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Institute of Law

Bank Deposit Guarantee Schemes and Bank Resolution:

International Financial Law

Prof. Kern Alexander

12 March 2026

Lecture session 4



Operational risks – case study (2019)

- UK Metro Bank mis-reported to the regulator its risk-weighted assets in standardised approach to qualify for lower capital requirement



- Once it discovered the mistake, it failed to inform its regulators – the Bank of England/PRA.
- Regulator later discovered the errors and cover-up and imposed fines £600 million in disciplinary action



Basel III – summing up

Regulatory change- Basel III

Increasing the quantity and quality of bank capital

Quality of bank capital

- * Tier1 will be largely equity and reserves

Quantity of capital

The overall ratios will rise and a leverage ratio to be introduced

- *Capital conservation
- *Countercyclical capital buffer
- *Forward looking provisions?

- *Capital requirements increasing
- *Trading book and securitisations

Counterparty risk

- *Changes to capital requirements

- *Changes to risk management
- Enhanced reporting – Pillar 3 - market discipline

Global requirements for liquidity buffers

- * Liquidity coverage ratio – requires stock of high quality liquid assets
- *Stable funding ratio- illiquid assets have to be backed by stable funding



Governance dimension: Basel III requires robust Pillar 2 implementation

- Corporate governance failures in banks one of the causes of the 2007 crisis.
- Citi's board of director's failures (former Treasury Secretary Robert Rubin on Citi board):
 - *“the bank's directors were the principal authors of its difficulties, in view of the ‘reckless business model’ that they pursued”*
- De Larosière Report:
 - *“in Europe, failures in risk assessment and risk management were aggravated by the fact that the checks and balances of corporate governance also failed”*



Governance dimension: Basel III robust Pillar 2 implementation

- Regulators now focus on risk management and corporate governance
- Institutions can be subject to discretionary Pillar 2 capital charges
- Stress testing is a core part of the capital framework which sits alongside risk-based capital and leverage requirements. Stress tests provide an integrated forward-looking assessment of resilience and aim to ensure that banks can continue to support the real economy even in difficult economic conditions.
- The Bank of England develops regular stress testing of the UK banking system to assess the system's capital adequacy. Banks are expected to also perform their own stress tests.



Basel III – builds on Basel II framework

Pillar 1	Pillar 2	Pillar 3
Minimum Capital Requirements	Supervisory Review Process	Market Discipline
Additional / Refined Capital Basis - Liquidity Coverage Ratio (LCR) - Net Stable Funding Ratio (NSFR) - OTC Derivatives Charge - Quality and Level of Capital - Leverage Ratio - Capital Conservation Buffers - Countercyclical Buffers - Enhanced Loss Absorption Clause (Write-Off or Debt Conversion)	Supervision (Dialogue) - Firm-wide Corporate Governance - Managing Risk Concentrations - Alignment of LT Incentives - Sound Compensation Practices - Supervisory Colleges Capital (ICAAP) - Firm-wide Risk Management - Valuation Practice, Stress Tests Supervisory Review Evaluation Process (SREP) - Capital - Governance	Additional / Enhanced Disclosure - Risk Management <ul style="list-style-type: none"> • Market • Credit • Operational - Regulatory Capital Components - Detailed Reconciliation of Capital - Regulatory Capital Ratios - Securitisation Exposures
	<div style="border: 1px solid black; background-color: #e67e22; padding: 5px; width: fit-content; margin: 10px auto;">ICAAP and SREP can be used to assess portfolio risk exposures to systemic risks</div>	<div style="border: 1px solid black; background-color: #e67e22; padding: 5px; width: fit-content; margin: 10px auto;">Standardised or harmonised disclosure of information about exposure to, and management of, systemic risks could form part of additional or enhanced disclosure requirements</div>



Leverage ratio

$$\frac{\text{Tier 1 Capital}}{\text{Total Exposure}} \geq 3\%$$

- ❑ 3% minimum requirement became a Pillar 1 minimum requirement in 2018
- ❑ Banks required to make a regular set of disclosures on the level and composition of their leverage ratios

