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Cross-border bank resolution: how to make it workable?

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Objectives of the session

Banks need to issue significant amounts of TLAC/MREL instruments and investors require a clear understanding of these products and under what conditions they will assume losses.

In such a context, the objective of this session was to discuss the remaining challenges regarding the EU resolution framework taking into account the global context. Speakers were also invited to assess the obstacles to the smooth resolution of a global bank.

Executive Summary

1. EU Resolution Framework

The rationale for the discussion was to ensure that the right instruments were available to let taxpayers 'off the hook' following the financial crisis, and de risking the banking system. For the single currency's purposes, it might be necessary to have a single decision making body. For cross-border groups and those under the single supervisor, there was now a single resolution authority in the form of the banking union, although some areas needed to be clarified further.

Differences between MREL and TLAC

A number of representatives of resolution authorities agreed that TLAC and MREL were 'two sides of the same coin'. One explained that TLAC, as the international standard, was required to be 18% of risk-weighted assets and 6.75% of leverage ratio as from 1 January 2022 (16% of RWA and 6% of leverage ratio as from 1 January 2019). It was relatively easy to implement the main features of TLAC within the MREL framework; however, for this to take place, a change in legislation would be necessary, for which a proposal was currently being mooted. To reconcile MREL and TLAC in relation to G-SIBs, the best approach would be to begin with a standard MREL requirement for G-SIBs that was entirely consistent with the TLAC term sheet, before building the Pillar II aspect on top. Another panel member noted that Europe was trying to guarantee stability in the market by addressing systemic institutions, but was disregarding the systemic impact of bailing in certain asset classes, such as senior debt or deposits. Attention would need to be paid to this issue, especially as the stability elements of the package had not been addressed.

The UK's proposal regarding MREL had had a constructive intent behind it: MREL and TLAC needed to be aligned in order to implement them beyond the borders of the EU, and this proposal demonstrated that this synthesis could be achieved. Banks and regulators had previously been looking at different aspects of this question, but Europe needed to start considering what the unintended consequences might be in five years' time, and identify whether anything that had been introduced might have a destabilising impact. One bank had considered how it could meet its TLAC requirements in five years' time, and had concluded that it could not: these needed to be met on an on-going basis. One risk was the risk of liquidity not being forthcoming to refinance TLAC or the MREL liabilities, which added an element of instability during the interim period.

Who would invest in these bail-in instruments?

Investors also needed clarity regarding the creditor hierarchy, which meant having consistency across countries. They also needed clarity in relation to the precise definition of the MREL targets; as of the third quarter, investors still did not know the liabilities accepted, or anything about calibration and compatibility with business models, which was key to institutions' financial planning and capital planning of institutions.

It was important to preserve neutrality of design in relation to business models when designing resolution approaches. In order to fulfil the requirements of MREL and TLAC, an institution should not need to change anything particularly substantial about its business model; this was especially true regarding the SPE/MPE organisation of a bank. If an MPE group were treated as a consolidated group in relation to resolution, it was not clear what would be done about bail-in-able instruments in small jurisdictions where it was very difficult to issue subordinated debt.

For a common framework for subordination

Having a common European approach to the different types of debt that could be eligible for MREL requirements would be desirable, but would take a long time to put in place; in the meantime, effective tools for resolution would need to be implemented. The Italians and the French had put in place reforms, with the French approach similar to that of Germany eventually.

However, it was not only subordination that needed to be considered, but also the counter-factual analysis and how to implement the framework in the context of different legal frameworks. More harmonisation on the insolvency law front and a more harmonised approach to creditor hierarchy would be desirable, although this would not be easy to achieve. A representative of a resolution authority reminded the audience that in any resolution, we have the counterfactual analysis and we have to prove that the creditor is not worse off than in insolvency. Therefore clarity and transparency were vital: investors should know that somebody who had invested in a deeply subordinated tool would hopefully never be called upon, but would be called upon before someone who had invested in a senior investment, and that only investors in guaranteed deposits would never be called.

The 8% issue was a controversial topic

BRRD and the SRM regulation had come into full effect on 1 January 2016, and there was now a mandatory bail in scheme, with bail-in decided by creditor hierarchy and not by credit name or wealth. European legislation made clear that MREL was a Pillar II requirement; it needed to be set entity by entity and was entirely risk specific. Resolution authorities would want to have all possible tools available, part of which was respecting that the SRB would need to bail-in de minimis 8% of total liability before it had access to the Single Resolution Fund. For these 120 systemically important institutions, and only these institutions, MREL of potentially 8% of total liability would be the norm.

