong incentives for host jurisdictions to refrain from taking independent actions based on their own resolution plans,</td>
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<td>More complicated process of valuation to determine loss absorbing capacity.</td>
<td>May result in a change of ownership and separation from the group,</td>
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<td>Additional forms of intra-group support necessary if the loss absorbing capacity is not sufficient to cover losses.</td>
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SPE is the preferred strategy although other possible alternatives are being explored.

Source: BFG’s elaboration on the basis of “G-SIFI resolution planning commitments” (FSB, Apr 2014)
### SPE vs MPE

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<td>Under an SPE strategy, resolution tools are applied to the nonviable bank’s holding company or parent entity. As a result, losses would be absorbed and the Group recapitalized without interfering with the operations of the Group's subsidiaries.</td>
<td>MPE involves two or more resolution authorities applying resolution tools to multiple parts of a group, and “is likely to result in a break-up of the group into two or more separate parts”, along a national, regional, or business-lines basis, particularly if a “distressed part of the group” needs to be detached. The healthy parts are either sold or become a &quot;residual group&quot;, while the diseased parts are individually bailed in.</td>
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<td>Namely, in SPE, losses in subsidiaries are transferred to the parent company. If this becomes insolvent, it is bailed in. This requires that an appropriate quantity of bail-able liabilities are issued at the parent holding company level. Such an approach is significantly simplified if the parent holding company does not book or otherwise contain any of the Group’s operational assets.</td>
<td>This requires preferred resolution strategies to be articulated for each part of the group that may be separately resolved.</td>
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## Comparison of strategies

### Single point of entry
- Under an SPE approach relatively little cooperation is required, but the home authority must be sufficiently credible to ensure that host authorities "refrain from taking independent action", although hosts could provide assistance as necessary.

### Multiple point of entry
- Under MPE, cooperation becomes more important. Each key host authority needs to be open about its plans, and the home authority needs to do the same, "ensuring a joined-up, collaborative approach with no surprises", (Paul Tucker, BoE, 2013).

### Hybrid strategies are also possible
- possible—for example, core operations in key jurisdictions where the G-SIFI is active might be resolved under SPE;
- while stand-alone operations in other countries are resolved following an MPE approach, closely linked regional operations might be resolved as a group in an overall MPE strategy.
Perhaps most importantly, the success of an SPE approach for a major international banking group wholly depends on a high level of trust between the resolution authorities of each jurisdiction in which the group has a bank. The resolution authorities in the jurisdiction of a subsidiary must have complete confidence that the authorities in the holding company jurisdiction will ride to the rescue if a local emergency breaks out. As matters stand, it is not clear that they will have that confidence.

Losses of the institution in resolution will accrue and be managed at the parent level under SPE, or at the parent and subsidiary levels under MPE. Both approaches can imply the use of a range of resolution powers, including bail-in, which plays a central role, particularly in SPE approaches.

Resolution is closely tied to supervision. Cooperation in the supervisory colleges has in some cases been held back by lack of agreement on how to handle the resolution of a cross-border bank.
Arrangements need to be made in order to ensure that critical financial and operational services provided by other parts of the group can be reproduced, and that adequate loss-absorbing capacity exists locally.

The role of the host supervisors must be strengthened. The host country supervisor is expected to participate in resolution, so the authorities should be given sufficient information with respect to the whole bank group in order to ensure the effective involvement of the host country.

Identifying the systemic parts of relevant cross-border banking groups and confining the efforts to those parts may also be a way forward in cross-border cooperation. The resolution plans may help in this respect. If no results in cross-border cooperation are attained, the fall-back solution is always to split a bank in trouble along country borders, but such an approach would seriously damage franchise value.