

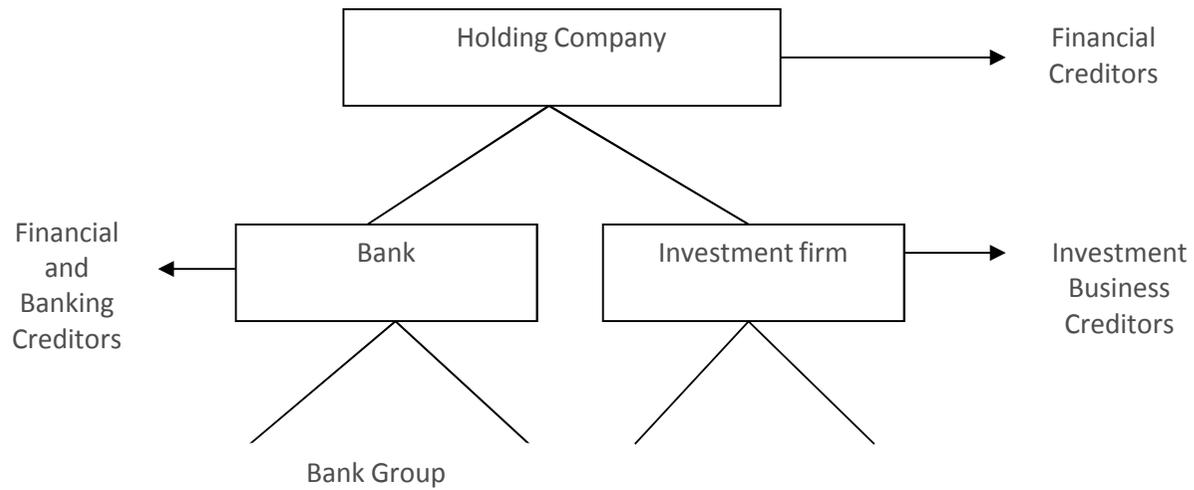
# The Critical Importance of Group Resolution

Simon Gleeson

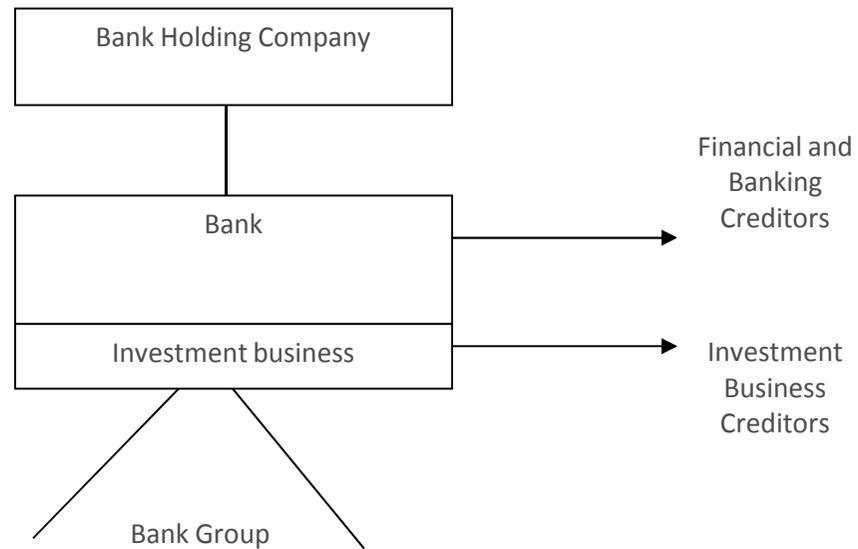
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# Group Structures