There was a controversial discussion of this 8% rule: one banking representative stated that there needed to be increased clarity regarding what this 8% referred to, as BRRD made it very clear that this was an entry hurdle to the resolution fund, expressed as the amount of bail-in that had to occur: there was no direct link to MREL. It was also not clear how small institutions with a lot of NPLs could be asked to raise 8% of bail-in-able assets in the context of a non-performing economy and a low rate of interest, or how this was compatible with the European projects on capital markets union.

It was a common sense conclusion that a minimum MREL would need to be established for all of the banks, but this might give rise to very serious consequences if the minimum MREL were to be set at 8%, notably as a substantive part of bail-in-able debt was not included in the current MREL definition. Additionally, this should not mean that every resolution case should require use of the resolution fund.

2. Global Crisis Management Framework

Living Wills

US authorities had recently issued results, including deficiencies and/or shortcomings, for eight of the firms subject to US living will requirements, providing this feedback in a transparent manner with two joint public documents having been issued. The firms involved had been asked to deal with a number of issues in their next submissions, including sorting out the capital and liquidity necessary in resolution; establishing a methodology for determining what that might be, and ensuring that these resources could get to where they were needed; a governance process to promote confidence that resolution would be entered into at the appropriate time; and dealing with some of the operational continuity issues that would arise during resolution, while dealing with derivatives in a way that did not engender disruption. Legal entity rationalisation would also need to be tackled.

Cooperation between Home/Host Supervisors and Resolution Authorities

There had recently been a US proposal for TLAC, which would require the US subsidiary a European G-SIB to issue internal TLAC to its parent bank, even if even if an MPE resolution strategy is contemplated for the foreign firm. MPE firms have raised concerns regarding the proposed requirement that foreign banking operations operating in the US issue internal TLAC to the parent; these MPE firms had been used to issuing debt externally in the local jurisdiction, and this proposed requirement would cause an adjustment to that. These firms would also like to be viewed in the same way as some of the US regional banks that were of their size and more closely resembled them, and to be allowed to compete on that basis. This raised some difficult issues, and discussions were underway.

Meanwhile there was not yet sufficient confidence from the firm perspective in the home/host discussion to accept pre-positioning of internal TLAC that might be outside of cash instruments, or that the legal context would allow for such contractual arrangements to take precedence over a statutory approach. This ties to the viability of large institutions' cross-border resolvability. With one bank's assets located in a different country, subject to different law, supervisors tended to ring fence and take precautions, which was reflected in the rules and in other ways.

It was also important to note that, in small markets, it was inconceivable that the complex instruments that were issued in developed markets would be replicated, and SPE models had not yet been put to the test. Collaboration between home or host via MOUs could be helpful.

According to a leader of the industry, It was not yet clear whether enough had been done to reduce the amount of ring fencing that had been seen in the past; this could still be dealt with, because the rules were not in place yet and it was not yet clear how internal MREL or internal TLAC would need to be distributed within Europe. Europe needed to be careful to preserve the many different 'level playing fields' that it was host to: the trans Atlantic field, where G-SIBs from one continent adhered to the same rules as those from another, and the domestic 'playing fields' within individual European jurisdictions.

Many G-SIB groups had quite varied balance sheets, containing tranches of debt that would qualify for TLAC and be ideal for bail in, but many of their subsidiaries were straightforward retail deposit-funded banks in a particular jurisdiction. From the industry perspective, whatever was done in relation to internal TLAC should not interfere with those business models, and to ensure that this was the case, it would be necessary to find forms of non-cash and non-rigidifying MREL and TLAC, i.e. 'soft' MREL and TLAC in the form of guarantees. Such guarantees did not need to be collateralised: loss absorbency or recapitalisation should flow within a group, with due attention being paid to the need not to ring fence liquidity and capital, and thereby create problems with 'brittleness'.

