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## **Bank resolution and the need for cross-border co-operation**

In my comments, I would like to provide the perspective of a supervisory authority – the Swedish FSA – with a relatively long experience of cross-border supervision and college work. Let me begin with a word of caution: cross-border recovery and resolution will be a real challenge. If we want to be able to meet this challenge, I think there are two main messages. First, we as authorities need to be flexible and agile and not become trapped by overly complex or mechanistic procedures. Second, in order to cooperate in group resolution colleges we need to overcome sometimes conflicting national interests. I will now explain why these messages are important. But let me start with some general comments on the new framework.

With the implementation of the legal frameworks for bank recovery and resolution, a new regulatory aim has been introduced. Supervision and regulation are no longer simply about limiting the likelihood of bank failure (i.e. reducing the probability of default). Now, new authorities have been set up with the explicit aim of reducing the systemic impact of bank crises, (i.e. reducing the loss given default) through the resolution of failing institutions. Fulfilling this aim will inevitably have a significant impact on the financial ecosystem.

In addition to this, by introducing an authority specifically focused on resolution, we are able to narrow and define more clearly the responsibilities of the supervisory authority. It will now be very clear in the regulation whether a bank is a going concern or a gone concern. And depending on the state of the bank, responsibilities and tools will be very different. I think this is very positive. The responsibilities of prudential supervisors and central banks in crisis management have in the past often been unclear and the border between going and gone concern has been blurred.

The new regulatory framework requires a huge effort to plan and prepare. Here it is important to strike the right balance and not end up with thousands of pages of so called living wills. But if rightly managed by authorities, the process of preparing has the potential to provide a valuable outcome. Even if recovery and resolution plans will not to be the exact manuals for managing a

specific crisis, going through the process has still forced banks and authorities to prepare options and alternatives. That is clearly a better starting point than what has been the case historically.

Another valuable output I would like to highlight is the much needed ex-ante clarity offered by a more robust framework for loss hierarchy with credible write-down and conversion procedures. Implicit government support to systemic banks will be viewed completely differently going forward. This, of course, in essence, is a good thing, but the transition to this new world will probably have a significant impact on bank business models and the structure of the financial system.

Let me now move on to my two messages on cross-border cooperation.

As most of you know, Sweden has a large financial sector, as indicated by the comparison of total banking group assets to domestic Swedish GDP. One reason for this is that many of the Swedish banks have expanded their businesses into the other Nordic and Baltic countries, primarily through an industry consolidation process in the 90's and early 2000's.

In general, the current business activities of the large banks based in the Nordic and Baltic region are mostly concentrated in this same geographical area. This means that co-operation between the individual Nordic and Baltic countries is very important, and it is something that we have focused on developing in the past few years – mostly in the field of bank supervision, but also in insurance and central counterparty supervision. And as we speak, co-operation with the Single Supervisory Mechanism is taking on increasing importance as well.

The new recovery and resolution framework will also require cross-border co-operation. Cooperation in resolution colleges will involve many different types of authorities (such as the Single Resolution Board). Resolution planning also forces us to seek credible answers to some very tough questions – such as who should bear the cost for failure. These are questions that supervisors and central banks, in the past, have often tried to avoid. It is good that authorities are now required to address these questions. But we should not think that it will be easy.

One key lesson highlighted by the financial crisis in 2008, is the need for flexibility for authorities and governments when dealing with a crisis. It will be important to maintain a degree of flexibility also in the future, even within the regulatory environment of well-defined mandates and pre-determined processes laid out in the Directive.

The backbone of the resolution framework is clear: ensuring that critical banking functions are maintained through a crisis and limiting the risks to financial stability – whilst not risking taxpayers' money. However, each crisis tends to be different in nature and rarely unfolds the way one expects or has planned for, so a degree of flexibility is no doubt practical, to say the least.

So my first key message is this: successful crisis management will always be based on clear objectives, but in terms of execution we need to be flexible and agile. We should stay clear of processes and requirements that might trigger or accelerate a crisis. Such actions would be de-stabilizing. To give a concrete example, let me mention the Financial Stability Board's proposal on Total Loss Absorbing Capacity. The current proposal is that a breach of TLAC requirements should be treated as severely as a breach of minimum capital requirements. This means that a solvent bank that is not able to refinance its maturing TLAC instruments due to a market wide meltdown might need to be resolved. I doubt that this is a very good idea.

In the EU framework, much focus has been on implementing the legal processes and necessary tools for resolution, such as bail-in, bridge bank and asset separation, as well as the processes for assessing and removing impediments to resolvability. Equally important, however, are the changes put in place to enable better cross border crisis management. Representing a supervisory authority which will be a future member of several resolution colleges, I can only emphasize that cooperation will be critical for success.

This statement holds true both nationally (between resolution authorities and supervisory authorities, as well as governments and central banks), and to an even larger extent in the international and cross border context. Group resolution colleges for large cross-border banks will be complex and involve many stakeholders. The colleges will need to find common ground and make progress in assessments and joint decision making, while at the same time balancing differing interests and mandates.

The Swedish FSA has been participating in a number of supervisory colleges, both as a home and a host authority. We have many positive experiences from cross-border cooperation. Nevertheless, cross-border cooperation between authorities with national mandates involves certain challenges. It can be very difficult to agree on key issues, such as how capital and liquidity should be managed across a group, and how much buffers each legal entity should have. And as we learned in 2008, cooperation quickly broke down once a bank was in serious trouble, even in previously well-functioning colleges. This happened all over Europe.

I think that cross-border cooperation provides an even greater challenge in recovery and resolution than in supervision. The aim of resolution is so clearly about limiting the cost for the national economy and its tax payers. In a way, resolution authorities start their real work once failure has already occurred and when there is not much left to save, except for the critical functions, while supervisors will often try (sometimes in vain and at great cost) to maintain the group as a going concern. But it means that supervisors have an interest in cooperating to make it work as a going concern. And still it is often very difficult. My worry is that resolution authorities might not have a strong enough interest in making cross-border banking work as a going concern.

To conclude, in order to agree on credible plans and robust preparations for recovery and resolution, some difficult choices and decisions will have to be made. These decisions will be difficult since they mean taking a stance on core aspects of national banking systems and links to sovereign interests. If we do not manage to take a constructive and cooperative approach, we cannot expect to be successful in cross-border crisis management or preserving overall financial stability. We need to take a broader view than the pure domestic one. So to repeat my second message one more time: in order to cooperate in group resolution colleges we will need to overcome sometimes conflicting national interests. This is a true challenge, but if we are successful it would benefit us all.