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# Resolution in an integrated global financial system: the role of operational continuity

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**Remarks by Dietrich Domanski, Secretary General, Financial Stability Board**[1]

Ladies and gentlemen,

Good afternoon. It is a pleasure to be here today, and I would to thank Elke König and the organisers for inviting me to speak. The usual disclaimer applies – the views expressed in my remarks are my own, and do not necessarily reflect those of the FSB or its members.

Ten years ago, policymakers faced a stark choice about how to end the too-big-to-fail problem. One option would have been to break up globally active financial institutions and to reduce, or eliminate, their systemic footprint by limiting their activities, size or international reach. The other option was to recognise the systemic importance of existing internationally active financial institutions and take steps to reduce their probability of failure to an acceptable level, and make it possible that they can fail without severe systemic disruption and without exposing taxpayers to loss.

G20 Leaders opted for the latter, and they were unambiguous in their commitment to end too-big-to-fail <u>and</u> to maintain an open and integrated financial system. This commitment is the basis for much of the work of the FSB over the past decade, and it is why we are here today.

My remarks are meant to provide the background for the panel discussion on operational continuity. The topic may sound purely technical, but it is not. Keeping critical functions of a financial institution operational is at the core of the resolution process. The question of whether operational continuity is ensured is therefore tantamount to asking whether resolution reforms have achieved their objective – effectively ending too-big-to-fail while preserving the benefits of an open and integrated financial system.

## Operational continuity and the effectiveness of resolution regimes

Let me begin with some observations on operational continuity and the effectiveness of resolution regimes. G20 jurisdictions have made significant progress in implementing resolution reforms. In June we submitted to G20 Leaders a summary table on progress in implementing G20 reforms.[2] There are quite a few green cells in this summary table, reflecting

[1] The views expressed in this speech are those of the speaker and do not necessarily reflect those of the FSB or its members.
[2] Financial Stability Board, *Progress in implementation of G20 financial regulatory reforms*, June 2019

substantial progress in implementing the FSB's resolution policies: recovery and resolution planning processes are in place for systemic banks in 16 out of 24 jurisdictions; crisis management groups (CMGs) have been established, and Total Loss-Absorbing Capacity (TLAC) (or MREL) resources are being issued.

Yet the title of the FSB's eighth report on the implementation of resolution reforms, to be issued next month, will be "mind the gap". A number of the identified gaps relate to further steps and capabilities that are still needed to ensure the operational readiness to maintain the continuity of a firm's critical operations as it enters resolution and throughout the resolution. Let me turn just highlight a few areas.

- TLAC – the objective of the FSB TLAC standard is to ensure that there are adequate loss-absorbing and recapitalisation resources available at the right time, in the right amounts and at the right location. The implementation of the standard therefore is key for the continuity of a firm's critical operations and a priority for the FSB. Work is underway to analyse how to achieve a balance between pre-positioned and non-pre-positioned TLAC resources and how the latter are managed so that they can be flexibly deployed within a banking group to be available where needed to support the execution of a resolution strategy.

- Bail-in execution – for TLAC to be affective as a central pillar of resolution measures, authorities and firms require the capabilities to successfully execute a TLAC bail-in transaction. For instance, a TLAC bail-in may raise questions in connection with a suspension of trading, cancellation of shares or the issuance, delivery or listing of new shares. The FSB is engaging with market participants on the practicalities of operationalising cross-border bail-in.

- Liquidity – continuity of critical operations in the lead up to and during resolution requires a firm to be able to meet its obligations. More work is required in a number of areas, including: with respect to firms' capabilities for monitoring liquidity; estimating and planning for liquidity needs in resolution, not least in foreign currency; liquidity provision at the material subsidiary level when the parent entity is in resolution; and the cross-border mobilisation of collateral. Authorities in home and host jurisdictions, including resolution authorities, supervisors, central banks and resolution funds, need to work together to make sure that there is clarity on their respective roles and responsibilities in providing liquidity support and access to public sector backstop arrangements.

- Continuity of access to financial market infrastructures (FMIs) – maintaining critical functions and meeting obligations requires access to FMIs (for example payments systems and central counterparties). The FSB held an industry workshop in May[3] to

[3] Financial Stability Board (2019) *Industry workshop on continuity of access to FMIs for firms in resolution – Informal summary of the workshop*, August 2019

explore ways to achieve efficiencies, for example through further engagement on likely communication and information needs of authorities and FMI service providers prior to and during a resolution of a member.