Legal Backing for Effective Cross Border Resolution

Effective resolution of a cross-border bank requires a high degree of trust between supervisors before, during and after resolution. But some countries do not yet have a full resolution regime in place and of those that do, there are questions over whether they contain avenues for giving effect to the resolution actions of a foreign authority. This is the reason why the question is whether mutual confidence between supervisors needs to be supplemented by additional arrangements and what could be envisaged to favour such arrangements. The FSB has work in progress in this regard.

A representative of a bank stated that his institution's approach to meeting the TLAC requirements had been to do so via holding company issuance. This meant having a surplus of long dated funds at the centre; therefore, you were 'damned if you did, and damned if you did not'. Having these centrally while not needing them created a drag on the business, but these were not needed out in the group, either. The question was what kinds of arrangements his bank needed to implement – not only to meet the expectations of CMG countries, but also, and importantly, those of non-CMG countries as well – to find a good balance. His institution would not want to be over-deploying TLAC within the group, where there was a direct cost of holding it centrally.

Detailed Summary

EU Resolution Framework

Differences between Minimum Requirement for own funds and Eligible Liabilities (MREL) and Total Loss absorbing Capacity (TLAC)

A public authority speaker noted that the close connections between this panel discussion and the previous one related to “Towards an EU Deposit Insurance Scheme (EDIS)?” were demonstrated by the fact that two people were on both panels. However, a solution needed to be found by segregating the issues, rather than trying to bundle everything together, which made things even more difficult. The reason for this panel discussion was the same as for the previous panel: everyone wanted the taxpayer ‘off the hook’ following the financial crisis, and this meant having different instruments available. The banking system had to be de risked; there was global agreement regarding this.

For the single currency, it had not been enough to have a toolbox that was mostly the same as the Bank Recovery and Resolution Directive (BRRD) that was being transposed into national law; it might also be necessary to have a single decision making body. For cross-border groups and those under the single supervisor, there was now a single resolution authority in the banking union. This represented completion of the banking union. However, there were some areas in which more clarity was necessary.

Regarding the MREL review, one representative of a resolution authority noted that BRRD and the SRM regulation had come into full effect on 1 January 2016; this represented a significant shift in resolution regulation in Europe. There was now a mandatory scheme of bail-in, with bail-in decided by creditor hierarchy and not by credit name or wealth. The European legislation made clear that MREL, in regulatory or supervisory terms, was a Pillar II requirement; it needed to be set entity by entity, rather than group by group, and was entity risk specific. This had been the framework that the SRB had tried to promote. For the 120 largest banking groups, a normal insolvency procedure would probably not be the preferred route; resolution according to the new toolbox might be better for them, because these banking groups had critical functions and were important to the financial stability of member states, or to the Union as a whole.

A number of representatives of resolution authorities stated that TLAC and MREL were ‘two sides of the same coin’. One explained that TLAC, as the international standard, was required to be 18% of risk-weighted assets and 6.75% of leverage ratio as from 1 January 2022 (16% of RWA and 6% of leverage ratio as from 1 January 2019). It was relatively easy to implement the main features of TLAC within the MREL framework, as there was only one area that did not fit into the framework. MREL was Pillar II, and TLAC was a minimum requirement. However, this gave rise to the question of what was needed to make this happen: a change in the EU legislation would be necessary, and there was a proposal currently being mooted regarding how to do so. MREL would be put in place, and MREL targets for the banks would be set, during 2016: it had been in place since 1 January, and the TLAC features could, and would, be implemented into this system.

A representative of a bank agreed that it was possible, as well as vital, for MREL and TLAC to be reconciled, particularly for G-SIBs. The best way to do this was to begin with a standard MREL requirement for G-SIBs that was entirely consistent with the TLAC term sheet. The Pillar II aspect could then be built on top, enabling the Single Resolution Board (SRB) to meet the bank-by-bank, institution-by-institution requirement imposed by BRRD. A standard MREL requirement for G-SIBs that was exactly the same as TLAC was achievable; following this, an MREL add-on could be introduced in the form of guidance, which would ideally sit above the combined buffers to avoid some of the other problems that had been seen earlier in 2016.

A public decision maker noted that she had been the rapporteur for the initiative report of the European Parliament in 2010, together with the Commission; this had examined how to manage a banking crisis across different countries. This had entailed building up a new framework to address failing banks and to address the post-crisis problem; it was important that memory be harnessed to make sure that this happened. A great deal of work had taken place on this topic.