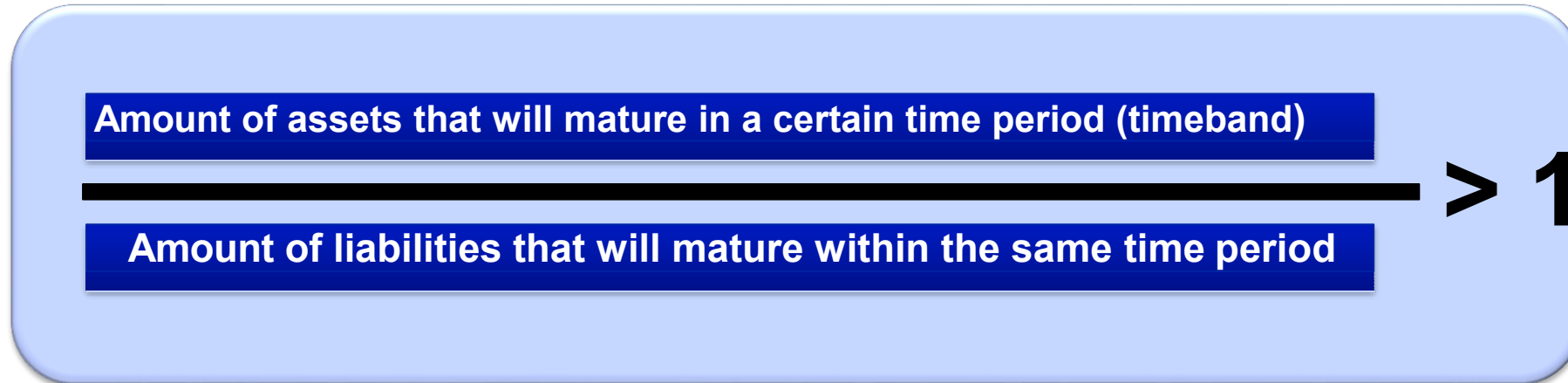


Leverage ratio

- Excessive levels of leverage in the build up to the financial crisis were a significant factor in the stress and failure of many banks
- Leveraged funding of assets with liabilities rather than equity
- Leverage ratio - a Capital Measure (Tier 1 capital) divided by an Exposure Measure (on-balance sheet assets, derivative exposures, securities financing transaction exposures and off-balance sheet items) → To act as backstop to the risk-based requirement
- 3% minimum requirement became a Pillar 1 minimum requirement in 2018
- Banks required to make a regular set of disclosures on the level and composition of their leverage ratios



