The Critical Importance of Group Resolution

Simon Gleeson
Group Structures
1. “Bank/nonbank” Model
2. “Big Bank” model
3. “Global multi-bank” Model
4. “Conglomerate” model
Summary of US Bank Group Regulation

- Bank
  - Bank activity restrictions – Reg Y
  - Inter-group transaction restrictions – Reg W
- Investment Firm
  - Financial Holding Company activity Restrictions – Reg Y
  - Financial Holding Company

Inter-group transaction restrictions – Reg W
Summary of UK Bank Group Regulation post Vickers

Financial Holding Company

Retail Bank

Commercial Bank

Bank activity restrictions – Legislation

Inter-group transaction restrictions – Large Exposures
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
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

1. **Proposed core trigger test:**
   - Insolvency-based tests
   - No longer fulfils conditions for authorisation; OR
   - Regulatory capital test
   - Actual or “likely” failure

2. **Supplemental condition**
   - Last resort: no other measures available
   - Resolution is in the public interest
Resolving Deposit-Funded banks
### Resolving the Retail Bank - 1

Balance Sheet – Bank B

<table>
<thead>
<tr>
<th>Assets</th>
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<tbody>
<tr>
<td>Cash</td>
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- 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

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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?
Contact

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