The common thread of these initiatives is that they aim to provide firms and authorities with further certainty needed to build operational capabilities. Capabilities are essential for both firms and authorities to ensure they have the knowledge, skills and resources to execute a resolution. Adequate resolution capabilities will also provide authorities with optionality – that is, the ability to successfully pursue multiple options – in the face of a firm's failure. This is essential, given that the circumstances of a future failure are impossible to predict with accuracy. Adequate resolution capabilities also establish credibility, as they demonstrate to stakeholders and the public that authorities are willing and able to act.

## Operational continuity in an integrated financial system

So much on progress and open issues in achieving operational continuity in resolution. But how does all this relate to the objective of preserving an integrated global financial system? Let me offer a couple of thoughts, drawing on the FSB's June 2019 report[4] on market fragmentation, a workshop on pre-positioning and market fragmentation that the FSB held in Philadelphia in September, and other ongoing work in this area.

The basis for ensuring operational continuity and preserving integrated markets is the TLAC standard. The standard expects firms to pre-position a portion of resources locally in jurisdictions where operations are significant and material. The purpose of this prepositioning is to assure hosts of the continuity of the operations in their jurisdictions, and to assure home authorities that those operations that are critical to the group as a whole can be maintained. Therefore pre-positioning should be mutually beneficial and incentivise home-host cooperation. At the same time some resources need to remain freely available to be deployed flexibly where needed to support resolution.

While pre-positioning is intended to provide home and host authorities clarity and optionality, there may be tensions. Home regulators may want to ensure maximum scope and flexibility to resolve the banks at a group level, and host authorities want to ensure that sufficient resources are accessible locally when an entity enters resolution.

The TLAC standard and the internal TLAC guidelines recognise these tensions. By providing a range from 75-90% for internal TLAC, the standard acknowledges that the balance needs to be found through effective cooperation and dialogue between home and host supervisors. Indeed, the FSB standard suggests that home/host discussions of a firm's resolution strategy guide the decisions on pre-positioning of internal TLAC.

[4] Financial Stability Board, *FSB Report on Market Fragmentation*, June 2019

The challenge is essentially to strike a balance between an approach that builds confidence and cooperation ex ante and in the event of a resolution being triggered, provides the necessary incentives for cooperation and resources for a resolution ex post.

Operational capabilities come into the picture in two different ways. First, the approach that home and host authorities take with respect to pre-positioning of resources may influence operational arrangements. One obvious example may be funding arrangements, where the availability of collateral assets in individual jurisdictions may affect the ability to access central bank liquidity, or public sector liquidity support more generally.

Second, arrangements that financial institutions make for operational continuity may also affect how authorities see the options available to them if a firm enters resolution. One example here may be the information that home and host authorities have about firm capabilities. The Philadelphia workshop highlighted that both home and host authorities are dependent on those capabilities. Adequate information on such capabilities may help create certainty and build trust.

So where does this leave us? Authorities at the Philadelphia workshop highlighted the extent to which post-crisis cooperation on regulatory reforms have provided a solid basis from which resolution decisions could be based. They also noted the improvements that have taken place in cross-border supervisory and regulatory cooperation. And there was also a sense that further efforts to strengthen such cooperation can help to address harmful and unintended market fragmentation.

Of particular relevance in this context may be efforts to reinforce the role of crisis management groups. These groups are central to efforts to further strengthen resolvability, and are therefore part and parcel of efforts to ensure operational continuity on a cross-border basis. The CMGs conduct regular resolvability assessments and are expected to review, as part of those assessments, the extent to which the resolution strategy and TLAC arrangements help to provide comfort to home and host authorities. Moreover, these groups have a critical role as a mechanism to share information on operational continuity issues, and thereby provide comfort to home and host authorities, and, through the interaction with their respective supervisors, to financial firms.

## Conclusion

The determination of authorities to address the too-big-to-fail issue has been clear for over a decade. Many, but not all, FSB jurisdictions are now in a better position to achieve this goal. In taking work on operational continuity forward, it seems important to bear in mind the objectives that G20 Leaders set out a decade ago – ending too-big-to-fail and preserving an integrated global financial system.

Thank you very much.