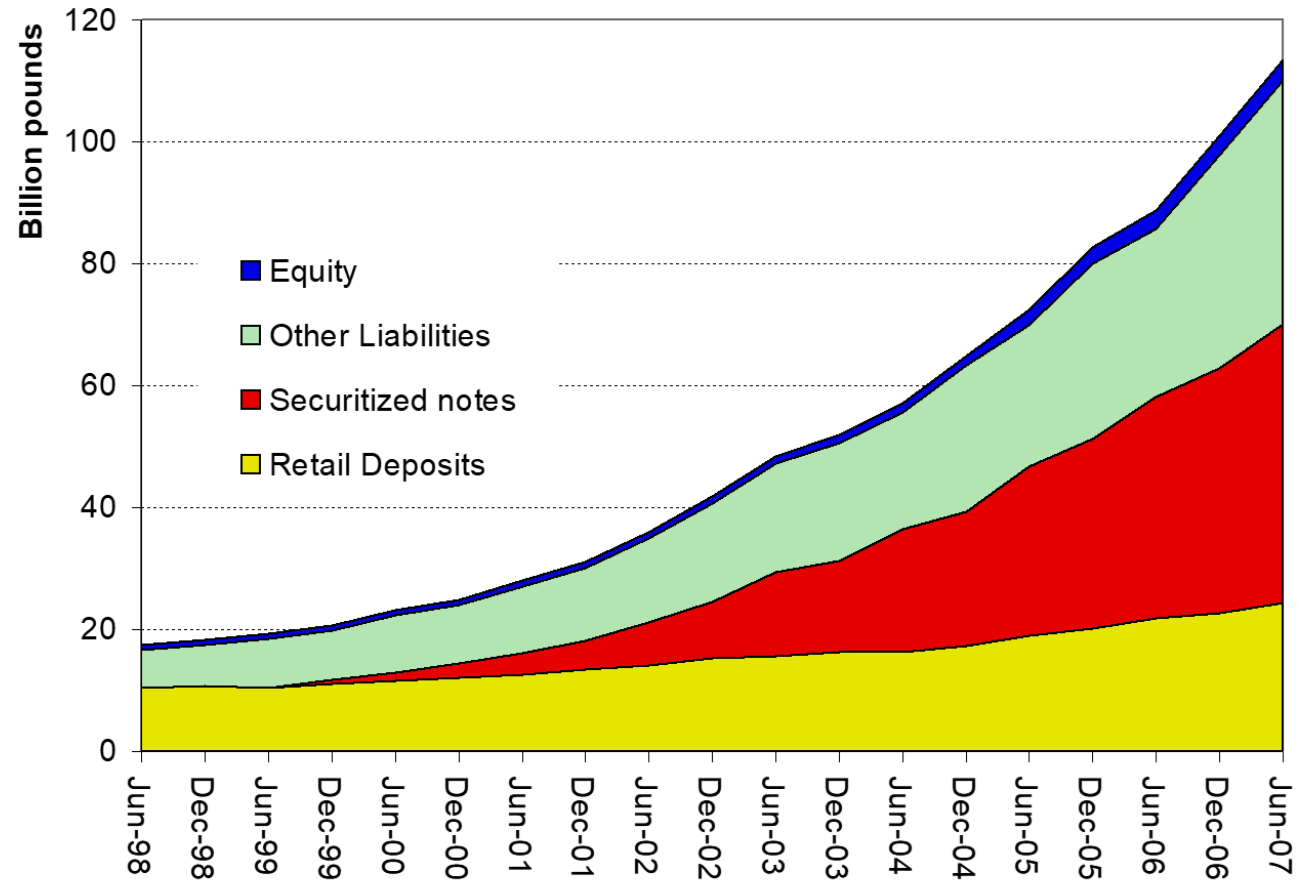
Liquidity Gap



- Bank management must manage the risks of the liquidity gap
- Satisfactory Liquidity
- Liquidity risk is essentially the risk of being unable to honour deposit withdrawals or repay other liabilities at maturity



Composition of Northern Rock's Liabilities
(June 1998 - June 2007)





Liquidity requirements: LQR

Liquidity Coverage Ratio (LCR)

Stock of High Quality Liquid Assets

Total Net Cash Outflows over a 30 day period

>100%



Liquidity requirements: NSFR

General rule:

Net Stable Funding Ratio (NSFR)

$$\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} > 100\% \text{ over 1 year}$$

For residential mortgages designed to support banks in making home mortgage loans:

$$\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} > 65\% \text{ over 1 year}$$



Liquidity requirements

Liquidity Coverage Ratio (LCR)

- ▶ Banks should have sufficient high quality, unencumbered assets in order to meet stress scenario, specified by the supervisor
- ▶ Stock of high quality liquid assets > 100% (broadened to include more sovereigns and level 2 assets 40% of stock – e.g., covered bonds, non-financial corporates)
- ▶ Net cash outflows over 30 days
 - ▶ Run off rate floors reduced - e.g., retail/ SME-SME lowered to 5% (stable), 10% (less stable)

Net Stable Funding Ratio (NSFR)

- ▶ Intended to promote longer-term structural funding by requiring that the ratio of available stable funding to required stable funding exceeds 100% over a one year time horizon.
- ▶ Available amount of stable funding > 100%
 - ▶ Considering raising available stable funds factors for retail & SME
- ▶ Lower required stable funding for residential mortgages – 65% not 100%
 - ▶ Transition observation phase up to 1st January 2018

Reporting

- ▶ Contractual cash flow mismatch reporting (regulatory report)
- ▶ Concentration of funding (regulatory report)
- ▶ Available unencumbered assets (regulatory report)
- ▶ Market-related monitoring tools



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Basel IV reforms ('Basel IV endgame')



Background – Dec 2017

- “The package of reforms endorsed by the Group of Central Bank Governors and Heads of Supervision (GHOS) now completes the global reform of the regulatory framework, which began following the onset of the financial crisis.” Mario Draghi, Chairman of the GHOS
- “These reforms will help reduce excessive variability in risk-weighted assets and will improve the comparability and transparency of banks' risk-based capital ratios. Now that the Basel III regulatory reform agenda is complete, we must focus on the important task of ensuring the standards are implemented consistently around the world. The Committee, through its Regulatory Consistency Assessment Programme, will therefore continue to monitor closely the implementation of the Basel III standards.” Stefan Ingves, Chairman of the Basel Committee (Dec 2017)



Basel IV - Output floor – key elements

- An aggregate output floor, which will ensure that banks' risk-weighted assets (RWAs) generated by internal models are no lower than 72.5% of RWAs as calculated by the Basel III framework's standardised approaches. Banks will also be required to disclose their RWAs based on these standardised approaches (details on disclosure to follow in a consultation paper)
- Revised floor places a limit on capital benefits a bank using internal models can derive relative to the standardised approaches



Key elements-credit risk

- A revised standardised approach for credit risk, which will improve the robustness and risk sensitivity of the existing approach
 - For example, Basel II standardised approach assigns a flat risk weight to all residential mortgages. In the revised standardised approach, mortgage risk weights depend on the loan-to-value ratio of the mortgage
- Revisions to the internal ratings-based (A-IRB) approach for credit risk, where the use of the most advanced internally modelled approaches will be limited to low-default portfolios
 - For example, banks will use the foundation IRB (F-IRB) approach for exposures to large and mid-sized corporates, banks and other financial institutions (ie asset classes that cannot be modelled in a robust and prudent manner) which applies fixed values to loss-given-default and exposure at default parameters



