



Cross-Border Resolutions

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**Opening address from Jerzy Pruski,  
Chair of the Executive Council and President of IADI**

Thank you, Michèle, for the warm introduction. And let me take the opportunity to commend you and the CDIC team for the wonderful organization of the conference. Events like this are a precious opportunity for IADI members from all over the globe to come together, share experiences and explore ways to become stronger components of the financial safety net architecture

The topic of the conference - Cross-Border Resolution - is a timely and important one. And that's because it is one of the most challenging aspects of crisis management.

In my introductory remarks I will focus on Cross Border aspects of Resolution. Let me start by enumerating some reasons why the problem of Cross-Border Resolution is so difficult to cope with.

1. First of all, there is the supervisory time inconsistency problem at the prevention and early intervention stage, quite ahead of resolution. Local supervisors face a natural disadvantage because a large proportion of banking operations provided by SIFIs takes place outside their respective jurisdictions. As a result of cross-border interconnectedness among separate SIFIs, the real nature of their operations and - in the end - risk assessment and risk distribution are hardly possible to be sufficiently monitored and controlled by local supervisors. This may lead to significant, let me call it, supervisory time lags and finally diminish the results of resolution action.

2. Trade-off between effective decision-making and the number of involved parties.

The bigger the financial institution is, the more geographically distributed are its operations. G-SIFIs conduct business in many countries and their operations are important for local markets and the financial stability of these markets. At a local level, the standard safety net usually comprises from three to five participants: the ministry of finance, central bank, supervisor plus DGS and resolution authority. Even the sole process of resolution in many jurisdictions is carried out by multiple authorities and may require a court order or confirmation to be effective.

An important issue is how to bring such locally diversified frameworks to cross border cooperation and crisis management. An effective solution for local coordination and country representation is a precondition for cross border cooperation in resolution.

In crisis management it must be possible to take a decision quickly when required. There is no doubt that as the number of authorities involved in decision making increases, this negatively influences the speed and therefore the effectiveness of the process. On the one hand this number

should not be unnecessarily large but, on the other hand, there's an unquestionable justification for all jurisdictions with systemically important operations to be involved.

The participation of only five countries results in a crisis management group that could be composed of from 15 to even more than 20 authorities and would grow following the extension for more countries involved. Is this regulatory coordination problem solvable in practice?

3. Are there sufficient incentives for coordinated cross border resolution and crisis management?

It is not obvious that any country in which the operations of cross border institutions pose a risk for financial stability would like to participate in decisions on the resolution of an institution. Systemic importance can be perceived differently at the country and institution level. Significantly different perception of systemic risk and the resulting inconsistency of incentives could prevent the transfer of assets between subsidiaries and the parent company and among subsidiaries themselves. The odds for private sector solutions remains

low and the dominant strategy boils down to ring fencing and fragmentation. Particularly challenging is the relationship between the host country and the home country when a subsidiary is of systemic importance for the host country, while completely insignificant from a group and home country perspective. A cooperative solution may not be available. The question of the existence of sufficient incentives to cooperate in a cross border dimension is additionally challenged by the coexistence of subsidiaries and branches.

4. Let me now briefly refer to recognition of resolution and safeguards.

As is stated in FSB Thematic peer review: “The ability of existing mechanisms in many jurisdictions to give effect to foreign resolution actions remains unclear. Very few jurisdictions have provisions for administrative mutual recognition and enforcement by the resolution authority of actions taken by foreign authorities.”

It follows therefore, that the countries hosting subsidiaries should have safeguards that resolution taken in other jurisdictions will not automatically trigger relevant results or actions in their jurisdiction with negative ramifications for financial markets and stability. The impediments for participation in cross border resolution are deeply rooted in bankruptcy law, corporate law and protection of minority shareholders, to list only the most important.

