

RESPONSE TO FINANCIAL STABILITY BOARD CONSULTATION - EFFECTIVE RESOLUTION OF SIFIs

Introduction and Summary

The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 48 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for about 35% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

The FSB consultative document rightly relates the need for effective resolution of SIFIs to the avoidance of systemic disruption, and protecting taxpayers from the risks and losses that arose during the banking crisis where banks regarded as “too big to fail” had in various ways to be underwritten by the state. We agree with both these objectives. The BSA represents mutual deposit-takers that are not G-SIBs and the vast majority of our members are not individually systemic even in a national context. But our members do use and rely on financial infrastructure – such as agency banking and the payments system – that in turn depends on global or national SIBs. So we would clearly support the avoidance of systemic disruption. But the costs of the measures to deal with the “too big / too complex to fail” problem need to be better localised on the G-SIBs that give rise to the problem in the first place, not spread indiscriminately across all deposit-takers, systemic and non-systemic. Unfortunately, the FSB’s proposals on statutory bail-in fail in this respect – the targeted approach, explored by the European Commission earlier in the year, is a much better and less damaging tool.

In this response we concentrate on those matters of direct relevance to our members. We also respond from within the UK context of the recently established, tried and functioning resolution regime introduced by the UK’s Banking Act 2009. We follow the sequence of the consultation questions in the FSB’s Overview section.

Effective resolution (QQ 1-2)

Broadly yes¹, with an important qualification : the third objective (page 9) is incomplete – in allocating losses, the regime should as far as possible protect the remainder of the deposit-taking sector and their depositors (exposed to the failing firm through deposit insurance schemes) as well as the taxpayer. The resources of deposit insurance funds are not a “free good”, as they derive from levies that are effectively a tax on all bank deposits. Ultimately the cost of deposit insurance falls on bank depositors, who are mostly the same people as taxpayers. We also underline the importance of respecting the hierarchy of creditor claims, with a no creditor worse off concept as in the UK.

Bail-in powers (QQ 3-8)

We do not agree with the statutory bail-in approach. The targeted, contractual approach – (as described in the European Commission’s technical consultation in January 2011) will deliver comparable outcomes at lower cost, and in particular avoids harming the funding instruments of non-systemic banks.

¹ The UK ‘s SRR generally follows this framework

The unsatisfactory nature of statutory bail-in becomes even more apparent when the practicalities are considered. We can see some arguments for excluding certain classes of creditor, such as swap, repo and derivative counterparties, insured retail depositors, and covered bonds, from the scope of statutory bail-in. However, further exclusions such as wholesale deposits and short-term debt, mean that the approach would not be remotely comprehensive. The main category of claim subject to write-down would be longer-term unsecured debt, mostly debt securities, though for our smaller members this could include other long-term senior borrowings such as bilateral or syndicated bank loans. And this outcome would be perverse: it is recognized elsewhere that longer-term funding is preferable to short-term funding, but the impact of bail-in would in effect penalize longer term debt holders for their extra contribution to financial stability by lengthening the refinancing profile of the borrowing bank. Longer term debt, however desirable in terms of liquidity risk, will become particularly difficult and expensive to raise. The following perverse actions and outcomes would be likely, and might well neutralise or outweigh any benefit from statutory bail-in :

- Investors could migrate to shorter dated paper if it is not subject to 'bail-in' which would adversely impact the maturity profile of institutions and make them inherently less stable as they would have to roll-over larger proportions of their funding more frequently.
- Investors would prefer secured claims – e.g. covered bonds-over unsecured ones which would increase the amount of assets encumbered to the detriment of creditors generally.
- Wholesale investors in predominantly retail funded banks, including - in the UK - all BSA members - would be penalised relative to a similar investment in a universal bank because the impact of any debt write-down would be more concentrated and therefore more severe.

Undermining the principle of equal treatment is undesirable - arbitrary discrimination between equal-ranking types of creditor undermines contractual certainty as creditors will assume the worst. Debt restructuring arbitrage will also be unavoidable.

Recovery and resolution plans (QQ 14-15)

We agree with the FSB that the need for RRP only arises for systemic firms : as the document states² “ An adequate, credible RRP should be required for any firm which is assessed by its home authority to have a potential impact on financial stability, in the event of liquidation of that firm.” By necessary implication, full scale RRP should *not* be required for non-systemic deposit-takers. We foresee, however, a serious risk of “mission creep” – as has already happened in the UK where, through policy error, the requirement for RRP for all deposit-takers has been embedded in legislation.

Depositor preference (Annex 7)

The Annex gives good coverage of the arguments for and against depositor preference. The BSA can see merit in extending a preference at least to insured depositors, as this mitigates the otherwise substantial impact of insured losses on the rest of the deposit-taking sector and their customers. If it is too difficult in practice to prefer only the insured portion of eligible deposits, for simplicity all eligible deposits could benefit. Transitional provisions protecting existing instruments are also necessary, otherwise market disruption will be widespread. In principle, convergence on preferences would be desirable, but looks difficult to achieve, at least outside the EU.

We have no specific comment to make on cross-border implications (QQ 9-11), resolvability assessments (QQ 12-13), improving resolvability (QQ 16-19), timelines (Q 20) or Annex 8 : temporary stay on early termination rights. 2 September 2011

² Overview section, top paragraph on page 17