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News release

4 May 2012

Resolution: a progress report – speech by Paul Tucker

Speaking at the Institute for Law and Finance Conference in Frankfurt on 3 May 2012, Paul Tucker – the Bank's Deputy Governor for Financial Stability and Chairman of the Financial Stability Board's Resolution Steering Group – provided a progress report on global planning for resolution regimes aimed at addressing the problem of Too Big To Fail. He stressed that a robust, credible resolution regime "... can lead to a much better financial system, with stronger market discipline and so less stability-threatening imprudence"; and he outlined some different resolution strategies and developing thinking on how to operationalise these strategies.

Paul Tucker observed that, since the financial crisis, the "…genie is out of the bottle" and governments no longer have a free option to choose whether or not to pursue a resolution policy agenda to address Too Big To Fail; if risks in banking are not incorporated into the yields of bonds issued by those banks, they will end up reflected in higher sovereign borrowing costs. "Resolution regimes are a way for the authorities to avoid the direct hit to the public finances while at the same time containing disorder in the financial system". But Paul Tucker said that "... there is no silver bullet. We need resolution tools that work in different contexts for different types of bank/dealer."

Paul Tucker remarked that all resolution tools should share a common trigger; and that that trigger should be set at the point at which the bank "…no longer meets the criteria for being authorised and, crucially, when there is no reasonable prospect of its doing so again."

Paul Tucker noted that employing resolution tools to transfer the critical functions of a bank to a buyer may be achievable only for relatively simple commercial banks. Bail-in offers an alternative resolution tool designed to meet the challenges of resolving Systemically Important Financial Institutions (SIFIs). By writing off the equity and converting part of the bank's debt into equity, the bank and its group can be recapitalised without the complexity of separating its business lines and without destroying all of its franchise value.
Paul Tucker then described two types of resolution strategy that employ bail-in. The first is 'top-down' resolutions of complex groups, employing bail-in at the level of the holding company. By bailing-in only at the level of the holding company, the resolution allocates losses in a way that reflects the structural subordination of debt issued at the top of the group. The resolution also avoids affecting the balance sheets

of the operating subsidiaries and so reduces the cross-border problems caused by conflicting insolvency laws.

Paul Tucker went on to mention the debate about which kinds of creditor claims should be bailed in. He observed that the approach to allocating losses "…should probably be the same whatever the resolution tool used and, indeed, the same as in a standard insolvent liquidation." That suggests that, in the long run, one way to 'exempt' some types of claim would be to place them higher in the creditor hierarchy by changing insolvency law.

Applying the top-down approach relies on the holding company and its group having sufficient debt to bail-in. For large and complex banking groups that are funded by deposits rather than bonds, Paul Tucker outlined a second type of resolution strategy. Under this strategy, the Deposit Insurance Scheme is effectively bailed-in by contributing upfront an amount towards the recapitalisation that is not more than the Deposit Insurer would have stood to lose in a standard liquidation. Insured deposits remain intact. "That approach could, if necessary, be applied in different regions to different distressed subsidiaries of the group." There is much work still to be done on planning, but he notes that "…it is worth doing."

Paul Tucker then looked ahead to the Financial Stability Board's work programme for 2012 and into 2013. Preliminary peer reviews will be followed by more exacting examinations of jurisdictions' resolution regimes by the IMF and World Bank. "Meanwhile, authorities are enjoined to produce assessments of resolvability of Global SIFIs and the obstacles in their way; firm-specific agreements for co-operation amongst home and host resolution agencies and supervisors; and resolution plans by the end of this year."

Finally, Paul Tucker considered the implications this has for supervisors. He argued that holders of bank debt will be incentivised to monitor the risks taken by banks. "This is market discipline: an extra line of defence." But supervisors will not be idle, and must carry out detailed planning for how they would execute a bail-in via dedicated Crisis Management Groups and Living Wills. Paul Tucker said the Bank of England is fully behind the FSB's proposed Peer Review process. Paul Tucker concluded by saying that the EU directive on resolution regimes will be "…crucial in giving us all the tools we need"; with Dodd-Frank already in place, "…it will help set the tone for the world."

Key Resources

Resolution: a progress report (38KB)
http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech568.pdf
Full speech by Paul Tucker