Key attributes of effective resolution regimes

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THE Financial Stability Board (2011) outlines the key attributes of effective resolution regimes for financial institutions. It sets out the responsibilities, instruments and powers that regulatory authorities should have for effective and orderly resolution of financial institutions. It also protects vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation, without taxpayer exposure to loss from solvency support.

The key attributes relate to scope, resolution powers, set off, netting, funding of firms in resolution, recovery and resolution planning among others.
It is imperative to note that these key attributes are not homogeneous in all sectors and circumstances due to different national legal systems and market environments and sector-specific considerations.

Following the global financial crisis, the mandates of deposit protection schemes have been expanded in most jurisdictions to include, among other roles, involvement in problem bank resolution.

Scope

The resolution regime should be comprehensive enough to cover financial institutions that are viewed to be systematically significant or critical if they fail.
In other words, the resolution regime should cover institutions such as banking institutions, non-banking financial institutions, holding companies of a firm, subsidiaries that are significant to the operations of the business insurers and financial market infrastructures.

Resolution Powers

In general the resolution regime should be explicit powers, which may include power to replace senior management and directors of an institution and manage all the affairs of the institution including collecting outstanding loans or advances. The insurer may have powers to override shareholders of the institution in the best interest to resuscitate the firm.

This may be through capitalisation or restructuring the company's assets or liabilities or effect the closure and orderly wind-down of the whole or part of a failing firm with timely payout or transfer of insured deposits and prompt access to transaction accounts and to segregated client funds.

The choice of resolution powers should be guided by the need to minimise resolution costs and maintain stability and continuity of critical banking functions.

Resolution process

International Association of Deposit Insurers (IADI) (2009) indicated that deposit insurer or financial safety net participant should have the authority to establish a flexible mechanism to help preserve critical banking functions.

This is achieved by facilitating the acquisition by an appropriate body of the assets and the assumption of the liabilities of a failed bank.
Chakrabarty (2011) argued that it is necessary to establish such resolution procedures which will allow flexibility for resolution at a lesser cost than otherwise likely during depositor reimbursement due to liquidation.

For the purposes of ensuring finality and timely resolution of an identified weak, troubled, problem or insolvent banking institution, as the case may be, the law should empower the authorities to, with or without any approval,

assignment or consent of any director, officer, shareholder, creditor, depositor, or investor of the banking institution concerned, establish and implement, or cause implementation of, a plan of

resolution based upon any one or any combination of the following:

- Merge a banking institution with another banking institution;
- Acquisition of a banking institution by another banking institution;
- Purchase and assumption of any asset or liability of a banking institution, including assets held in trust;
- Transfer any asset or liability of a banking institution, including assets held in trust;
- Establish and own temporarily, a bridge banking institution which may acquire part or all of the assets and liabilities of the subject banking institution on the basis of the resolution plan;
- Take possession, control of an identified weak, troubled, problem or insolvent institution with specific powers to establish and institute a definitive and timely plan of resolution; and/or
- Take any action necessary to give effect to the plan of resolution in respect of the concerned banking institution, including the sale or closure of any branch, agency, or other office of the institution and, subject to any other law, the dismissal of any of its officers or employees.

Funding of firms in resolution

Deposit insurer should have all funding arrangements in place to ensure prompt reimbursement of depositors with minimal use of public funds.
In situations of systemic crisis the insurer may require back-up funding from government, other safety net players such as the central bank or borrow from capital markets to meet depositor payments.

Contributory institutions should provide primary funding through payment of premiums to meet the cost of deposit protection as it is their members that benefit directly from deposit protection.

In relation to this, deposit insurers around the world collect premiums either ex-ante or ex-post to meet deposit obligations.
Framework for cross-border co-operation

Resolution authorities should be empowered and encouraged to achieve co-operative solutions with foreign resolution authorities (FSB 2011).
Relevant information may be exchanged between deposit insurers or other financial safety net players in other jurisdictions taking into account confidentiality issues.

There are situations where more than one deposit insurer is involved for example in cases where a banking institution has a foreign branch.
It becomes imperative to ascertain the insurer who will be responsible for the reimbursement of depositors.

With increasing global financial integration, consistency in the basic principles that guide deposit protection essential to maintaining a level playing field internationally, hence information exchange among deposit insurers gains importance (Chakrabarty, 2011).

Recoveries

In some jurisdictions deposit insurers have significant roles in the recovery process including being a lender, creditor and liquidator or receiver.
In some instances due to limitation in capacity the insurer may appoint a liquidator or abdicate the function to another financial safety net.

In all these circumstances the deposit insurer is entitled to benefit from the proceeds of recoveries arising from the failure of its member (IADI, 2009).
In jurisdictions where preference is given to deposit insurers once depositors are compensated, the deposit insurer shall be subrogated, up to the amount of the compensation, to any rights and remedies in respect of the protected deposit concerned that may be vested in or available to the depositor.

In circumstances where the set off or netting method applies to deposit claims it should be applied in line with the insolvency law in that jurisdiction.
Set-off, netting, collateralisation, segregation of client assets

The legal framework governing set-off rights, contractual netting and collateralisation agreements and the segregation of client assets should be clear, transparent and enforceable during a crisis or resolution of failed contributory institutions, and should not hamper the effective implementation of resolution measures (Walker, 2011).

Entry into resolution and the exercise itself of any resolution powers should not in principle constitute an event that entitles any counter party of the firm in resolution to exercise acceleration or early terminating rights under such agreements provided the substantive obligations under the contract continue to be performed (Bin, 2013).

Regular updates and review

Jurisdictions are encouraged to put in place an ongoing process for recovery and resolution planning, covering at a minimum domestically incorporated firms that could be systemically significant or critical if they fail.

Supervisory and resolution authorities should ensure the recovery and resolution plans are updated regularly, at least annually or when there are material changes to a banking institution's business or structure.

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