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THE FINANCIAL SUPERVISORY  
AUTHORITY OF NORWAY

**NORGES BANK**

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## **Response to the Financial Stability Board's consultative document Effective Resolution of Systemically Important Financial Institutions**

### *Introduction*

Norges Bank and Finanstilsynet welcome this initiative of the Financial Stability Board (FSB) to introduce an international standard for crisis management of financial institutions. The financial crisis and its aftermath have shown that improved frameworks for crisis resolution are needed, especially for large, complex cross-border financial institutions.

Resolution frameworks are important measures in the regulation of financial institutions. A proper resolution framework protects important functions during market turbulence and facilitates swift and constructive economic recovery from financial crises. A proper resolution framework makes owners, and also creditors, bear the losses, without spending taxpayer money. Moral hazard is thereby reduced.

The Norwegian banking crisis in the early 1990s was managed such that owners did in fact bear a large part of the losses during the crisis.<sup>1</sup> However, creditors of the larger failed banks bore no losses. Cross-border banking was also negligible in Norway in the early 1990s. Since then, cross-border banking in the Nordic area has evolved, and the Nordic area is more or less an integrated banking market.

The Norwegian authorities therefore welcome the initiative to introduce an international standard for crisis management of financial institutions. Cross-border crisis management is facilitated when the resolution powers and tools of authorities operating in different jurisdictions are harmonised. We support the proposal that authorities must have broad

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<sup>1</sup> See "The Norwegian Banking Crisis", Norges Bank Occasional Papers 33, <http://www.norges-bank.no/no/om/publisert/publikasjoner/skriftserie/33-the-norwegian-banking-crisis/>

powers to be able to handle the large range of possible crises in different complex financial institutions and different market situations. As a safeguard to these powers, the principle of “no creditor worse off than in liquidation” should be guiding. Frameworks for judicial review should allow compensation of stakeholders ex post, without allowing reversal of measures taken by the resolution authorities.

*Comments on specific questions*

*Effective Resolution Regimes*

**Q1: Comment is invited on whether Annex 1: Key Attributes of Effective Resolution Regimes appropriately covers the attributes that all jurisdictions’ resolution regimes and the tools available under those regimes should have.**

Norges Bank and Finanstilsynet generally support the proposed broad toolkit for crisis management. However, we encourage the FSB to give a more comprehensive analysis and a discussion of the need for early intervention, in particular on the threshold condition for entry into resolution.

*Bail-in powers*

**Q3: Are the elements identified in Annex 2: Bail-in within Resolution: Elements for inclusion in the Key Attributes sufficiently specific to ensure that a bail-in regime is comprehensive, transparent and effective, while sufficiently general to be adaptable to the specific needs and legal frameworks of different jurisdictions?**

Norges Bank and Finanstilsynet share the view that statutory bail-in may be a suitable tool for recapitalising a bank, or parts of a bank, when a recapitalisation is deemed necessary to sustain access to essential services. In that respect, a bail-in may reduce the need for a bail-out using public money. In the elements discussed in Annex 2, we miss a discussion of potential legal problems that may arise if the statutory bail-in is retroactive, i.e. if debt contracts that were signed prior to passing statutory bail-in into law were also subject to such bail-in.

**Q4: Is it desirable that the scope of liabilities covered by statutory bail-in powers is as broad as possible, and that this scope is largely similarly defined across countries?**

We believe it is an advantage if the scope of liabilities covered by statutory bail-in powers is as broad as possible and to the greatest extent similarly defined across jurisdictions. (See, however, response to Q6.) The principle of “no creditor worse off than in liquidation” should be guiding in the implementation of bail-in powers.

**Q6: What classes of debt or liabilities should be outside the scope of statutory bail-in powers?**

It may be that certain liabilities, such as unpaid salaries or other reasonable employee compensations, as well as claims of a more incidental nature, should be protected. The question of what claims should be excluded from bail-ins should be explored further.

**Q7: Will it be necessary that authorities monitor whether firms’ balance sheets contain at all times a sufficient amount of liabilities covered by bail-in powers and that, if that is not the case, they consider requiring minimum level of bail-in debt? If so, how should the minimum amount be calibrated and what form should such a requirement take,**

*e.g.,:*

*(i) a certain percentage of risk-weighted assets in bail-inable liabilities, or*

*(ii) a limit on the degree of asset encumbrance (e.g., through use as collateral)?*

Statutory bail-in powers will give creditors increased incentives to secure their claims. The possibility of bail-in may force also large banks to pay a price for their debt that to a greater extent reflects the underlying risk of the banks. We therefore support the proposal to explore a minimum requirement for the level of bail-in debt. The requirement should be designed together with the scope of liabilities covered (see response to Q4), so that bail-in both reduces moral hazard and facilitates the recapitalisation of a distressed bank without the use of public funds.

#### *Cross-border cooperation*

*Q9: How should a statutory duty to cooperate with home and host authorities be framed? What criteria should be relevant to the duty to cooperate?*

Norges Bank and Finanstilsynet support the proposal that home and host authorities should have a statutory duty to seek cooperative solutions to distress in a cross-border financial institution whenever the stability of the financial system in one of the countries could be at risk.

*Q10: Does **Annex 3: Institution-specific Cross-border Cooperation Agreements** cover all the critical elements of institution-specific cross-border agreements and, if implemented, will the proposed agreements be sufficiently reliable to ensure effective cross-border cooperation? How can their effectiveness be enhanced?*

Even when a country is committed to cross-border cooperation, situations can emerge where unilateral action is needed to achieve domestic financial stability. The Norwegian experience of branches and subsidiaries of distressed foreign banks during the recent financial crisis is one example. We therefore endorse the safeguard that individual jurisdictions are given flexibility to act when necessary to safeguard domestic financial stability, e.g. with intervention and resolution tools supplementary to those taken by the foreign bank's home country.