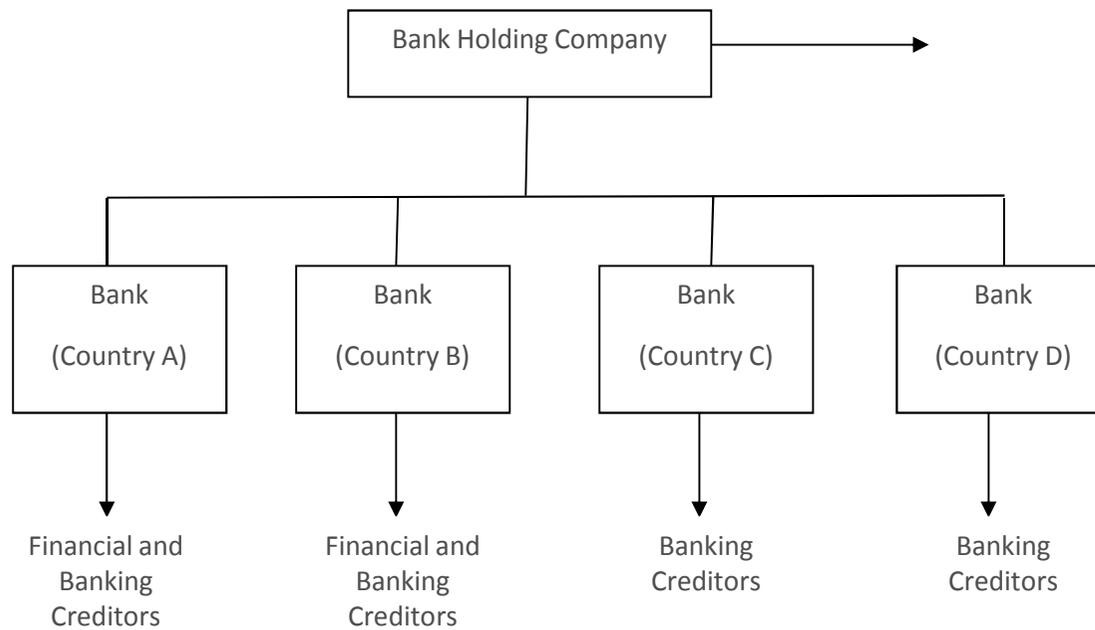
# 1. “Bank/nonbank” Model



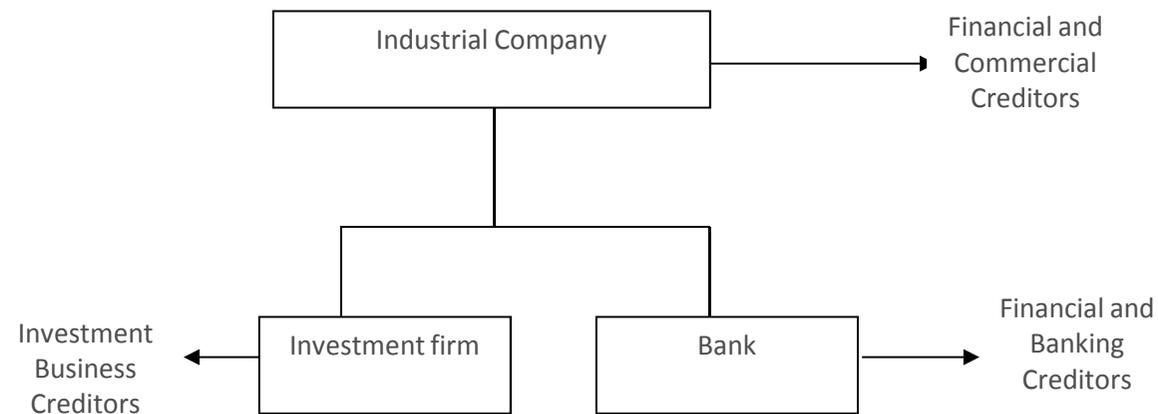
## 2. “Big Bank” model



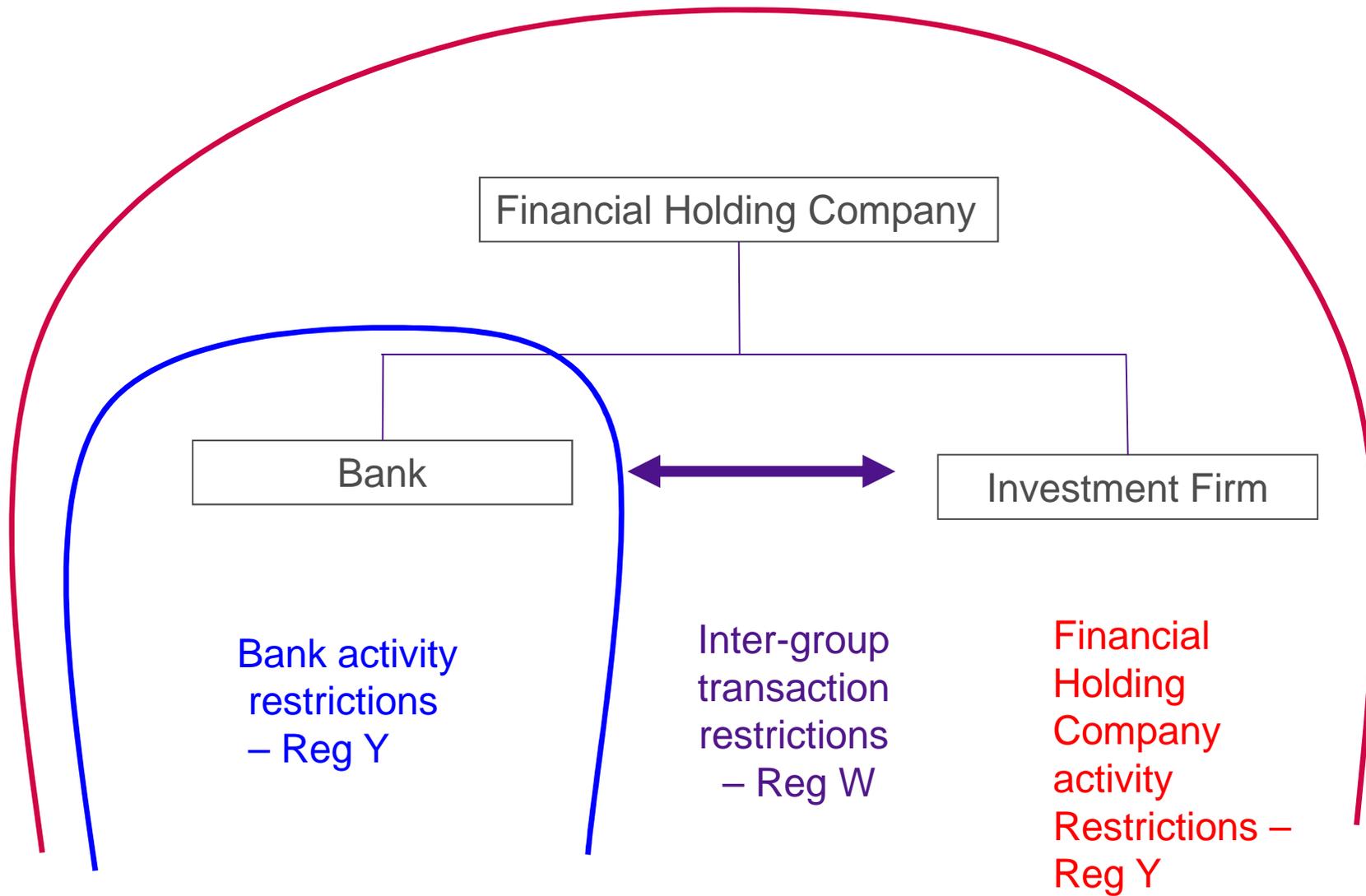
### 3. “Global multi-bank” Model



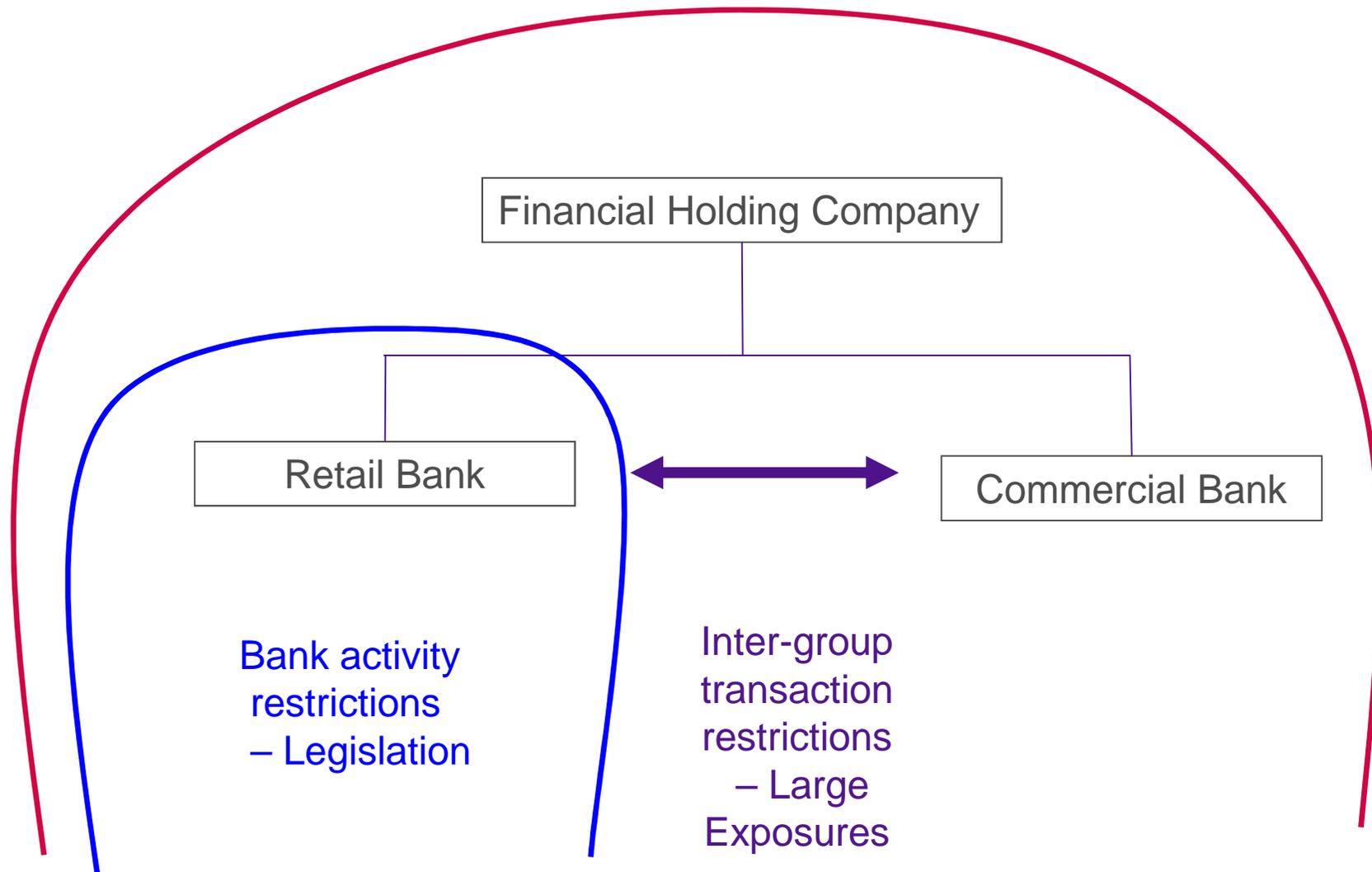
## 4. “Conglomerate” model



# Summary of US Bank Group Regulation



# Summary of UK Bank Group Regulation post Vickers



# Bank Groups



## The Problem

↑ **“The challenge in putting forward a proposal for the structure of group supervision ...is to balance two competing views of a .... group: one view sees a ...group as a single economic entity within which risks are pooled and diversified, the second recognises the group as a collection of separate legal entities with segregated risks”**



