The importance of resolution planning and loss-absorbing capacity for banks systemic in failure

Public statement

Ensuring bank resolvability remains the most efficient way to tackle the problem of the implicit 'too big to fail' subsidy for big banks and to avoid a bail-out by the taxpayer.[1] The lessons from the 2023 bank failures reinforced the need to maintain momentum and advance the work on bank resolvability and to avoid complacency.[2] That experience underscored that any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime that has the attributes set out in the FSB *Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes)*.[3] The FSB's work on bank resolution until now has primarily focused on global systemically important banks (G-SIBs). Significant progress has been made to enhance their resolvability since the adoption of the FSB's Key Attributes. However, existing FSB guidance on resolution planning and resolution execution may also be relevant for other banks that may be systemically significant or critical if they fail ("banks systemic in failure"). The failure of such banks could also have severe consequences for the financial system or the broader economy, and authorities and such banks should be prepared for resolution. Previous FSB evaluations, [4] peer reviews,[5] and technical work undertaken by the FSB[6] suggest further work is needed on operationalising resolution planning for these banks. The current statement aims to clarify the importance of resolution preparedness for these banks, recognising that the principles outlined are already established for G-SIBs.

Following the March 2023 bank failures,[7] the FSB held a workshop on banks systemic in failure. This statement is informed by discussions at that workshop and other ongoing work. Below are some considerations to inform jurisdictions' regulatory and policy frameworks for the resolution preparedness of banks systemic in failure. Besides its work on G-SIBs, the FSB will continue to consider banks systemic in failure in its future work on bank resolution planning topics.

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1 FSB (2023), *2023 Bank Failures: Preliminary lessons learnt for resolution*, October.

2 FSB (2023), *2023 Resolution Report: 'Applying Lessons Learnt'*, December.

3 FSB (2024), *Key Attributes of Effective Resolution Regimes for Financial Institutions (revised version 2024)*, April. The Key Attributes were adopted by the FSB Plenary in October 2011 and endorsed by the G20 Heads of State and Government as "a new international standard for resolution regimes" at the Cannes Summit in November 2011.

4 FSB (2021), *Evaluation of the effects of too-big-to-fail reforms: Final Report*, March.

5 FSB (2019), *Thematic Peer Review on Bank Resolution Planning*, April.

6 FSB (2022), *2022 Resolution report: Completing the agenda and sustaining progress*, December.

7 FSB (2023), *2023 Bank Failures: Preliminary lessons learnt for resolution*, October.

Authorities should assess which banks may be systemically significant or critical if they fail

Resolution authorities, in coordination with other relevant authorities, should assess which banks may be systemically significant or critical if they fail. Authorities should ensure they have sufficient information to make this assessment in normal times and in a crisis. This also includes banks that were not explicitly designated as systemically significant or critical prior to their failure.

Authorities and banks systemic in failure should be prepared for resolution

Authorities should have the appropriate resources, tools, and powers to, if needed, resolve banks systemic in failure. Authorities' preparedness includes having an up-to-date assessment of the options available to conduct such resolution, and assurance that such options can be implemented quickly and effectively. Banks systemic in failure should ensure they are resolvable in a way that protects their critical functions without severe systemic disruption and avoids the use of taxpayers' money.

Authorities should consider the need for loss-absorbing capacity

Loss-absorbing capacity (LAC) on the balance sheet of a bank enhances authorities' ability to resolve the bank without severe systemic disruptions and without the use of taxpayers' money. It also provides for an additional layer of loss-absorption that may prevent negative systemic effects and uninsured depositors from taking losses, which may forestall or reduce deposit runs.

At the same time, banks and banking systems in different jurisdictions have different characteristics. For this reason, jurisdictions need to consider how to best implement the concept of LAC for banks established in their jurisdictions. Some TLAC Principles for G-SIBs are relevant also for other banks systemic in failure. A number of FSB jurisdictions have already adopted external LAC requirements for banks, beyond G-SIBs, that could be systemically significant or critical if they fail, where authorities set the amount, quantity and implementation timeline on a case-by-case basis. Such LAC requirements are for instance applied to all banks (EU, Hong Kong, UK), to D-SIBs (Canada, Mexico, Switzerland), or to a subset of D-SIBs (Japan).[8]

[8] In the US, the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation requested comment on a proposed rule on *Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions*.

