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EBF Response to FSB consultation on Funding Strategy Elements of an Implementable Resolution Plan

The European Banking Federation welcomes the Guidance on Funding Strategy Elements of an Implementable Resolution Plan. For your consideration, we have provided the following key messages and answers to the consultation questions below.

Key Points

- ◆ EBF supports the approach provided by the FSB which aims at operationalising funding within the resolution planning.
- ◆ As recognized in part 4, banks in resolution situations should have the guarantee of a credible public back stop for use when necessary, with a clear understanding of the liquidity resources available and conditions to be met.
- ◆ A clear message needs to be sent following a resolution process that the bank is solvent again and that access to liquidity sources will mitigate concerns and facilitate private investors to step in.
- ◆ Conservative liquidity indicators such as the LCR and NSFR should neither be duplicated nor recalibrated for resolution. The LCR quantifies liquidity needs in a stress scenario for 30 days. If a resolution strategy cannot be implemented during this period then the resolution strategy might not be the right answer.
- ◆ Responsibilities between authorities and banks should be clarified. The fulfilment of “the principles for sound liquidity risk management and supervision” proposed by BCBS should be enough to cover section 1 of the FSB consultation paper. However, in order to get organised and act quickly to estimate liquidity needs, the communication between resolution authorities and banks should be guaranteed.
- ◆ We support the elements in the consultative document that confirm that home and host resolution authorities, central banks and supervisors should cooperate to support the consistent and effective implementation of group-wide and local funding plans, as well as establish clear protocols and division of responsibilities during both a resolution scenario and the events leading up to that point, and that plans should be detailed and established timely, in advance and to fit banks with cross-border banking models. These plans should then e.g. include how collateral can be utilised, even if eligibility criteria between central banks differ and cash is needed in currencies which differ from collateral the bank is holding.
- ◆ A bank should be allowed to be in breach of its LCR/NSFR in the first steps of resolution or at least to be able to take central bank eligible assets into account in the reserves for LCR and NSFR computation.

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Answers to consultation Questions

1. Do the funding strategy elements in the consultative document address all relevant aspects of a resolution funding plan? What other aspects, if any, should be considered?

The EBF supports the FSB's initiative to address funding strategy elements of an implementable resolution plan.

- **A credible public liquidity guaranteed backstop is needed for limited scenarios.**

With the current liquidity regulatory framework in place, it seems less probable that past cases could be repeated (i.e. Northern Rock failed because of poor liquidity risk management). Nowadays, it is very likely that if an entity fails because of liquidity, the reasons behind the failure are linked to a reputational or solvency problem.

For these circumstances, no matter the amount of liquid assets that banks may hold, the assurance that a liquidity backstop in case is needed to help implementing the resolution strategy. Very high LCR ratios do not protect against these situations. A clear message needs to be sent following a resolution process that the bank is solvent again and that access to liquidity sources will mitigate concerns and facilitate private investors to step in. New potential liquidity requirements would not solve reputational or solvency problems.

In this context, it is essential to have a clear understanding of liquidity resources, in every jurisdiction, in particular in an on-going crisis situation.

The FSB guidance should make a clearer distinction between different types of scenarios for which the efficient and possible measures will not be the same: i.e. slow burn or fast burn scenarios (see section 3.2 in FSB consultation) need to be placed in the context of an idiosyncratic and/or systemic crisis:

- In case of a fast burn scenario, the firm would still have liquidity reserves. The liquidity actions of the recovery plan would not have had sufficient time to be fully implemented. In that case, funding in resolution could be dealt with through the implementation of those actions, in particular the use of the remaining central bank eligible collateral.
- In case of a slow burn scenario, it seems important that the resolution plan takes into account the economic conditions at the time of the entry into resolution:
 - Systemic crisis: it can be expected that central banks will ease their collateral policy by accepting broader types of collateral (e.g. non-investment grade assets, residential loans, consumer loans, etc.). Many arrangements of that type have already been put in place in the last few years (e.g. ACC Immo in France). However, it seems hard to expect clarity from central banks about the criteria for new eligible collateral would be. A general statement from central banks, in this type of situation, that institutions would have a broader possibility to bring collateral with appropriate haircuts would be more helpful.