# What is a group

## ↑ **An association of separate legal entities**

- Different insolvency rules and jurisdictions
- Company law regulates inter-company dealings
- Assets of each entity ring-fenced for the benefit of creditors of that entity in distress
- Transmission of surplus capital difficult
  - Dividends
  - Share redemptions
  - Regulatory resistance to capital reduction
- Contribution to a capital shortfall almost impossible



# The Group

## “Contagion risk”

- The name for the fact that in credit terms the market disregards legal niceties and perceives the group as a whole

## Risks managed at group level

- Liquidity
- Concentration
- Operational
- Management

# Let them eat cake...?

Management structure

IT system

IT system

Company

Company

Company

Company



## Resolving Legal and Risk Positions

- In an insolvency the individual creditors' recourse is to the assets of the legal entity
- Prior to insolvency, the individual creditor's best hope is a group restructuring
- Surplus capital should be capable of being moved around the group as efficiently as possible
- Liquidity, concentration and operational management should not be affected by balance-sheet issues relating to specific subsidiaries

**BUT**

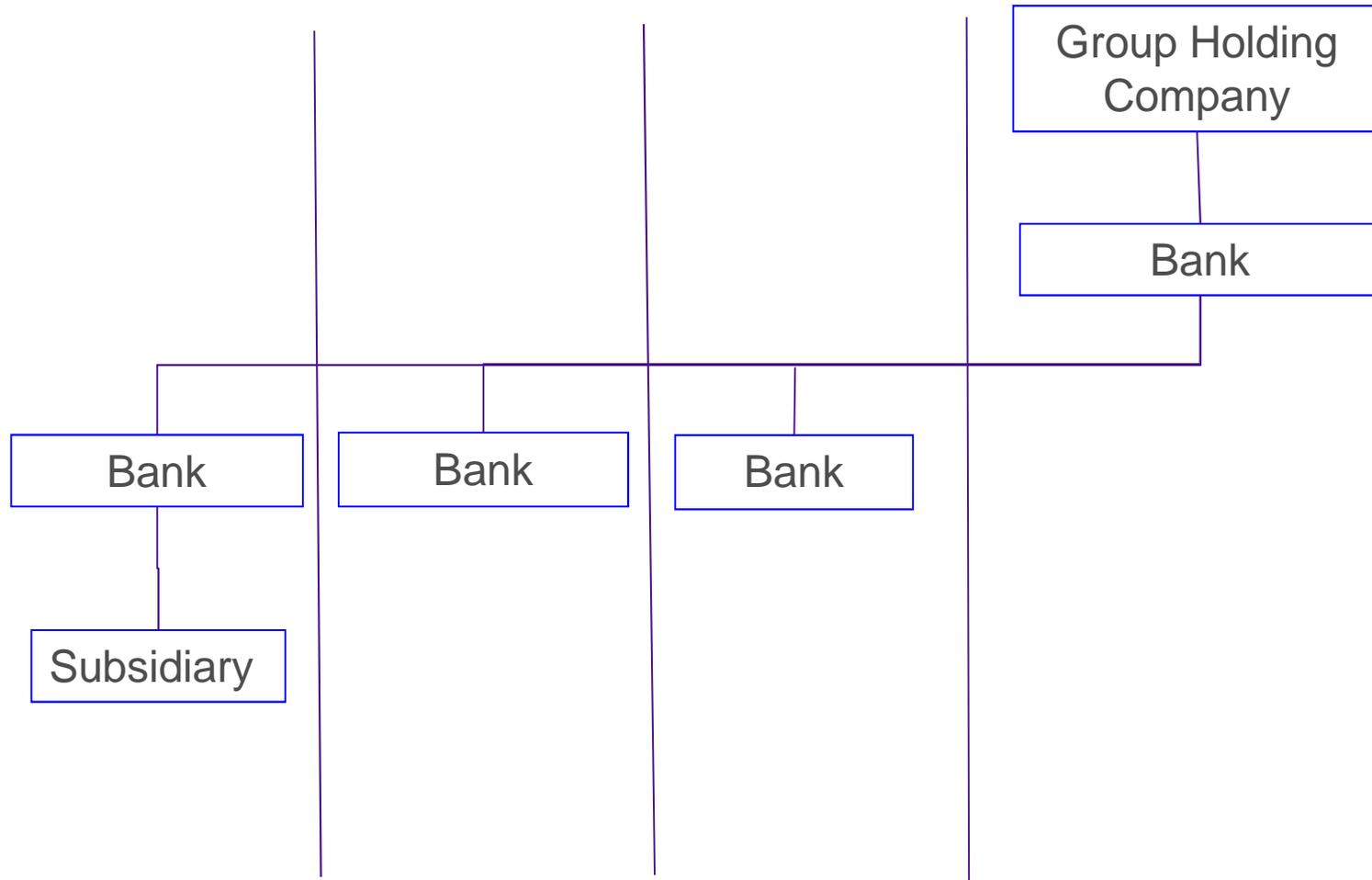
- Investors who have invested on the strength of a particular balance sheet should have recourse to the specific assets of that issuer