Annex: Background to the FSB's public statement

Introduction

In November 2023, the FSB held a workshop on how authorities assess systemic significance of banks and issues related to LAC (i.e., a set of capital and debt instruments to ensure loss absorbency and recapitalisation in crisis) for banks other than G-SIBs. The discussions were informed by the failures of three large regional banks in the United States in early 2023, which confirmed that banks not identified as G-SIBs can still be systemically significant or critical if they fail. Workshop participants discussed jurisdictions' practices in assessing systemic significance, existing jurisdictional LAC frameworks, challenges identified when a bank issues LAC, cross-border aspects of LAC, and the extent to which the Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution (TLAC Principles)[9] may also be relevant for other banks systemic in failure.

The workshop discussions informed the development of the above public statement, which provides considerations to inform jurisdictions' regulatory and policy frameworks for the resolution preparedness of banks systemic in failure. Such banks are subject to a large variety of jurisdictional frameworks, provide different economic functions, and function in different economic structures. Therefore, each jurisdiction needs to determine which of its banks other than G-SIBs may be systemic in failure and how to best ensure that these banks can be resolved in an orderly manner without exposing taxpayers to loss from solvency support, while maintaining continuity of banks' vital economic functions. Such determinations are relevant both during resolution planning and at the time of a bank's failure.

Assessing systemic significance and criticality

Having an ex-ante view on whether a bank may be systemically significant or critical if it fails supports resolution authorities' preparedness and informs the resolvability requirements authorities may impose on banks, including a LAC requirement. To assist authorities in assessing systemic significance in the context of resolution planning, two international guidance documents are available, the implications of which authorities should assess not only on a standalone basis, but also jointly. The FSB Guidance on Identification of Critical Functions and Critical Shared Services[10] and the Basel Committee on Banking Supervision (BCBS) standard SCO50 on domestic systemically important banks (D-SIBs)[11] both provide an ex-ante view on systemic significance or criticality. Each of these standards then focuses on a different point in the lifecycle of a bank (i.e., the BCBS standard is on systemic importance in going concern, while the FSB guidance covers criticality in failure) and thus the results of their standalone application may not be the same. Jurisdictions' existing practices are generally based on either the FSB guidance or the BCBS standard, or elements of both.

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9 FSB (2015), *TLAC Principles and Term Sheet*, November.

10 FSB (2013), *Guidance on Identification of Critical Functions and Critical Shared Services*, July.

11 See BCBS principles to identify domestic systemically important banks, SCO50 Domestic systemically important banks.

Designating some banks as systemically significant or critical to subject them to resolution planning and LAC requirements may affect not only an individual bank but also indirectly other market participants (e.g. smaller banks that would be ordinarily liquidated in a crisis). Therefore, in addition to financial stability considerations and broader resolution objectives, when designating banks as systemically significant or critical, it would be important to consider such indirect impacts.

Notwithstanding ex-ante assessments, extraordinary circumstances may prompt authorities to consider a bank systemically significant or critical at the time of failure, for example if there is a risk of wider-than-expected contagion, which may require them to exercise their resolution powers in a different manner than they would have done absent those circumstances. It is thus appropriate that authorities also consider upfront how they would approach assessing systemic significance or criticality at the moment of failure, and what information they may need for those assessments. Elements of both frameworks – the FSB Guidance and the BCBS standard SCO50 – can inform such assessments.

Loss-absorbing capacity

Having LAC on banks' balance sheets provides several benefits. These include the enhanced capability for authorities to resolve those banks without severe systemic disruption and without exposing taxpayers to loss from solvency support. Additionally, the availability of sufficient LAC, which provides an additional layer of loss-absorption before uninsured deposits, may forestall or largely reduce deposit runs.[12] LAC is not only relevant when resolving a bank via bail-in but also when resolving a bank via the use of transfer tools. Absent sufficient LAC to recapitalise a bank, resolution authorities might have to resort to other sources of loss-absorption to execute resolution successfully.[13]

LAC requirements for banks systemic in failure support authorities' efforts to mitigate risks to financial stability. When setting or reviewing their LAC policy, authorities may consider the underlying rationale of the TLAC Principles and the Guiding Principles on Internal TLAC applicable to G-SIBs[14] also for other banks systemic in failure. Existing jurisdictional LAC frameworks for such banks tend to reflect the following TLAC Principles:[15]

- There must be sufficient loss-absorbing and recapitalisation capacity available in resolution to implement an orderly resolution that minimises any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers (that is, public funds) to loss with a high degree of confidence. (cf. TLAC Principle (i)).

- Investors, creditors, counterparties, customers and depositors should have clarity about the order in which they will absorb losses in resolution (cf. TLAC Principle (xi)). A

12 See, for example, FDIC (2023), *Remarks by Chairman Martin J. Gruenberg on The Resolution of Large Regional Banks — Lessons Learned*, August.