Key elements-G-SIB leverage ratio buffer

- A leverage ratio buffer for global systemically important banks (G-SIBs), which will take the form of a Tier 1 capital buffer set at 50% of a G-SIB's risk-weighted capital buffer
 - For example, a G-SIB subject to a 12% risk-weighted higher- loss absorbency requirement will be subject to a 6% leverage ratio buffer
 - Capital distribution constraints will be imposed on a G-SIB that does not meet its leverage ratio buffer



Summing up

- Transition to regulatory reforms will require additional costs in capital and liquidity buffers. Regulatory capital should be a constraint on the growth of assets
 - Capital Regulation – more macroprudential and focused on systemic risks. Basel IV limits use of risk weightings
 - Liquidity identified as important problem
 - Pillar 2 focus on supervisory approach to bank corporate governance and risk management
 - Environmental risks (climate change) (Lecture 5)



Swiss Regulatory Reforms – Focus: UBS

- Background: Following the emergency takeover of Credit Suisse by UBS in March 2023, the Swiss Federal Council published a comprehensive reform package on 7 June 2025 aimed at strengthening financial stability and oversight.
- Objectives of the Reform:
 - Limit systemic risks posed by large institutions
 - Establish clear individual accountability in leadership
 - Enable earlier crisis detection and intervention
 - Reinforce trust in Swiss financial supervision
- Implementation Timeline: Consultation in Autumn 2025 → Legislation by 2026 → In force from 2028 at the earliest.



Stricter Capital Requirements

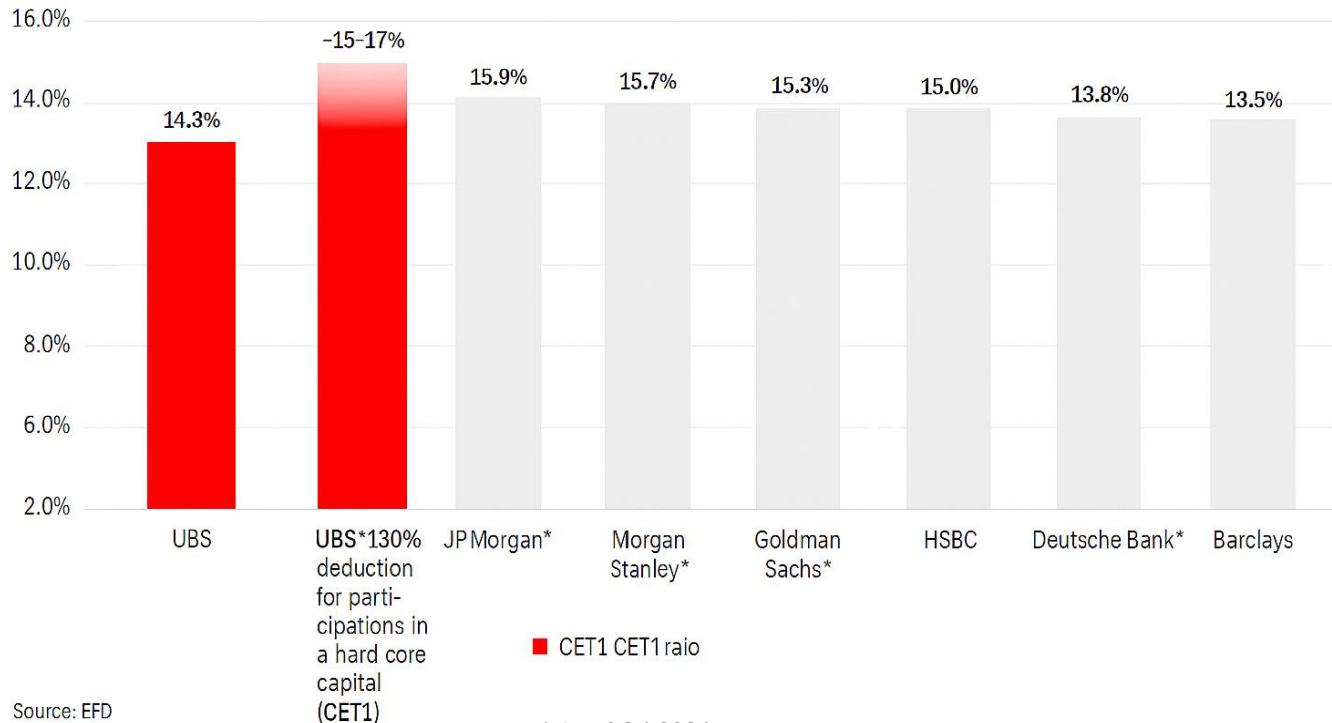
- Full deduction of investments in foreign subsidiaries from CET1 (UBS AG level):
 - Current requirement: 60% of capital in foreign subsidiaries backed by CET1.
 - Proposed requirement: 100%, i.e., full deduction of the book value of UBS AG's equity stakes in overseas subsidiaries from CET1 capital.
 - UBS estimates this would require \$23 bn more CET1 capital.
- Stricter valuation rules for intangible assets (software, DTAs) to enhance loss-absorbency, plus stricter prudential valuation adjustments (PVAs).
- Total incremental CET1 capital required at UBS AG:
 - Estimated at \$24 bn, reflecting all proposed adjustments.
 - CET1 ratio at UBS Group level would increase to 19% before, and fall to 17% after deductions.
 - Combined with Credit Suisse integration requirements, total CET1 impact: \$42 bn.



