Cross-Border Resolution in Europe

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Agenda

1. Lessons from financial crises:
   - What did work?
   - What did not work

2. Financial Trilemma

3. Sketch of European supervisory and resolution regime

4. Conclusions
1. What did work?

ECB was effective

- Clear line of command: president
- Engagement participating members: Governing Council
- Clear mandate: stability euro area
- Ex ante burden sharing: ECB capital key
- Implicit national fiscal backstop
- Strong legal backing: Treaty
Problem:

• Failure of large banks poses national and cross-border externalities
• Cross-border externalities are ignored by national authorities

Why?

• Accountability to national politics (i.e. domestic taxpayers)
• National legislation/procedures for insolvency
Nationalism

“My country is my castle”
Asymmetries in: **Overlap/conflicts of national interests**

1. **Domestic objectives**
   - Safeguarding domestic financial system
   - Minimizing costs incurred by domestic taxpayers

2. **Resources (capacity)**
   - Supervisory staff
   - Financial resources

3. **Accounting and legal infrastructure**

4. **National resolution regime**
   - Trigger for bankruptcy
Table 2.1: Alternative patterns of asymmetries

<table>
<thead>
<tr>
<th>HOST country entity</th>
<th>HOME country/parent bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Systemic</td>
<td>(a) Potential for coordination</td>
</tr>
<tr>
<td>Non-systemic</td>
<td>(c) Conflicts of interest and potential for coordination problems</td>
</tr>
</tbody>
</table>
2. Theory

How to address asymmetries in national interests?

Financial trilemma – 3 policy objectives:

1. Maintain global financial stability
2. Foster cross-border banking
3. Preserve national authority

Only 2 out of 3 objectives can be obtained!
Financial trilemma

Figure 2.1. The financial trilemma

1. Global financial stability
2. Cross-border banks
3. National authorities
It boils down to choice on sovereignty:

1. Handing over partly -> supra-national solutions
   a) Supra-national / co-ordinated supervision
   b) Burden sharing (under universal approach)

2. Keeping full sovereignty -> restrictions on cross-border banking
   a) National supervisors requiring subsidiaries
   b) Ring fencing assets (under territorial approach)
3. Principles for international co-operation

Start with endgame: resolution

1. Incentives for co-operation (promote/require)

2. Move from “can authorities co-operate” (MoUs, etc) to “will authorities co-operate” (incentives/treaties)
Sketch of European regime

1. European Resolution Authority with access to funding

2. European Central Bank

3. European Banking Authority
European Fire Brigade
ERA for crisis resolution

• clear line of command: president in centre crucial for timely resolution

• involvement of member states but not in driving seat (move away from national champions)

• recapitalising banks is a government task; so no financing from ECB

• ERA could issue bonds underwritten by participating member states or a loan from ESM

• European-wide mandate

• ERA established by Regulation (akin to EBA)

• Special resolution regime for EBA banks in Regulation
• deposit insurance at European level for EBA banks
• funded through risk based premiums with fiscal backstop
• based on Regulation
ECB for LOLR

• LOLR support for EBA banks (banks with a national license go to NCBs)

• general burden sharing for potential LOLR losses

• financial stability mandate for ECB: euro area (Governing Council) or European-wide (General Council)?

• FDICIA: how to prevent overgenerous LOLR by ECB, while handing over subsequent solvency problems to ERA?
EBA for getting license

- Supervision of (large) cross-border banks by EBA
- New structure with chair and executive directors
- Chairs of NSAs participate and co-decide in Council
- Challenge: how to solve prima donna problem?
- European-wide mandate
- License based on Regulation
Funding of crisis resolution

- At federal level (in the US, deep pockets at federal level) or by member states (in Europe, deep pockets at member state level)
General or specific burden sharing?

- LOLR is based on general burden sharing

- Change ECB burden sharing key from euro-area to EU-27 for profits and losses on LOLR and decision-making to General Council (see Irish rescue package)

- Crisis resolution: smooth transition from LOLR to resolution suggests general burden sharing; or mix of general (financial stability as public good) and specific (location specific benefits, e.g. Nordea in Nordic-Baltic region; Fortis in Benelux) burden sharing
Two-tier banking system?

- National and federal licensed banks as in the US
- EBA license: compulsory or voluntarily (opt-in)?
- Follow structure of competition (ECN) or central banks (ESCB)?
- Prima donna problem suggests the ECN approach
4. Conclusions

1. In current setting, national interests dominate. So, cross-border externalities are ignored.

2. Global banking needs fiscal backstop

3. European Framework
   - EBA: supervision on European mandate
   - ECB: LOLR
   - ERA: resolution with funding based on ex ante burden sharing