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News release

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Resolution of Large and Complex Financial Institutions: The Big Issues - Speech by Paul Tucker

Speaking at a European Commission conference on crisis management in Brussels today, Paul Tucker - Deputy Governor for Financial Stability and chair of the Financial Stability Board's Working Group on Cross Border Crisis Management - discusses issues around resolving large, complex financial institutions in an orderly way without injecting public money. He says: "Bluntly, the challenge is how to sustain the provision of financial services during a crisis without the state bailing out uninsured creditors". He supports the increased adoption by national authorities of special resolution regimes (SRR). But he stresses that each country having its own SRR does not address the resolution of cross-border banking groups or investment banks with complex trading books.

Drawing on the international debate, Paul Tucker raises two issues for discussion. First, he asks whether authorities should consider making adjustments to creditors' claims in the form of haircuts or equity conversions in a going concern rather than as creditors of a bank entering an insolvency process as a gone concern. He says: "[One] approach would be to deploy a super special resolution framework that permitted the authorities, on a rapid timetable, to haircut uninsured creditors in a going concern." Because an investment bank is highly levered, relatively small percentage haircuts could materially recapitalise a distressed firm. Paul Tucker suggests the approach ".would in effect combine features of standard regimes for resolving commercial banks (rapidity, public policy objectives) with some features of the US Chapter 11 for non financial companies (haircuts for creditors in a continuing business)". He calls for a debate on whether something along these lines could work, pointing out that failure to address the issues around resolving complex trading books would quite probably lead to tougher regulation of those businesses.

Second, Paul Tucker discusses the obstacles to handling the resolution of internationally active institutions. He says ". policymakers need to face up to, and decide whether or not to fix, the really big issues about how insolvency and resolution laws are applied to internationally active financial companies."

He goes on to summarise the differences between 'territorial' and 'universal' principals governing resolution, both of which have material drawbacks. He explains the features of what could be described as 'modified universalism'. This would be based on a principle of equitable treatment of worldwide creditors which would

be consistent with the imposition of losses on unsecured creditors. He says this ".would involve host authorities choosing to defer to and cooperate with a resolution brought by the home country authorities provided that certain conditions held. Separate proceedings might be employed by host countries, but allowing assets from such proceedings to be remitted to the home country, 'lead' resolution."

In conclusion, Paul Tucker states that: "One possible way to cut through Too Big To Fail is to adjust our sense of what 'Fail' involves. Perhaps it does not have to involve liquidation or administration. Perhaps it does not have to involve a binary shift from 'going concern' to 'gone concern'. But it does have to involve loss for equity holders and uninsured creditors. It does have to rekindle market discipline. It does have to preserve the flow of financial services. Those are, surely, the essential components of the resolution leg of the regulation, structure, resolution triangle that make up the reform debate. Individual countries or economic areas such as the EU can get only so far on their own. To cope with distress in global banking, we need to decide whether or not we want international collaboration in the resolution of cross-border banking groups. That is a question which, one way or another, the highest reaches of the authorities should answer as part of the reform debate. Once that is clear, some of the questions about structure and regulation might become clearer."

Note for Editors

Paul Tucker is currently the chair the Financial Stability Board's Working Group on Cross-Border Crisis Management.

Key Resources

Resolution of Large and Complex Financial Institutions: The Big Issues - Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech431.pdf>