She was confident that reconciliation between MREL and TLAC would be adequately managed. She was more concerned by the imbalance that she saw in relation to the generalised application of the 8%, as the mirror example, the FDIC, did not have a minimum bail-in. There would be TLAC for SIFIs, if this were applied, but in Europe, all of the banks – even if they were not SIFIs – would need a bail in of 8% if they wanted to be able to use resolution facilities. The problem she perceived was not the objective of fairness in shifting the cost of resolution to taxpayers into shareholders, but the stability of the market, which was another objective of banking union.

Europe was trying to guarantee stability in the market by addressing systemic institutions, but was disregarding the systemic impact of bailing in certain asset classes, such as senior debt or deposits. This was a transition period, and those involved should be intelligent enough to check and monitor what they were doing – particularly as the stability elements of the package had not been addressed and the backstop for the resolution fund in particular. This was vital to bear in mind if the end result was going to be something that Europe had not anticipated; it needed to safeguard banking union.

A representative of a bank stated that the intent of the UK's proposal regarding MREL had been good: MREL and TLAC had to be aligned in order to implement them beyond the borders of the EU. The proposal demonstrated that this synthesis could be achieved. Banks had been looking at 'one side of the equation': i.e. what the requirement was, how they were going to meet it, and what terms existed. The regulators had been looking at the other side: what the intent in resolution was, and whether it would actually work. Europe needed to be concerned about the unintended consequences in a few years' time, when banks were under stress but not in resolution, and ask whether Europe had established something that had a destabilising impact.

His institution had considered how it could meet its TLAC requirements in five years' time, and had concluded that it could not: these needed to be met on an ongoing basis. One risk was the risk of liquidity not being forthcoming to refinance TLAC or the MREL liabilities; there was a risk of fragility, to the extent that this was employed in different parts of the group. This might be something that banks could meet as a requirement, or something that worked from a regulatory perspective, but added an element of instability during the interim period.

Who would invest in these bail-in Instruments?

A representative of a bank stated that, from investors' perspectives, clarity regarding the creditor hierarchy was one of the aspects of clarity and predictability that was necessary. For investors to be active in this market, there would need to be some kind of consistency across countries belonging to a single area, which was embodied by the banking union. Now, there were different solutions in Europe regarding the hierarchy of instruments to be built in in the event of trouble within institutions, and significant effort should be put into trying to achieve some kind of convergence, as soon as possible.

This was not the only element of clarity that was necessary, however. Banks in the EU are waiting for a precise definition of the MREL targets; as of the third quarter, they still did not know the liabilities accepted, or anything regarding calibration and compatibility with business models, which was key to the financial planning and capital planning of institutions. This was an area in which you would want genuine investors. As well as the difficulties experienced by banks holding TLAC and MREL liabilities, there were some questions about what this meant in relation to market making.

For a common framework for subordination

A representative of a resolution authority stated, regarding whether there could be a common European approach to the different types of debt that could be eligible for MREL requirements, that this would be desirable, but was a matter of timing and urgency. The sector had to be ready to cope with any problems, taking into account what existed and changing what needed to be changed. This resolution authority was in favour of a common approach to credit hierarchy in Europe, but this would definitely take time to create. In the meantime, effective tools for resolution would need to be implemented; this was why the German, Italian and French reforms, even if they did not have the same shape or the same goal, should make the use of the bail-in tool easier. The first stage was developing these tools.

This panel member had liked the French approach, and was not alone in this respect; the markets generally agreed with him. This was not particularly different to the German approach, and had been ‘a matter of timing’. The German approach to this new categorisation had a retroactive effect; it touched on the existing debt. The French approach was more progressive, and therefore needed time to be effective, but ultimately, it should have much the same result. The Italian approach was slightly different.

According to him, TLAC represented a baseline for thinking about resolution requirements in Europe. There was now an international agreement on TLAC, which had not been easy to reach. This had been calibrated for G-SIBs, but this did not mean that it could not be applied to other institutions and institutions that could pose systemic problems, such as D-SIBs; it was a good framework, and they should leverage on this requirement. However, in the European context, other institutions would need to be taken into account. TLAC was a Pillar I, so Pillar II needed to be considered, but the TLAC requirement had been calibrated to cover even the most extreme scenarios. If there were to be a Pillar II, this would be linked to the individual analysis of the institution’s resolvability assessment, and placed higher than Pillar I.