- Idiosyncratic crisis: a change in central banks collateral policy is hardly conceivable in case of an idiosyncratic situation (the central bank will not adapt its general conventional policy for one institution). In that case, the bank will have already used all its funding capacity before the entry into resolution. The funding strategy of the resolution plan should therefore mainly rely on liquidity providing resolution actions (sale of business and asset separation). As in this case the whole financial system is still in good shape, it should be less problematic to find private sources of funding as in the first case (systemic crisis). Besides those actions, the only other possible liquidity source would be Emergency Liquidity Assistance (ELA) in the banking union (or equivalent), however:
 - Article 10 (3)(b) of the BRRD (SRM Art 8(6)(b) states that "*the resolution plan shall not assume any Central Bank emergency liquidity assistance*", but we welcome the clarification by the FSB that the identification of temporary public sector backstop mechanisms (such as ELA) does not equate to an assumption that such funding is necessarily available (footnote 18);
 - up until a threshold amount of EUR 2bn the main responsibility for the provision of ELA lies at the national level, with the NCB concerned. But according to the agreement on ELA¹, when the ELA operations are above this threshold, the Governing Council of the ECB can decide to prohibit the execution of the operations if there is a risk that the respective ELA interferes with the single monetary policy of the Eurosystem.

The latter situation (slow burn scenario in an idiosyncratic crisis) seems to be the more difficult to deal with. The possible recourse to a credible public back-stop is the appropriate solution. This backstop should be in line with the FSB guiding principles (temporary and necessary funding, minimising moral hazard).

- **More coordination between authorities could improve the resolution outcomes.**

Further, the FSB guidance should specify more precisely the responsibilities of both the supervision authority and the resolution authority. This would permit a better harmonisation of practices and give more visibility to the banking industry.

- **Monitoring requirements in resolution can lean on existing supervisory requirements.**

In this sense, entities manage their liquidity risk according to the principles for sound liquidity risk management and supervision, which are designed by BCBS for banks in a going concern, and the supervisor's recommendations and their local liquidity requirements (which supervisors use as early warning tools).

The supervisors in the context of the supervisory review and evaluation process must assess the fulfilment of the legal requirements and the way the entities manage, value

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https://www.ecb.europa.eu/pub/pdf/other/Agreement_on_emergency_liquidity_assistance_20170517.en.pdf?23bb6a68e85e0715839088d0a23011db

and control their liquidity risk. Supervisory measures, early intervention measures or even the declaration of failing or likely to fail can be triggered once the aforementioned analysis has been carried out by supervisors. It should be clearly stated that liquidity monitoring requirements in resolution can lean on existing supervisory requirements. It is important to avoid the implementation of new requirements.

We think that other liquidity requirements or more stressed calibration of the current indicators (mainly LCR) will not solve the potential problem of liquidity in resolution. Furthermore, we think these regulatory measures could be procyclical forcing supervisors to declare an entity failing or likely to fail well in advance it really becoming necessary.

Moreover, it seems useful to clarify responsibilities between authorities and banks. Indeed, banks in the EU may not have access to the detailed resolution plan defined by resolution authorities. As such, if several scenarios are defined, the bank should know which is the resolution strategy favoured by the resolution authority.

2. Do you foresee any challenges in the development of firm capabilities to facilitate the execution of the funding strategy, as set out in section 1?

The consultative document should specify which actions carried out by different authorities (supervisors and resolution authorities) should be realised during each of the resolution periods (early intervention/entry into resolution/moratorium/resolution) while being mindful not to overload the bank with operational requirements that would slow down the recovery and/or resolution process.

For example, the methodology for estimating liquidity needs for resolution (paragraph 1.1) should prioritise the central scenario defined by the resolution authority, instead of multiplying the scenarios. We find other elements in paragraph 1.1 which overlap with the resolution authorities' and supervisors' responsibilities (i.e. operational obstacles to transferring funds between entities within centrally managed banking group with an SPE resolution strategy, forecasting the schedule of liquidity inflows and outflows).

3. Does section 1 identify all relevant aspects for estimating liquidity needs for resolution? What other aspects, if any, should be considered?