Stricter Capital Requirements: Core Capital Ratios in an International Comparison

Core capital ratios in an international comparison

If all measures proposed by the Federal Council were implemented, UBS' Common Equity Tier 1 (CET1) ratio would, according to current estimates, be slightly above that of other internationally active major banks. To some extent, this ratio can also be influenced by management decisions.



Source: EFD

* As of Q4 2024



Swiss Capital Reform Debate (since Federal Council Proposal, 2025-2026)

- Federal Council Proposal (June 2025)
 - Part of the Swiss government’s post-Credit Suisse reform package to strengthen financial stability.
 - Proposal: require 100% CET1 backing of UBS AG’s equity investments in foreign subsidiaries (currently ~60%).
 - Aim: ensure the Swiss parent bank holds sufficient loss-absorbing capital and reduce potential taxpayer exposure.
- Estimated Impact on UBS
 - UBS estimates the proposal could require around USD 23–24 billion of additional CET1 capital at the parent-bank level.
 - The requirement mainly reflects the full deduction of foreign subsidiary investments from CET1.
- Political Debate (2025–2026)
 - UBS and banking industry groups argue the proposal goes beyond Basel standards and may weaken the competitiveness of the Swiss financial center.
 - The Federal Council argues stricter rules are necessary given UBS’s systemic importance after the Credit Suisse takeover.
- Parliamentary Developments & Current Status
 - In December 2025, a parliamentary committee recommended reviewing the proposal to ensure the requirements are “more proportionate.”
 - Possible adjustments discussed include modifying the capital treatment of foreign subsidiaries or allowing broader forms of regulatory capital (bonds instead of equity capital).
 - Reform proposals remain under political debate in Parliament.
- Legislative process expected 2026–2027; implementation unlikely before ~2028.



Senior Managers Regime & Remuneration Controls (Pillar 2 focus)

- Formal «senior managers regime» requiring clear assignment of individual responsibility.
- Introduction of clawback mechanisms: ability to cancel bonuses, claw back variable remuneration, withdraw FINMA recognitions.
- Caps on bonuses were considered but rejected; focus instead on effective clawbacks.



Supervisory Treatment of Foreign Bank Subsidiaries – BCBS Guidance

- Solo (stand-alone) capital requirements
 - Regulators should ensure each subsidiary holds sufficient own capital independent of group capital.
 - The Committee does not specify a method – national authorities determine how to measure this (solo) adequacy.
- Group-level capital inclusion
 - When calculating group consolidated capital, include both:
 - The subsidiary's own capital (net of intra-group exposures), and
 - Ist required contribution to total group capital.
- No double-counting
 - Gains from intra-group transactions should be adjusted.
 - Subsidiary contributions are fully included – no deduction or add-backs back into CET1 at group level.