Another representative of a resolution authority reminded the audience that in any resolution, the goal was to prove the counterfactual and that the creditor was not worse off than in an insolvency process. This could either be done through modelling, which it would not necessarily be easy to prove reflected reality, or through having a ‘solid layer of liability’ that would be the first at risk. This related to the earlier discussion about clarity and transparency: investors should know that if you had invested in a deeply subordinated tool, you should hopefully never be called upon, but you should be called upon before your neighbour who had invested in a senior instrument. Only an investor in guaranteed deposits would never be called, because this person had the protection of the DGS.

How internal TLAC or internal MREL would be distributed within Europe?

A leader of the industry explained that, on the subject of business models, it was important to preserve neutrality of design in these resolution approaches. It should not be the case that, in order to fulfil the requirements of MREL and TLAC, an institution should need to change anything particularly substantial about its business model; this was especially true regarding the SPE/MPE organisation of a bank. To comply with this new approach to resolution, MPE banks might be forced to become de facto SPE if they were made to issue internal TLAC. When entities functioned in an independent and separate way, this would create problems, in particular where sufficient care was not given to the issue of extra-territoriality.

If an MPE group were treated as a consolidated group in relation to resolution, it was not clear what would be done about bail-in-able instruments in small jurisdictions where it was very difficult to issue subordinated debt. These would either issue to the mother company, and destroy their model, or would issue in foreign currency; as such, although the goal was to reduce the risk in one dimension, forex risk would be created in another one.

According to another representative of the industry, it was not yet clear whether enough had been done to reduce the amount of ring fencing that had been seen in the past; this could still be dealt with, because the rules were not in place yet and it was not yet clear how internal MREL or internal TLAC would need to be distributed within Europe. Although there was discussion of groups and G-SIBs, very often G-SIB groups were made up of many different entities, some of which resembled D-SIBs or even not-systemic domestic banks. Europe needed to be careful to preserve the many different 'level playing fields' that it was host to: the trans Atlantic field, where G-SIBs from one continent adhered to the same rules as those from another, and the domestic 'playing fields' within individual European jurisdictions.

Many G-SIB groups had quite varied balance sheets, containing tranches of debt that would qualify for TLAC and be ideal for bail in, but many of their subsidiaries were straightforward retail deposit-funded banks in a particular jurisdiction. According to this speaker, from the industry perspective, whatever was done in relation to internal TLAC should not interfere with those business models, and to ensure that this was the case, it would be necessary to find forms of non-cash and non-rigidifying MREL and TLAC, i.e. 'soft' MREL and TLAC in the form of guarantees. Such guarantees did not need to be collateralised: loss absorbency or recapitalisation should flow within a group, with due attention being paid to the need not to ring fence liquidity and capital, and thereby create problems with 'brittleness'.

The 8% issue was a controversial topic

Resolution authorities would want to have all their tools available. Part of this was respecting the fact that, in a resolution scenario, the SRB would need to bail-in de minimis 8% of total liability before it had access to the final tool in its toolbox: i.e. the Single Resolution Fund. This was the reason why, for the systemically important banks, MREL of potentially 8% of total liability would be the norm. This did not give any information about quality, whether this needed to be subordinated, which part needed to be subordinated, or about the timeline. As the panel member had said in the past, this needed to be decided on an entity-by-entity or group-specific level.

A representative of a bank replied that it was important to be very careful regarding the 8% rule. This was a ‘nice’ and a ‘very symmetrical’ number, but the question of what exactly this 8% referred to needed to be answered. BRRD was quite clear about this: the 8% figure only appeared in one place, as an entry hurdle to the resolution fund, and was expressed as the amount of bail-in that had to occur. There was no direct link to MREL, and there needed to be caution about moving from 8% of bail-in actually occurring to 8% of MREL being required; these were not the same things.

A representative of an EU Institution also raised concerns about the 8% figure: looking at the non-SIFIs, it was not clear how small institutions with a lot of NPLs could be asked to raise 8% of bail-in-able assets in the context of a non-performing economy and a low rate of interest, or how was this compatible with the European projects on capital markets union. During this transition period, Europe would need to be careful in generalising principles, which otherwise made sense, regarding the origin of the 8%. She could not see an example of actual application of a minimum of 8% anywhere in resolution, even during the crisis. During her time as shadow rapporteur, this had been calculated as a politically negotiated estimate of what would be needed, bearing in mind the experience of past crises, so that taxpayers would not be called upon during resolution. This had been an average estimate, and had not been intended to apply to all banks, whether small or large.