13 Examples of such sources are a resolution fund; a deposit insurance fund that can contribute to resolution; or, as a last resort, support by public authorities with ex-post reimbursement by banks.

14 FSB (2017), *Guiding Principles on the Internal Total Loss-Absorbing Capacity of G-SIBs ('Internal TLAC')*, July.

15 This is a non-exhaustive list and does not intend to suggest that remaining TLAC principles might not be relevant when considering loss-absorbing capacity for banks systemic in failure.

transparent hierarchy of liabilities on a legal entity basis for all resolution entities and material subgroup entities in the group provides clarity about how losses are absorbed and recapitalisation is effected in resolution.

- Instruments that are eligible to meet minimum LAC requirements should be stable, long-term claims that are not repayable on demand or at short notice (cf. TLAC Principle (viii)). Maturity restrictions on LAC instruments are important to ensure that, if a bank's financial situation deteriorates, the loss-absorbing capacity available in any subsequent resolution is not diminished through a withdrawal of funds.

- Exposing instruments eligible for minimum LAC to loss should be legally enforceable and should not give rise to systemic risk or disruption to the provision of critical functions (cf. TLAC Principle (vii)). Subordination (whether statutory, structural, or contractual) of eligible LAC to operational liabilities on which the performance of critical functions depends can help ensure that the eligible LAC can be credibly and feasibly loss-absorbing.

The nature and operating environment of the jurisdiction's banking sector is important when considering the feasibility and design of any domestic LAC framework. There is significant variation across jurisdictions in banks' business models, available financial safety nets, and characteristics of domestic financial markets. These variations may partially explain why different jurisdictions take different approaches to LAC frameworks, for instance in terms of requirements on the amount or quality of instruments eligible to count as LAC, or scope of application. If a jurisdiction intends to implement a LAC framework, the assessment of banks' systemic significance or criticality in failure will be an important aspect that informs the framework's scope of application.

There are considerations that may be relevant for some jurisdictions regarding issuing LAC, such as demand in the market, banks' funding costs, and preparing for issuing LAC (such as obtaining a credit rating, compliance with securities laws and prospectus requirements, market outreach, and know-how). That said, there have been examples of jurisdictions with less advanced debt markets in which small- and medium-size banks successfully issued LAC.

Several measures may be available to authorities to address these considerations. For example, they could phase in a LAC framework and calibrate proportionately the target levels for the amount and quality of LAC requirements in line with the preferred resolution strategy. Moreover, they could induce banks systemic in failure to: (i) conduct self-assessments on the LAC eligibility of their debt instruments, (ii) obtain a credit rating, and (iii) involve external advisers to increase market outreach and broaden their investor base. Authorities could also: (i) consider the relevant factors (e.g. access to capital markets) in determining the timeline for LAC implementation, (ii) support banks to develop a well-established issuance plan, and (iii) engage with market participants to promote understanding of resolution and LAC instruments and closely monitor market responses to LAC issuances.

Cross-border aspects

The distress of a bank systemic in failure can create cross-border spillovers. Since financial systems are interconnected across borders, banks that are systemic for a national financial

system can also have an international footprint. It is therefore important for authorities to consider potential spillover effects when considering the resolvability of a bank. There are also cases where a bank may be systemic in the host jurisdiction, but the home authority has not made this determination for the group, or the operations in the host jurisdiction are not considered material to the group. In such cases, it is nonetheless important for authorities to establish avenues for cross-border information exchange and cooperation. Structures similar to the Crisis Management Groups (CMGs) that are in place for G-SIBs may be appropriate for other banks with systemic cross-border presence. Additionally, the FSB guidance on cooperation with non-CMG host authorities might provide useful considerations for cases of cross-border banks systemic in failure where CMG-like structures are not presently in place.[16]

A number of jurisdictions have adopted internal LAC requirements in order to ensure the appropriate distribution of loss-absorbing and recapitalisation capacity within resolution groups for banks systemic in failure, following principles and eligibility features similar to those prescribed in the Guiding Principles on Internal TLAC of G-SIBs. Authorities and banks would need to consider any legal and operational constraints in deploying resources across borders, including the upstreaming of losses from a subsidiary to a foreign parent (beyond equity losses).[17]

[16] FSB (2015), *Guidance on Cooperation and Information Sharing with Host Authorities of Jurisdictions where a GSIFI has a Systemic Presence that are Not Represented on its CMG*, November.

[17] See also FSB (2023), *Deployment of Unallocated Total Loss-Absorbing Capacity (uTLAC): Considerations for Crisis Management Groups (CMGs)*, July.