Michelle Bowman, Speech: «Taking a Fresh Look at Supervision and Regulation» (June 6, 2025) and

- Objective: Holistic Review of Bank Capital Framework
 - Reassess whether capital, leverage ratios, stress testing, GSIB surcharges and Basel III standards are working in harmony.
- Fit to the Enhanced Supplementary Leverage Ratio (eSLR)
 - The eSLR has become overly binding for large banks, particularly affecting low-risk business like Treasury market intermediation.
 - Bowman noted it was based on outdated reserve forecasts, leading to unintended market distortions; She announced a forthcoming proposal to recalibrate or partially eliminate the eSLP as a «backstop».
 - Reconsider adoption of the Basel framework and reassess its Governance structure – too much European influence



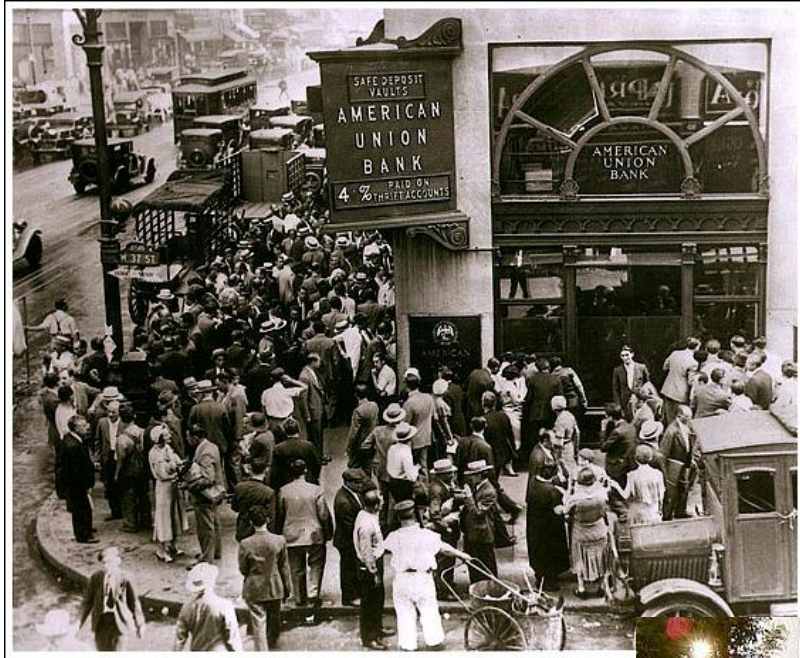
Michelle Bowman, Speech: «Taking a Fresh Look at Supervision and Regulation» (June 6, 2025)

- Stress-Testing and Transparency Reforms
 - Proposed phase-in extensions to reduce volatility in stress capital buffer requirements.
 - The Board's plans broader changes later in the year aimed at supporting transparency, fairness, and predictability in stress-testing processes.
- Reassessing GSIB Surcharges & Basel III Calibrations
 - The July conference will re-evaluate Global Systemically Important Bank (GSIB) surcharge guidelines and Basel III risk-based reforms for large banks.
- Tailoring for Smaller & Community Banks
 - Recent testimony in Congress (Feb 2026)
 - Recognizing that capital frameworks affect banks of all sizes, Bowman emphasized reviewing community bank ratios, calibration of leverage ratios, and suitability of capital rules for mutual banks.



Concluding points

- Regulatory Capital - Basel Capital Accord (Basel III/IV) evolving standards
- Liquidity requirements
- Capital regulation become stricter, less reliance on models
- Governance - conduct and operational risk (now more important)
- But we still have banking crises – SVB Bank (2023) and Credit Suisse (2023)





