LIQUIDITY AND RESOLUTION

EUROPEAN UNIVERSITY INSTITUTE -
FLORENCE SCHOOL OF BANKING AND FINANCE
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Dominique Laboureix – Board Member

Single Resolution Board

2 | SETTING THE SCENE: SRB MISSION & BOARD

BOARD






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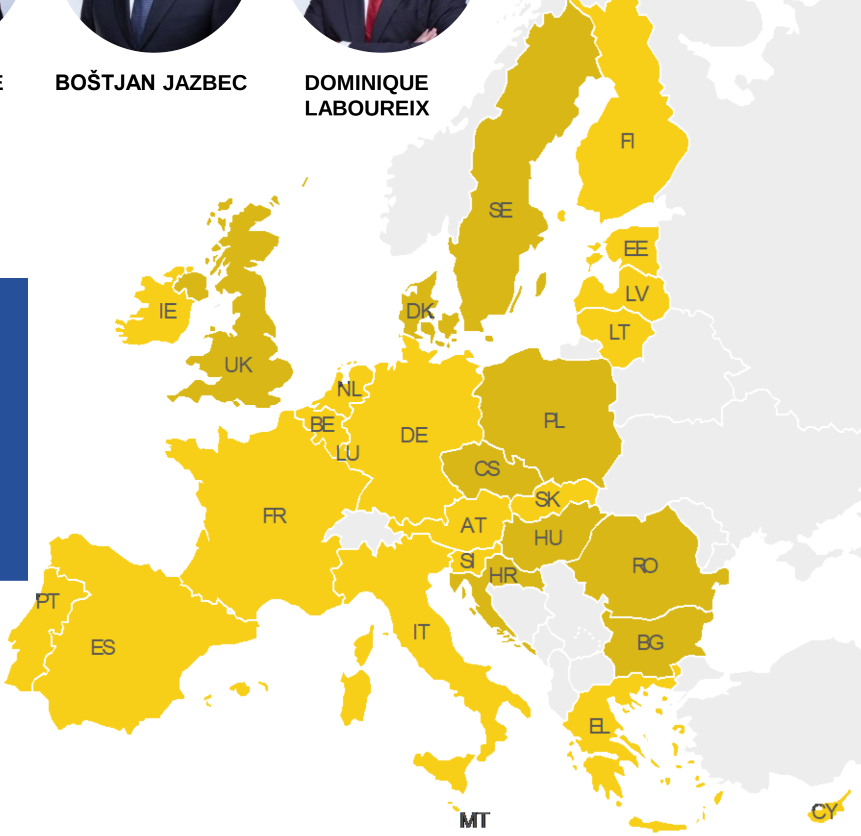
MISSION

The mission of the SRB is to ensure an orderly resolution of failing banks with minimum impact on the real economy and the public finances of the participating Member States of the Banking Union.



OBJECTIVES

- To help avoid destabilising financial markets and minimise the costs to taxpayers
- Ensure continuity of critical functions in case a bank must be resolved
- Safeguard financial stability at Member State & prevent contagion
- Protecting public funds
- Protect depositors, investors, client funds and client assets

MAIN TASKS

- Resolution plans
- MREL
- Assessment of resolvability and obstacle removal
- Elaborate and enact resolution schemes
- SRF

PROTECT & CONTROL

4 | SETTING THE SCENE: THE LIQUIDITY CONUNDRUM

► The resolution framework provides for **powers and tools to restore the solvability** of failing institutions. However, it is not enough to successfully handle a resolution action.

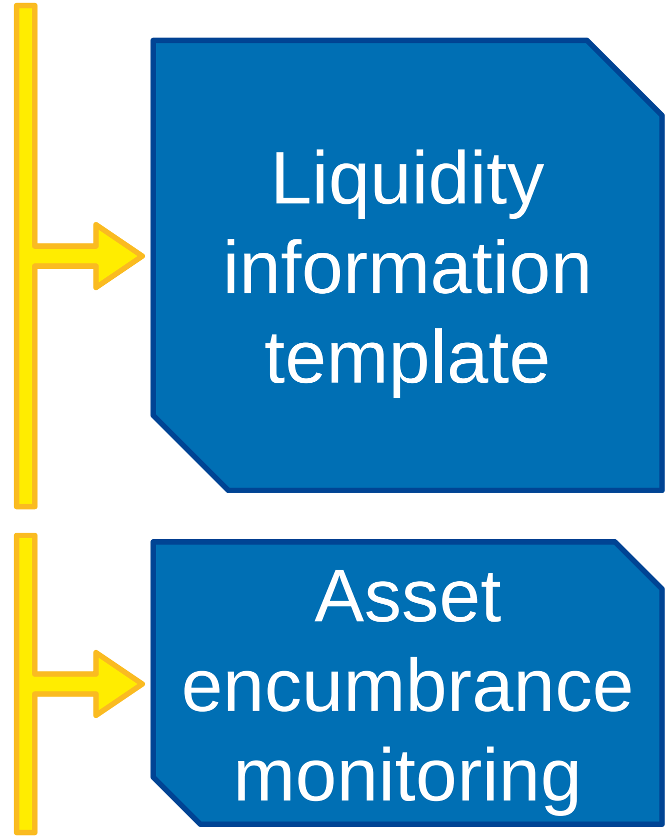
► Even if a bank is well recapitalized after the resolution weekend, it is expected that it will still experience **liquidity stress** due to:

- **Liquidity outflows**: depositors may withdraw their money and creditors terminate their operations with the bank;
- **Difficulties to access market funding**: private counterparties will likely be reluctant to deal with the bank in the immediate aftermath of a resolution, at least on an unsecured basis.

► **Secured funding**, either with private counterparties, or more likely with central banks will play a key role for funding in resolution, but enough collateral (quality and quantity) is not necessarily available in all cases.

5 | LIQUIDITY ISSUES ARE KEY FOR RESOLUTION PLANNING (1/3)

1. Get a precise **understanding of the liquidity position of each bank and its funding structure**, incl. stock of liquid assets and the projections of cash inflows and outflows.
2. **Evaluate the liquidity needs** that could arise after the resolution weekend on the basis of the information available and according to the preferred resolution strategy and tool(s).
3. **Ensure at all times that resolvability** of the institutions, through the availability of liquidity-providing options that could be activated to meet the potential liquidity needs after a resolution.



6 | LIQUIDITY ISSUES ARE KEY FOR RESOLUTION PLANNING (2/3)

To achieve these objectives, resolution authorities work closely with supervisory authorities and banks to assess:

► The banks' funding structure (funding resources and needs) in going concern and in stressed situations.

- E.g. funding through the markets, deposits, short term/long term exposures.

► The banks' counterbalancing capacities at the point of the crisis, in particular the collateral available.

► The impact of recovery options (e.g. deleveraging capacities, sale of business).

► The impact of liquidity stress tests / past crisis situations.

► The banks' capabilities to deliver reliable data in a timely manner.

7 | LIQUIDITY ISSUES ARE KEY FOR RESOLUTION PLANNING (3/3)

► Resolution authorities expect banks to develop the capabilities to monitor, report and estimate sources and liquidity positions for the material operating entities.

- The monitoring of liquidity in crisis requests updated data on a daily basis under stress conditions to assess the liquidity outflows and inflows.
- IT systems should be sufficiently flexible to provide information suitable for decision-making under different resolution scenarios ("fast burn" and "slow burn" failures).

► Monitoring asset encumbrance and identification of assets that can be mobilised as collateral across the group.

- Banks should be in a position to rapidly identify assets that:
  - may be eligible to support resolution funding, including less liquid assets.
  - could be used as collateral for secured funding either through the market or through public funding (e.g. central bank).

8 | ROLE PLAYED BY CENTRAL BANK LIQUIDITY AND NEED OF A PUBLIC BACKSTOP (1/4)

- The first objective of resolution planning is to get funding through the private market. Once recapitalized, the bank should also get access to the normal monetary policy post resolution.

- Nevertheless, in many cases, it is likely that **temporary public funding** will be necessary at the point of resolution to let the time to restore market confidence and to take appropriate actions.

- In the Banking Union, three public sources of funding could be considered: **ordinary central bank facilities**, **Emergency Liquidity Assistance (ELA)** and the liquidity support from the **Single Resolution Fund (SRF).**

- **The use of the SRF and ELA is never envisaged in resolution plans**; nevertheless, the IRTs discuss with the groups during the resolution planning phase on the groups' capabilities to identify collateral potentially available for secured funding, in particular for accessing ordinary central bank facilities.

9 | ROLE PLAYED BY CENTRAL BANK LIQUIDITY AND NEED OF A PUBLIC BACKSTOP (2/4)

- ►**Ordinary central bank facilities/ELA** can be available to a bank in resolution provided it is recapitalised and it could provide a sufficient amount of collateral to secure the funding. ELA remains an emergency measure at the risks of the national central bank which provided for it.

- ►The **SRF may provide liquidity support** to a bank through a loan, a guarantee on liabilities or a combination of both instruments. This liquidity support may be used as a complement or enhancement for the ECB/National Central Banks' facilities.