It was a common sense conclusion that a minimum MREL would need to be established for all of the banks, but this might give rise to very serious consequences if the minimum MREL were to be set at 8%. The intention was that deposits would be transferred; however, going by the details of the legislation, to use the resolution fund or any other instrument without immediately triggering the resolution of the bank, you would have to bail-in 8%.

A non SIFI that bailed in 8% would very likely touch senior debt or deposits if it had to engage in some kind of preventive recapitalisation, managed by some countries under an IPS regime or in other ways. Outside this kind of special regime, to engage in this kind of transfer, you would need to go through a procedure in DG Competition; in all scenarios, it would be necessary to go through preventative recapitalisation. The DGS was considered state aid, and so fell within another framework from DG Competition, which had criteria – established by guidelines in July 2013, and operational in August – that included bailing in and sharing of cost. DG Competition retained responsibility for these criteria.

A representative of another resolution authority agreed that there was a need to be careful when dealing with the 8% level. It was important to have a point of reference, but this should not mean that every resolution case should require use of the resolution fund. It needed to be borne in mind that a substantive part of bail-in-able debt was not included in the current MREL definition; the status of the 8% threshold would need to be clarified if there were to be an effective implementation of this kind of Pillar II approach.

The representative of a resolution authority who had first made reference to the 8% figure replied that this was a controversial topic, and she did not want to start defending the thinking that had been behind it. However, the 8% minimum bail-in-able debt was by no means considered to be applicable to all banks in Europe; she had only been talking about the systemically important banks, which was more than just the G-SIBs, totalling around 120. It did not even apply to all cross border banks. For the other banks, there needed to be a very well-functioning and fit-for-purpose system, which was the DGS; otherwise, you would be creating two-tier banks.

A public authority speaker noted that in a previous seminar, there had been mention of the idea that Europe might make banks more risky at the expense of having markets become less risky, or vice versa. The deduction rules for TLAC debt instruments might hinder market-making and reduce the size of market appetite for these instruments.

A representative of a resolution authority replied that, although he had not been part of that previous discussion, his institution's view was that it was doing what it could to address the problem of the G-SIB resolutions, which – as had been seen in 2008/09 – created the potential for severe disruption to the financial system, which extreme costs in terms of their impact on the economy. Steps needed to be taken to avoid a recurrence of that experience, which would likely necessitate some adjustments in the market.

A representative of the European Parliament stated that she did not advocate constant changing or revising of legislation, but this was 'uncharted territory'; Europe should be extremely careful in what it did, and monitor the procedure. However, not everything could be legislated for; there was a need to have credible institutions. She was confident that SSM, SRM and the Commission would be careful to fine tune the existing legislation to produce not only a system that was fair to taxpayers, shareholders and creditors, but also a stable system that citizens could understand and people could feel comfortable with. This was the critical element for re establishing trust in the market and institutions.

Europe had not foreseen a scenario in which people did not understand what was happening, and where smaller banks were disappearing and being bought by bigger banks, when it had started this process. The FDIC experience had resolved 500 banks or so without bailing in deposits or creating any crisis, and still had 6,000 banks working in the economy with a level of diversity that helped to stabilise the financial sector. This panel member trusted the EU Institutions, and hoped that common sense would prevail during this process.

Global Crisis Management Framework

A representative of the public authorities invited the panel to consider the status of resolution at the global level, work on which was being led by the FSB, and reflecting the present state of international relations, insofar as the ECB sat with resolution authorities in crisis management groups.

Effective resolution of a cross-border bank requires a high degree of trust between supervisors before, during and after resolution. Banks and resolution authorities are making significant efforts to put in place credible resolution plans on how to deal with situations which might lead to the failure of systemically important banks. Therefore, home and host authorities must share relevant information and interplay in order to take into consideration all components of the group or institution and make effective decisions. But some countries do not yet have a full resolution regime in place and of those that do, there are questions over whether they contain avenues for giving effect to the resolution actions of a foreign authority. This is the reason why the question is whether mutual confidence between supervisors needs to be supplemented by additional arrangements and what could be envisaged to favour such arrangements. The FSB has work in progress in this regard.