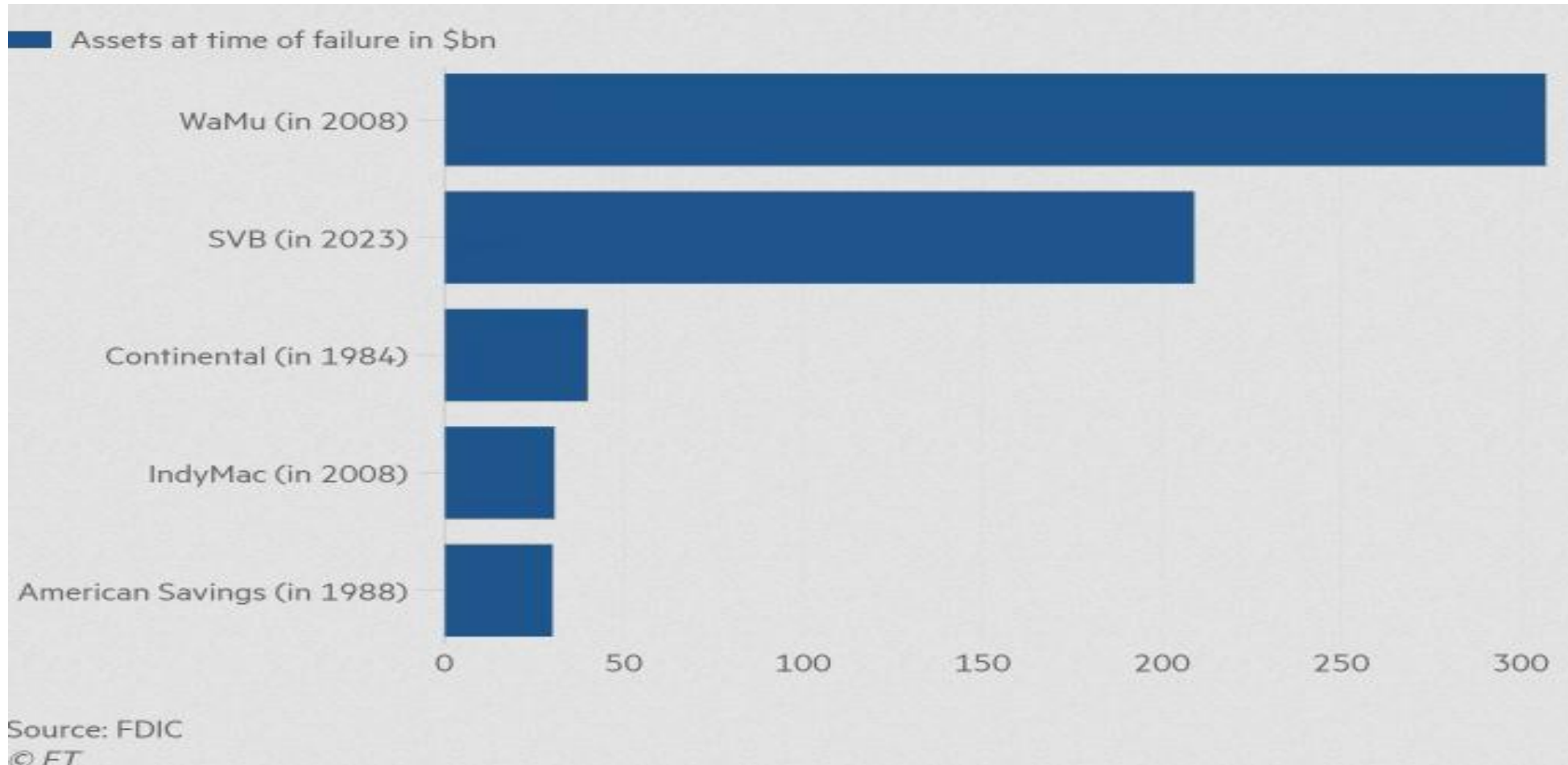
Deposit Insurance

“After all there is an element in the readjustment of our financial system more important than currency, more important than gold, and that is the confidence of the people”

– Franklin Delano Roosevelt



SVB is second-biggest US failure in history





We will do “whatever is needed” to save the US banking system

– Joe Biden, 13 March 2023



Deposit Insurance

General Characteristics

- Deposit insurance has two main purposes:
 - Depositor protection
 - Financial stability
- Primarily funded through contributions by participating banks
- Coverage is in most cases limited to a certain amount and/or certain types of bank accounts
- The designs and features of national deposit insurance schemes vary considerably
 - However, there are international standards for deposit insurance



Deposit Insurance

Depositor Protection

- Difficulty of assessing a bank's soundness and risk profile
- A bank failure has a potentially calamitous impact on households and SMEs
 - Households and SMEs often only have accounts at one bank
- Without deposit insurance, depositors have to await the end of the insolvency proceedings in order to get their savings back
 - Usually, they will only receive a small fraction thereof – at best



Deposit Insurance

Financial Stability

- A bank run could possibly cause further runs on other – sound – banks, resulting in liquidity problems for that bank
 - Risk of a domino-effect
- Deposit insurance bolsters confidence in the banking sector
 - Confidence is one of the most vital goods in the financial sector



Deposit Insurance

IADI Core Principles for Effective Deposit Insurance Systems

- International Association of Deposit Insurers (IADI)
 - Established 2002 to enhance the effectiveness of deposit insurance systems by promoting guidance and international co-operation
 - Currently representing 87 deposit insurers
 - Domiciled at the BIS in Basel
- Core principles issued in 2009 (in co-operation with the BCBS)
 - Revised in November 2014
- Included in the FSB's list of key standards



Deposit Insurance

IADI Core Principles

Principle 1 – Public Policy Objectives

Principle 2 – Mandate and Powers

Principle 3 – Governance

Principle 4 – Participation with other Safety-net Participants

Principle 5 – Cross-border Issues

Principle 6 – Deposit Insurer's Role in Contingency Planning and Crisis Management

Principle 7 – Membership

Principle 8 – Coverage

Principle 9 – Sources and Uses of Funds

Principle 10 – Public Awareness

Principle 11 – Legal Protection

Principle 12 – Dealing with Parties at Fault in a Bank Failure

Principle 13 – Early Detection and Timely Intervention

Principle 14 – Failure Resolution

Principle 15 – Reimbursing Depositors

Principle 16 – Recoveries



Deposit Insurance

Mandate and Powers (Principle 2)