UK

France

Germany

Non-EU

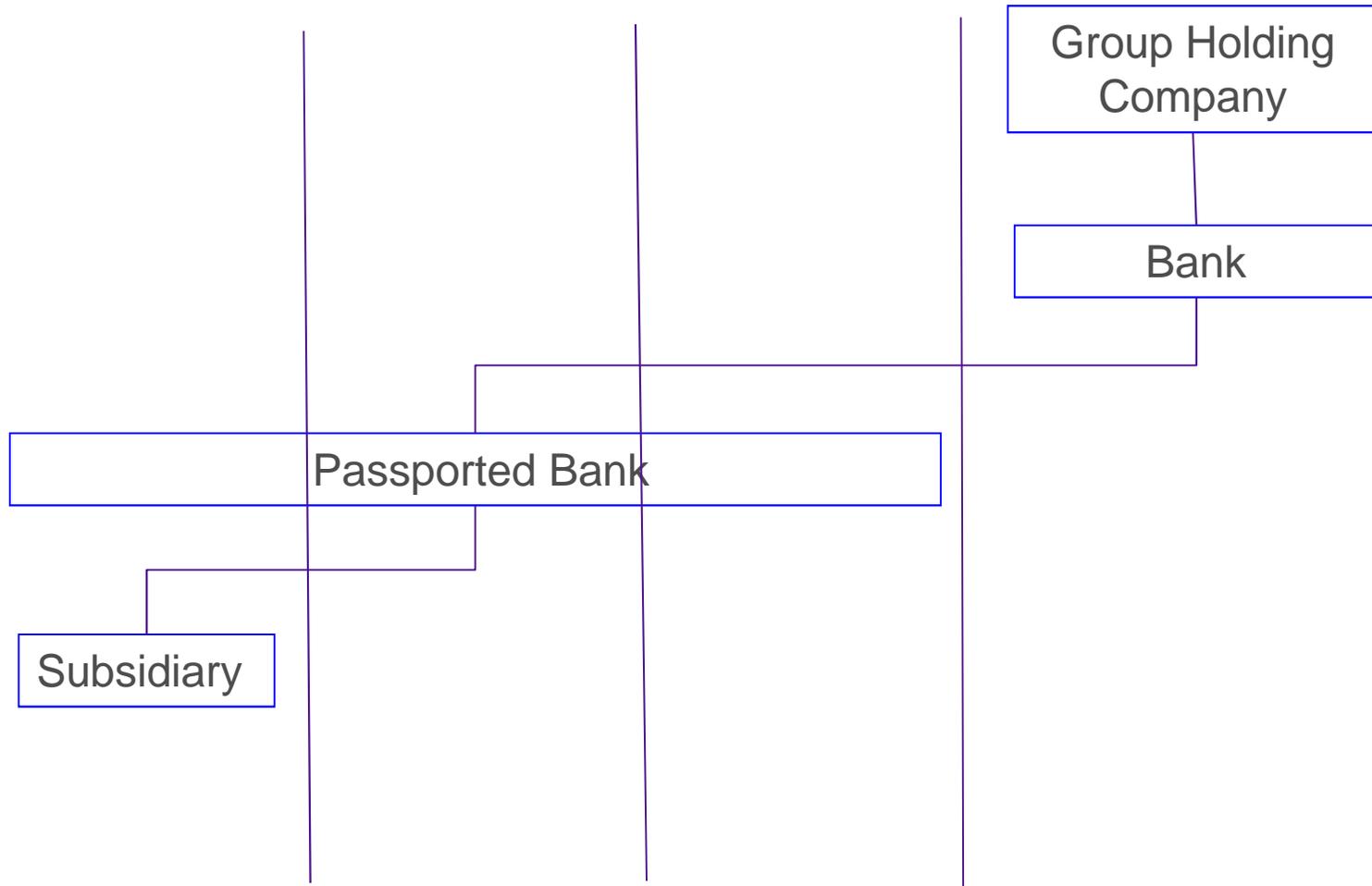


UK

France

Germany

Non-EU



# Additional issues

- ↑ **Use of cross-border recognition measures**
- ↑ **Creditor safeguards**
- ↑ **Ownership caps**
- ↑ **Events of default**
- ↑ **Transition to the new regime**

# Bank Resolution Triggers

# Scope

- ↵ **Banks (credit institutions)**
- ↵ **Some investment firms**
- ↵ **Bank holding companies**
- ↵ **Affiliate service providers (some powers)?**
- ↵ **Branches of non-EU banks?**

# Resolution triggers

## ↑ **Proposed core trigger test:**

- Insolvency-based tests
- No longer fulfils conditions for authorisation; OR
- Regulatory capital test
- Actual or “likely” failure

## ↑ **Supplemental condition**

- Last resort: no other measures available
- Resolution is in the public interest



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# Resolving Deposit-Funded banks

# Resolving the Retail Bank - 1

## Balance Sheet – Bank B

### Assets

Cash	50
Retail Loans	200
Mortgage loans	300
Commercial loans	<u>100</u>
	<u>650</u>

### Liabilities

Deposits	500
Short-term funding	100
Equity	<u>50</u>
	<u>650</u>

Unexpected loss of 60 in commercial loan portfolio

Equity eliminated – unsustainable

BUT

NCWO means that short-term funding providers will receive at least 90% of nominal (assuming all depositors preferred)

Therefore bail-in can only create 10 of new equity without breaching NCWO test

# Resolving the Retail Bank - 2

## Balance Sheet – Bank B

### Assets

Cash	50
Retail Loans	200
Mortgage loans	300
Commercial loans	<u>100</u>
	<u>650</u>

### Liabilities

Deposits	500
Short-term funding	100
Equity	<u>50</u>
	<u>650</u>

Unexpected loss of 40 in commercial loan portfolio

Equity reduced to 10 – unsustainable

BUT

NCWO means that short-term funding providers will suffer no loss.

Therefore any resolution violates NCWO?



↑ Questions?

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# The Critical Importance of Group Resolution

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