Living Wills

A speaker discussed the recently announced results of the review of living wills in the US, including certain of the deficiencies and/or shortcomings identified in those results.

Indeed, the relevant U.S. authorities had recently issued results for eight of the firms subject to US living will requirements, along with accompanying public materials. There was transparency in the feedback given to the firms involved: two public documents had been issued jointly, setting out the guidance that had been given to these firms and the framework that had been used for assessing their plans.

The firms had been asked to deal with a number of issues in their next submissions, including sorting out the capital and liquidity necessary in resolution; putting in place a methodology for determining what that might be, and ensuring that these resources could get to where they needed to be in resolution; a governance process to promote confidence that resolution would be entered into at the appropriate time, when those resources were still available; and then, once in resolution, dealing with some of the issues that would arise in the areas of operational continuity and dealing with the derivatives of these institutions in a way that would not lead to disruption. Finally, the area of legal entity rationalisation would need to be tackled, which meant aligning business lines and legal entities that provided optionality in resolution. All eight firms had been asked to look at these issues.

A representative of a different resolution authority noted that she had not been entirely surprised by what had happened in the United States in relation to living wills; these were difficult issues to tackle, and more work needed to be done on them, with the industry and the public sector working together.

Cooperation between Home/Host Supervisors and Resolution Authorities

Another representative of the public authorities noted that there had recently been a US proposal for TLAC for foreign G-SIBs, whereby even if an MPE resolution strategy applied to this group, there would be requirements for the US subsidiary for European banks to issue internal TLAC to the parent bank. Implementation of TLAC in the US ultimately is expected to be subject to a Federal Reserve rule, as this was the authority that had issued the proposed rule. There had been concern on the part of the MPE firms regarding the requirement that foreign banking organizations operating in the US should issue to the parent; these MPE firms had been used to issuing debt externally in the local jurisdiction, and this proposed requirement would cause an adjustment to that. These firms would also like to be viewed in the same way as some of the US regional banks that were of their size and more closely resembled them, and to be allowed to compete on that basis. This raised some difficult issues, and discussions were underway.

A banking representative stated that there was not yet sufficient confidence in the home/host discussion to accept pre-positioning of internal TLAC that might be outside of cash instruments, or that the legal context would allow for such contractual arrangements to take precedence over a statutory approach, as could be seen from the ring fencing that was still present in the market. This ties to the viability of large institutions' cross-border resolvability. With one bank's assets located in a different country, subject to different law, supervisors tended to ring fence and take precautions, which was reflected in the rules and in other ways.

As well as the observations that had already been made regarding how internal TLAC could impact institutions' business models, it was important to note that it was inconceivable that the complex instruments issued in developed markets would be replicated in small markets. At the other extreme, SPE models had not yet been put to the test. Collaboration between home or host via MOUs could be helpful.

It was further noted that, regarding the implementation of TLAC, the Federal Reserve's proposed rule would only cover the US's eight G-SIBs; it would not apply to smaller institutions. The rationale is to help deal with the failure of a systemically important institution, avoiding the disruption to the financial system and the economy that had been seen during 2008. For the smaller institutions, the US bank resolution authority had proved itself capable in at least two previous crises of being able to deal with the failure of smaller and medium-sized institutions without causing disruption to the broader financial system and economy. This was partly a result of the deposit insurance system that the US had in place, where the losses were absorbed by the deposit insurance fund, which was paid for by contributions from the industry, as opposed to from the taxpayers.

Legal Backing for Effective Cross Border Resolution

A representative of a bank stated, in relation to the free flow of instruments, that his institution's approach to meeting the TLAC requirements had been to do so via holding company issuance. This meant having a surplus of long dated funds at the centre; therefore, you were 'damned if you did, and damned if you did not'. Having these centrally while not needing them created a drag on the business, but these were not needed out in the group, either. The question was what kinds of arrangements his bank needed to implement – not only to meet the expectations of CMG countries, but also, and importantly, those of non-CMG countries as well – to find a good balance. His institution would not want to be over-deploying TLAC within the group, where there was a direct cost of holding it centrally.