ABI Associazione Bancaria Italiana

# The management of bank crisis in the new European supervisory architecture

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*Siena, April 1-2, 2011*

# 1. The moral hazard issue

The issue of crisis management and resolution of SIFIs is of crucial importance for an effective new financial framework.

The policy relevance of these issues was clearly recognised by the Dodd Frank Act

In Europe, after the creation of the new EU supervisory framework, the Commission is going to issue a legislative proposal by the end of summer 2011 to create an EU framework for crisis management.

At the G-20 Meeting of 27 January 2011 in Paris, the Chairman of the Financial Stability Board Mario Draghi recognised that bank bail-outs reinforced the moral hazard issue and stressed the need for immediate intervention.

He indicated that the new Basel III rules, aimed at strengthening banks' capital buffers, were a positive step to help prevent future crises, by reducing the probability of the failure of large banks, but did not address the moral hazard problem.

# 2. The *SIFIs*

In November 2010, G-20 Leaders endorsed an FSB policy framework for addressing the moral hazard risks associated with SIFIs (and G-SIFIs)

The FSB, in consultation with the standard setters, will recommend the additional degree of loss absorbency and the instruments by which these can be met by end-2011.

The Basel Committee is finalising its methodology based in 5 factors

- Global Activity
- Size
- Interconnectedness
- Substitutability
- Complexity.

It will be presented at the FSB Plenary meeting of 5 April 2011. The BCBS is expected to launch a consultation around June, though it is not official yet.

# 2. The *SIFIs: the scoring*

The use of lists of SIFIs is not the right solution.

Every market participant contributes to systemic risk. Efforts should be led to the identification of sources and processes of systemic risk.

Capital surcharges should not be considered as an option in the systemic risk discussion

The adoption of the principle of proportionality is crucial. A "scoring" of systemic relevance should be assigned to each intermediary as part of the Supervisory Review and Evaluation Process (SREP) which the supervisory authorities carry out in accordance with the Second Pillar.

The "scoring" will allow additional measures (in terms of enhanced supervision and loss absorption) required by the G-20 for SIFIs to be effectively calibrated.

The application of identical measures to all intermediaries identified as SIFIs would end up adversely impacting those intermediaries that adopt traditional business models and prudent asset structures.

# 3. The Shadow Banking System

Paying attention to the shadow banking system (US/FSOC; UK/ Financial Policy Committee; FSB, etc..)

The discussion around the regulation of the shadow banking system is particularly important

Imposing tighter controls on banks will drive borrowers to less regulated sources and, as a result, politicians and regulators should consider the need to close regulatory gaps avoiding that the maturity transformation role of European banks is taken up by the shadow sector.

Can be regulation unrelated to banking models (wholesale, retail, investment, universal, commercial) ?

"One framework fits all" approach should be duly investigated, and corrected, in order to provide incentives for the traditional banking model, the deposit-taking model, which is able to ensure both financial stability and support for the real economy, namely SMEs.

# 4. The framework for banking crisis management

The Commission adopted a Communication "An EU Framework for Cross-Border Crisis Management in the Banking Sector" on 20 October 2010 which set the full range of features:

- – early intervention
- – bank resolution
- – insolvency framework
- – financing of bank resolution

- It will constitute the structure of the legislative proposal that the Commission intends to publish by the end of the summer 2011.

Details and complex technical issues were put under consultation at the beginning of the 2011.

The work on cross-border crisis management in the banking sector will be completed by the European Commission's Internal Market Directorate General in the 2012 with a legislative proposal to harmonise the MSs' regimes in the field of insolvency law in the banking and financial sector.

# 4. The framework: an enhanced role for EBA ?

ABI supports the EC project. It is ambitious.

Powers of early intervention will continue to be exercised by prudential supervisors under the CRD. Each MS will identify a resolution authority to exercise the resolution powers.

There is room for improvements.

- The Commission's proposal should be improved for granting meaningful powers to the EBA both for the:
- – definition of methods and operating instructions for the application of new obligations (such as reinforced supervision, stress tests, recovery plans, the definition of agreements on group support) proposed for the new EU framework, and
- – settlement of any disputes between national authorities

# 4. The framework: toolbox of measures

The new framework aims to equip authorities with common and effective tools and powers to tackle bank crises at the earliest possible moment, and avoid costs for taxpayers. The toolbox of measures will include:

- Preparatory and preventative measures such as a requirement for institutions and authorities to prepare for recovery and resolution plans

- Powers to take early action to remedy problems before they become severe such as powers for supervisors to require the replacement of management, etc..

- Resolution tools, such as powers to effect the takeover of a failing bank or firm by a sound institution, or to transfer all or part of its business to a temporary bridge bank.

The regulation of special administration is in line with the provisions of Italian legislation: renewal of no more than one year, formal observance of shareholders' rights, limited liability system in the sense that the State does not become the guarantor of the commissioned bank.

# 4. The framework: the Group support

"Group support", the use of preliminary agreements which allow asset transfer if required, which the Commission conveniently proposes in a dual sense (by the Parent Company to the subsidiary and vice-versa), is aimed at recognising the group's dimension

Therefore ABI believes that should be properly incentivised, for example, by permitting centralised liquidity management and the necessary flexibility in calculating capital requirements at individual level, to encourage intermediaries to finalise said agreements, which have the merit to increasing the stability of the single EU market

# 4. The framework: the bank resolution fund

The Commission intends to financing resolution measures through Bank resolution funds to be established in each MS.

ABI has always opposed the creation of a national bank resolution fund, funded with obligatory contributions from banks, as this approach does not adequately take into consideration the levels of taxation in the different member states and the situation of those banking sectors, like the Italian one, which have faced the crisis without the help of public funds.

In addition, if the imposition is only regulated at EU level, it could lead to a significant competitive disadvantage on the international markets.

ABI believes that considering a purely national dimension for the funds could aggravate the different resolution authorities' tendency to engage in ring fencing in the case of cross border crises.

# 4. The framework: the Bail-in issue

A bail-in scenario involving senior unsecured debt would increase the cost of funding without fixing the problem: unsecured debt will be suddenly substituted by (costly) forms of collateralised debt which are excluded from application of the write-down

The contingent capital solution (which represents a contractual approach) appears to be less distorting given that it is aimed at specific categories of investors, who are aware of the risks they are running.

The issue of contingent capital should be adequately incentivated from a regulatory point of view, for example, allowing the recognition of contingent capital for countercyclical buffer purposes which shall be introduced with Basel III.

Unfortunately, the Basel Committee explicitly excluded the possibility of using contingent capital to feed the capital conservation buffer (2.5%), which must be composed by Common Equity.