5. Even if the above mentioned legal barriers were somehow removed, the funding of cross border resolution would still remain unsolved, which from a practical point of view seriously undermines the effectiveness of voluntary cooperation with nonbinding Memoranda of Understanding (MoU). Such MoU were widely shared before the current crisis in Europe and turned out to be hardly useful when the crisis occurred. Moreover, when launching a cross border action, the amount of funds needed for funding resolution actions can be significant and needed almost immediately - even if these funds are committed on a temporary basis, following the basic rule that owners and creditors bear (or absorb) losses. This is simply impossible on an ex post basis.

Therefore ex ante burden sharing seems to be crucial for cross border cooperation within resolution. This principle is broadly accepted on theoretical grounds, but carries with it tremendous problems with practical implementation.

I have mentioned only a few - perhaps the most important - obstacles to effective cross border resolution. But unfortunately the full list of impediments is longer.

Therefore it is hardly surprising that even if some countries have a long and successful track record of executed resolutions domestically, the cross border experience in resolution is rather limited. One positive example refers to initiative and operation of the Nordic-Baltic Cross Border Stability Group in combination with Nordea Crisis Management Group. Fortunately it has not been tested yet as no resolution was necessary. More extensive is the list of examples where the lack of the cross border cooperation resulted in disorderly bankruptcy or large-scale and inefficient usage of taxpayer money. A formidable illustration of negative consequences could be the Lehmann Brothers collapse, especially in the scope of joint UK and US

operations. Another is the rescue action with respect to Fortis, carried out by the governments of Belgium, The Netherlands and Luxemburg, not at a group level but along geographical borders.

This leads me to the fundamental question of how to make a cross border resolution operational and how to discard or at least mitigate the fear of cooperation in the field of cross border crisis management.

Two alternative ways of addressing this problem have emerged recently. Both of them aim for the creation of a bundle of incentives which would stimulate and make cross border resolution operationally manageable. The first one attempts to create a sufficient bundle of incentives in the form of a multilateral agreement with an international body responsible for cross border resolution. This is what the concept of the European banking union is about. Cooperation between a Single European Supervisor with a European Resolution Authority and probably a Pan-European Deposit Scheme should overcome obstacles and make cross border resolution operationally manageable. Let me add that the



roots for this approach are irrevocably anchored in the institutional framework of the eurozone and the concept of the common currency area.

An alternative approach attempts to address the coordination problem by creating adequate incentives from top to bottom. The concept of a single point of entry has been commonly developed by the Bank of England and FDIC and described in the seminal paper published last December.

According to this strategy, a single resolution authority applies its powers at the top point of the group, at the parent company level. Losses would be assigned to shareholders and unsecured creditors of the holding company. The activities of the sound subsidiaries in domestic and foreign jurisdictions - provided they are sound - would be kept operating and unaffected, thus limiting contagion. With respect to failing subsidiaries, resolution measures would be executed in cooperation with host authorities. This is a new and very promising approach to relations between the home country and the host country, which as long as a single point of entry is applicable, may adequately address the previously

discussed impediments and insufficient incentives to cross border crisis management and resolution.

There are some differences in terms of approach to recapitalization. Bearing in mind the divergent legislative framework and different amounts of loss absorbing liabilities at a parent company level, recapitalization can take place by exchanging or converting the required amount of unsecured debt of a failed company into equity. In the U.S. this would constitute capital of the newly established entity and in the U.K. additional recapitalization could apply to the failing company itself. An ex post versus ex ante approach to bail in is another way of exemplifying these differences.

So why is this discussion of critical importance for deposit insurers? Because directly or indirectly our industry will be in the centre of a cross border resolution. Therefore, we have to anticipate the changes in the global financial architecture and attempt to contribute to searching for optimal solutions.

Let me stop at this point.

It's my conviction that during our conference we will explore this relatively unknown territory and arrive at some important insights.

I wish all of you many fruitful discussions and once again, many thanks to Michèle Bourque and the CDIC team for all their hard work in organizing such a wonderful conference.