The implementation of the resolution strategy (as a last stage in the resolution process) should concentrate on the strategy defined by the resolution authority and not evaluate multiple scenarios.

Furthermore, in order to get organised and act quickly to estimate liquidity needs, we ask for more communication between resolution authorities and banks, on the resolution strategy.

For cross-border banks, central banks should contract swap each other, in order to reply to liquidity needs in foreign currencies.

Conservative liquidity indicators such as the LCR and NSFR should not be duplicated for resolution.

Additional liquidity requirements or an increased calibration of the current indicators (mainly LCR) will not solve the potential problem of liquidity in resolution. Furthermore, these regulatory measures could be procyclical forcing supervisors to declare an entity failing or likely to fail long before it really becomes necessary.

It should be specified that monitoring current requirements for liquidity indicators should leverage on the supervisory reporting framework.

4. Are there any obstacles to the identification and mobilisation of assets that could be used as collateral for both private and temporary public sector backstop sources of funding? How might any such obstacles be addressed?

As we have already mentioned, entities have to manage, monitor and value the liquidity risk according to the BCBS principles. One of the principles implies to have monitoring tools which allow entities to monitor assets which could be used as collateral. Collateral acceptance criterion for credit institutions under resolution should be flexible.

After resolution, entities may be solvent but with not enough collateral. For these exceptional cases, a credible public backstop should be granted. See question 5.

5. Are there any other actions that should be taken by G-SIBs and authorities to support the development and implementation of resolution funding plans?

We agree with the idea set forth in paragraph 3.3.: "The resolution funding plan should consider such actions (where permitted under the relevant legal framework, public sector backstop guarantees) to the extent they are available under the legal framework of the relevant jurisdictions." We encourage the FSB to inspire regulators to permit the possibility of including public sector backstop guarantees in the resolution planning and to support these in the respective legal frameworks for recovery and resolution.

After the recapitalization of a financial institution, resolution authorities may provide a guarantee and/or collateral to the relevant central bank for the provision of temporary funding. The necessity and the amount of this potential collateral requirement should take this recapitalised position into account. Where there are resolution funds, e.g. Single Resolution Fund (SRF) for the banking union, these funds might subrogate their claims to central bank positions once the SRF (funded by the private sector) is able to gather the amount of money needed. This would be in line with the spirit and existing concepts of current resolution regulations.

We do not agree with the idea of introducing quantitative indicators to determine whether an entity has entered into resolution. Furthermore, it would be very dangerous to link these indicators to the estimated potential liquidity needs that a bank would need to

implement a resolution strategy. Trying to estimate potential liquidity needs by assuming different hypothesis and counterparties' behaviour is a necessary exercise, but the outcome should never trigger resolution as these benchmarks themselves would become a self-fulfilling prophecy. Instead, the recovery indicators and the performance of the measures put in action following the recovery plan should be assessed by the competent authority and the resolution authority as the current framework already indicates.

Another key aspect that we should not overlook is communication. One of the main liquidity challenges for a bank after a resolution will be to regain the confidence of depositors. For example, it is essential to communicate that the resolved banks have been sufficiently recapitalised to achieve market confidence. It would also be useful for a resolved bank (at least temporarily) to take central bank eligible assets into account for its LCR and NSFR reserves in order to publish positive ratios (this is already possible for the LCR purpose through the restricted-use of committed liquidity facilities).

Furthermore, coordinated communication is key to preserve the credibility of the process. Markets and litigators can seize on these differences to allege that authorities were divided. A credible resolution framework is key for financial stability and market certainty. To help secure the success of future cases, exercises should perhaps include previously agreed communications to assure a united front when intervention or resolution proves necessary.

Finally, we support the elements in the consultative document that confirms that home and host resolution authorities, central banks and supervisors should cooperate to support the consistent and effective implementation of group-wide and local funding plans, as well as establish clear protocols and division of responsibilities during both a resolution scenario and the events leading up to that point, and that plans should be detailed and established timely, in advance and to fit banks with cross-border banking models. These plans should then e.g. include how collateral can be utilised, even if eligibility lists for collateral differ between central banks and the cash is needed in currencies which differ from the collateral the bank is holding.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.5 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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