In the European Economic Area (EEA), non-legally binding agreements on cross-border cooperation in financial crises existed before the financial crisis hit. These agreements resemble the Institution-specific Cross-border Cooperation Agreements presented in Annex 3. We miss in this annex a discussion of why the existing EU agreements did not work properly during the financial crisis and how the new Cross-border Cooperation Agreements could answer these shortcomings.

#### *Recovery and resolution plans*

*Q14: Does **Annex 5: Recovery and Resolution Plans** cover all critical elements of a recovery and resolution plan? What additional elements should be included? Are there elements that should not be included?*

Yes, we find that Annex 5 covers all critical elements of a recovery and resolution plan (but see response to Q17). We would particularly like to emphasise the importance of strategies that ensure rapid access to insured deposits and continuous operation of the payment system. If insured depositors only experience a brief halt in their access to deposits and the payment system is kept running, resolution authorities will have more time to resolve the remaining activities in the bank. This will reduce the likelihood that tax payers will be forced to subsidise large complex banks during a crisis.

We are somewhat concerned that requiring authorities to “include a comparative estimate of losses to be borne by creditors and any premiums associated with various resolution strategies”<sup>2</sup> may be too ambitious and have possible negative effects: We understand this to require ex ante estimates of the value of banks’ assets in a stressed condition, where asset values are particularly uncertain and markets often illiquid. Such assessments can be quite difficult to make both during a crisis and ex post, and hence too uncertain to make in any meaningful way ex ante. This means that any prior estimate of losses under different resolution strategies will be quite unreliable and therefore of little use in a crisis. The prior documentation of such estimates may influence the choices made by authorities in a crisis, for instance because creditors will use them as an argument for specific strategies, and can therefore lead to worse choices than if estimates are made on the spot. However, we fully support the proposal that a resolution plan includes a framework for making such estimates *during* crisis resolution to quickly assess the consequences of different resolution strategies based on current facts.

*Q15: Does Annex 5 appropriately cover the conditions under which RRPs should be prepared at the subsidiary level?*

We agree that home country authorities should lead the development of group resolution plans, but in coordination with relevant host authorities. Again it would be helpful to assess how these coordination activities should be organised to be more effective during financial crises than the EU agreements on cross border cooperation were (see Q10 above).

*Improving resolvability*

*Q17: Are the proposed steps to address the obstacles to effective resolution appropriate? What other alternative actions could be taken?*

We welcome the recommendations from the FSB to improve the resolvability of SIFIs. The recommendations illustrate that as SIFIs have become complex organisations, their resolution raises a number of issues and requires a very large amount of information. We would in particular encourage FSB to include recommendations on how to ensure rapid access to the insured deposits of the institutions. Such measures should be feasible within a shorter time frame than some of the mentioned recommendations in this annex and would be very helpful in an actual resolution process (see Q14 above).

We would want to highlight the importance of an institution’s complicated capital structure as an impediment to effective crisis resolution. The mere existence of multiple capital classes creates conflicting interests between different stakeholders, each expected to bear losses when different triggers are reached. This in turn paves the way for a multitude of legal actions, hampering the implementation of recovery and resolution plans. Even though the definition of capital elements is addressed in separate work streams, supervisors should have the issue in mind when assessing institution-specific resolution plans. Hence the combination of capital elements in an individual undertaking or group of undertakings should be addressed in the context of living wills.

If the supervisory assessment of the resolution plan shows that the organizational structure of the bank impedes effective crisis resolution, legal powers to rectify the situation should exist. One such power could be for host supervisors of systemically important branches to require that major branches are transferred into legal undertakings. However, this poses particular challenges within the EEA. Norges Bank and Finanstilsynet would encourage work to

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<sup>2</sup> See 4.3.i in Annex 5

establish a legal basis allowing host countries to require conversion from a branch of a foreign bank to subsidiary and a corresponding authorisation to require domestic banks to organise their activities abroad through subsidiaries rather than branches.

*Discussion note on creditor hierarchy, depositor preference and depositor protection in resolution*

*Q25: What other measures could be contemplated to mitigate the impediments to effective cross-border resolution if such impediments arise from differences in ranking across jurisdictions? How could the transparency and predictability of the treatment of creditor claims in a cross-border context be improved?*

A requirement that retail deposits are placed in an entity that is easily ring-fenced from other parts of the bank could mitigate impediments to both domestic and cross-border resolution – perhaps as efficiently as an internationally harmonized depositor preference. Norges Bank and Finanstilsynet therefore invite the FSB to explore such “retail ringfencing”, as well as the interplay with deposit guarantee schemes, in the pursuit of improved transparency and predictability of the treatment of creditor claims in a cross-border context.

*Discussion note on conditions for a temporary stay on early termination rights*

*Q26: Please give your views on the suggested stay on early termination rights. What could be the potential adverse outcomes on the failing firm and its counterparties of such a short stay? What measures could be implemented to mitigate these adverse outcomes? How is this affected by the length of the stay?*

Norges Bank and Finanstilsynet believe a temporary stay on early termination rights is probably a necessary tool to safeguard financial stability when a complex bank enters resolution. A temporary stay will reduce contagion in financial markets to the extent that early termination involves fire-sale liquidations of collateral and a sudden need for “terminated” counterparties to re-hedge their positions. A temporary stay could also be helpful for the resolution authorities in assessing the financial situation of the bank and could facilitate splits and transfers – without running the risk of contracts being suddenly terminated underway. However, we acknowledge that there are difficult questions concerning scope, conditions and delimitations that should be studied further – especially in a cross-border context.

Yours sincerely,



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