European Banking Federation

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EBF Response to FSB Consultation on Guiding Principles on the Temporary Funding Needed to Support the Orderly Resolution of a Global Systemically Important Bank (G-SIB)

The European Banking Federation is supportive of the international development of effective resolution regimes and acknowledges the immense progress the FSB has achieved in promoting globally consistent resolution planning for banks and strengthening bank's balance sheets with new loss absorbing capacity.

In this regard the EBF welcomes the FSB's efforts to provide general principles to address the so far unanswered question regarding potential liquidity needs in resolution for G-SIBs and other banks. Addressing the issue of access to liquidity is seen by the EBF as one essential missing component to help overcome the market confidence challenge in resolution. Ensuring temporary access to liquidity during resolution will further support the resolvability of global banks and thus further underpin financial stability. Failing to provide liquidity to a newly recapitalised, solvent bank during resolution could seriously undermine the efforts and objectives of maintaining critical economic functions and preserving economic value.

We therefore welcome the opportunity to provide the following key messages with regard to your consultation:

- First, it is important to emphasise that, within the new regulatory liquidity framework (LCR and NSFR), the industry is already building robust self-insurance in the form of HQLA resources. This should contribute to creating the conditions that may attract private-sector funding in the pre-resolution phase.
- In the run up to the resolution weekend the institution is already likely to have experienced a deterioration of its liquidity position, i.e. a depletion of its liquidity buffer and increased collateral requirements. Therefore, private funding sources, although preferred, may not be sufficient in the period immediately following the entry into resolution;
- There will, at least initially, be a high degree of uncertainty in the stabilisation phase immediately after the resolution weekend with respect to the future structure and composition of the new institution post restructuring, but also because resolution frameworks and instruments are as yet largely untested and market reactions cannot be predicted;

- Given that uncertainty, clients, depositors and investors are at best likely to take a cautious wait-and-see approach which will limit access to private funding sources, or at worst a panicked reaction by counterparties actively withdrawing deposits and unwinding their positions in the institutions in resolution. In this environment, it may be difficult to convince investors to provide additional funding, notwithstanding the capital solvency of the entity, while they are still in the process of valuing their losses as a result of the recent bail-in. Resolution authorities and central banks together will have a key role in restoring market confidence;
- Clients and investors will need time to analyse the new situation and prospects of the institution. For example, reorganisation plans are to be prepared, rating agencies are to analyse and rate banks post-resolution liabilities;
- Uncertainty could be mitigated by a clear and unambiguous commitment for public temporary liquidity support on central bank terms, if and when necessary. The certainty of a liquidity back-stop will likely prevent a panicked market reaction and possibly also give comfort and confidence to depositors and investors, maintaining stable funding. Ambiguity at this stage would be destructive.
- Furthermore, it may be more effective (and less demanding on available resources) to deploy public sector backstop guarantees to encourage private sector sources. Post-resolution the institution should be more than adequately (re-)capitalised. This is a different starting point compared to public liquidity support in the pre-resolution era. Instead of acting as Lender of Last Resort (LOLR) to prevent a bank failing, the LOLR would bridge a temporary funding gap to help the bank stand on its own feet again.
- To prevent losses public liquidity support could be given preferential status or be backed by collateral. This could however create a hurdle for private investors to step in. Instead, above market pricing would incentivise both banks and investors to replace public funding with private sources as soon as possible. The abstract concept of moral hazard should not be an impediment to temporary public provision of liquidity which is decisive to assure orderly resolution and immediate operational continuity of essential functions, and will eventually create confidence in potential liquidity providers and thus facilitate an ultimate private-sector resolution.
- Recent studies by the EU Parliament[1] show that, at least when the SRF is fully funded (and partially in the earlier years), loss absorption and recapitalisation capacity is good compared to the banking crisis in the last eight years. Nevertheless, resolution funds, even when fully funded, would need additional access to funding to provide temporary liquidity in some circumstances. This is more likely a role for central banks or governments. To mitigate the credit risk of (unsecured, non-preferred) public liquidity support resolution funds might however provide a guarantee to the LOLR to cover losses. This would be similar to the US where losses on the OLF have to be borne by the sector and would also be in line with the FSB Key Attribute 6.2.
- Also, we note the lack of reference to consider any recovery option that an institution may have likely executed before entering into resolution. The recovery actions that the institution have taken may have had significant balance sheet effects that need to be taken into account when considering the continued liquidity needs in the resolution phase.

[1] Estimating the bridge financing needs of the Single Resolution Fund: http://www.europarl.europa.eu/RegData/etudes/ATAG/2015/542688/IPOL_ATA(2015)542688_EN.pd

- Finally, although we understand that the FSB has classified resolution funds as public sector funding on the grounds that the decision-making power lies with public authorities, the economic reality is very different. These funds are constituted, and made good, by industry contributions. This difference in nature could be better recognised in the guiding principles to provide comfort to the public that no taxpayer money is being used.