- ►The SRB is aware of the constraints that the ECB and National Central Banks face for liquidity provisioning. However, **the role of Central Banks is key for two reasons** - **immediate** capacity to grant **sufficient** liquidity.

- ►The articulation of the different possible sources of liquidity in resolution is crucial in the provision of the appropriate amount of liquidity. For this reason, the ECB and the SRB work closely to handle funding stresses in resolution.

10 | ROLE PLAYED BY CENTRAL BANK LIQUIDITY AND NEED OF A PUBLIC BACKSTOP (3/4)

Lessons learnt from the Banco Popular Case (June 2017):

- ►The resolution of Banco Popular was the first big case of bank failure handled by the SRB.
- ►Emergency Liquidity Assistance (ELA) funding was given by the Bank of Spain ahead of the resolution decision, but this funding was not sufficient to prevent a bank-run.
- ►The day after the resolution decision, the buyer (Banco Santander) provided a lot of funding, which might have been difficult to find in other circumstances.
- ►Following the resolution of Banco Popular, it was recognized by all stakeholders that a solution, capable of addressing any future crisis, should be found, in particular for the largest banks.

11 | ROLE PLAYED BY CENTRAL BANK LIQUIDITY AND NEED OF A PUBLIC BACKSTOP (4/4)

►Although tools exist for the Banking Union, they also bear constraints to fund a bank in resolution:

- ELA is not initially designed to fund a bank in resolution and ordinary central bank facilities are not tailored for the specificities of a bank in resolution
- The SRF is limited in size.

►For ordinary central bank facilities, there are conditions in terms of eligibility and hair cutting. Hence, an additional mechanism should be set up to reinforce the confidence of the market:

- Resolution authorities and markets should have certainty there are tools available for finalising all features of the resolution scheme, including funding.
- The scale of the mechanism must be sizable and flexible enough to support the effective implementation of any resolution strategy.
- Only viable and solvent institutions in resolution should be supported with funding.

►Such a tool would address open issues in the current system and put the BU framework at equal footing with other jurisdictions such as the US or UK.

12 | LIQUIDITY IN RESOLUTION – THE UK APPROACH

- ►The Bank of England and the Treasury implemented in 2017 the Resolution Liquidity Framework (RLF). The RLF supplements the use of regular central bank's facilities.
- ►There are no official caps on the scale, the duration and the rates applied to this type of liquidity support, as long as it is enough to *"allow the firm to make the transition to market-based funding*".
- ►The liquidity is provided by the Bank of England against collateral, building on the collateral eligible for the other central bank's facilities. The use of the RLF is available upon approval from the Treasury.
- ►There is no resolution fund based on taxpayer's money. Ultimately the industry carries the risk of the liquidity support through funds raised by a bank levy.

13 | LIQUIDITY IN RESOLUTION – THE US APPROACH

► Title II of the Dodd Frank Act sets out the framework for resolving complex systemically important financial institutions (SIFIs), where liquidation through ordinary bankruptcy law would pose a threat to financial stability.

► The bank is declared by the Federal Reserve and the FDIC as 'in default or in danger of default'. The Secretary of the Treasury determines with the President that the conditions to trigger resolution are met and appoints FDIC as the receiver of the failed company and the Orderly Liquidation Authority.

► As resolution authority, the FDIC can borrow from the Treasury's resolution fund, the Orderly Liquidation Fund (OLF).

► The Treasury sets the amount, interest rate and duration of the advances. The OLF provides temporary liquidity to the bridge financial company, which ceases to exist as soon as private funding is again available. The funds are provided on a *"fully secured basis"*. There is also the option for OLF to provide a guarantee.

► The use of the fund can go up to 10 percent of the total consolidated assets of the bank until the Secretary of the Treasury and the FDIC agree on a plan and schedule for the repayments.

► The fund is financed *ex post*. The FDIC borrows from the Treasury to finance the resolution. If there is a net cost to the resolution, it is recouped by the FDIC through recoveries of the assets of the failed bank or contributions from the financial sector.

14 | CONCLUSION

- ►It is now well acknowledged that the current legislative framework (BRRD and, SRMR for the Banking Union) does not entirely address the liquidity issue.
- ►The SRB is supportive of all solutions which give confidence in its capacity to adopt and implement fully-fledged resolution schemes.
- ►As such, the SRB is ready to use the SRF resources but cannot be, for the biggest institutions, the only liquidity provider.
- ►Work should continue with the ECB and other public institutions, like the ESM, to find a robust solution.

THANK YOU!

For more information, please contact:
SRB-INFO@srb.Europa.eu

Single
Resolution Board