Paybox	Paybox Plus	Loss Minimiser	Risk Minimiser
Switzerland	United Kingdom	Canada	United States
Reimbursement of insured deposits in the event of a bank failure	Reimbursement and additional tasks, i.e. certain specific functions during bank resolution	Deposit insurer also takes part in selecting a resolution strategy (i.e. the most cost-efficient method)	Deposit insurer has both resolution and supervisory powers

Scope of the mandate



Deposit Insurance

Coverage (Principle 8)

- Examples (per depositor/bank):
 - Switzerland: CHF 100,000 (But only up to CHF 6bn system-wide)
 - United States: USD 250,000
 - EU: EUR 100,000 (or the equivalent thereof)
 - UK: GBP 85,000



Deposit Insurance

Membership (Principle 7)

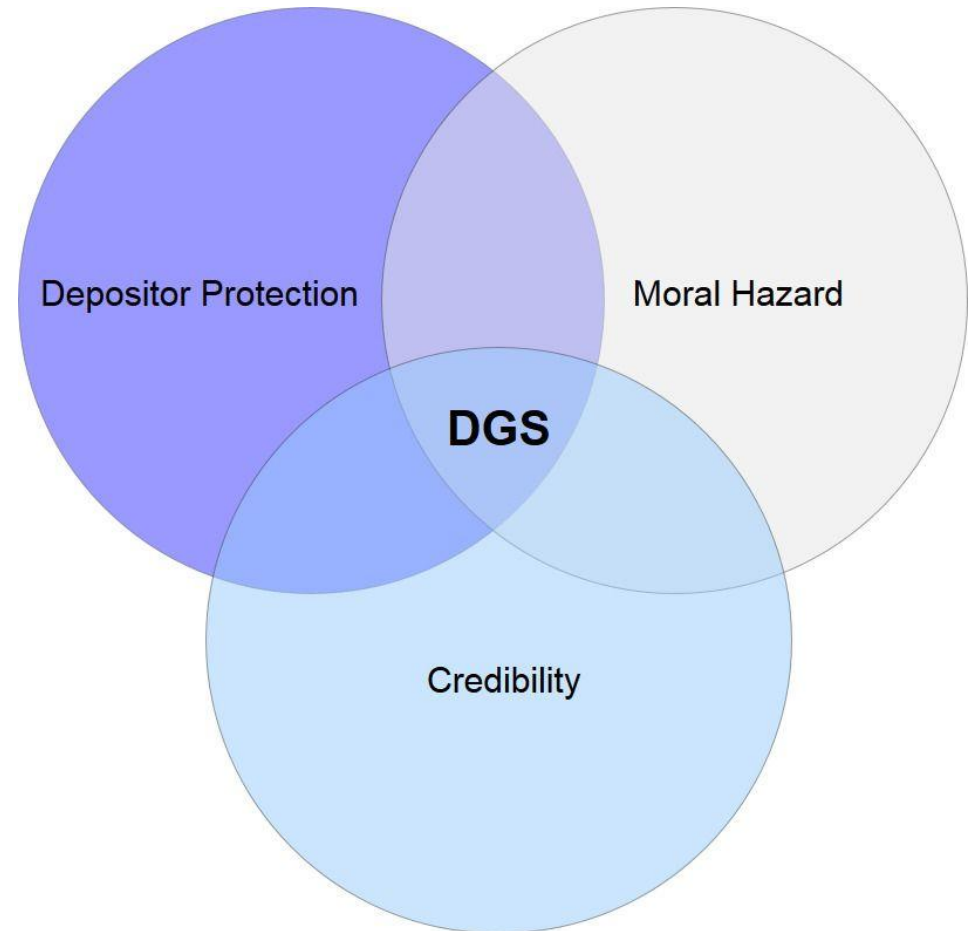
- Membership compulsory for all banks
 - This includes both private-sector and state-owned banks
- Level playing field; no market distortions
- Even after the revocation of a bank's license, membership continues for a certain time



Deposit Insurance

Coverage (Principle 8)

- “Limited, credible and cover the large majority of depositors but leave a substantial amount of deposits exposed to market discipline”
- No co-insurance as this may undermine the effect of a DGS (e.g. UK until October 2007)





Deposit Insurance

Sources and Uses of Funds (Principle 9)

- Funding through premia collected from the DGS' member institutions
- The premia have to incorporate the risk-taking of each member institution
- Funding should be on ex ante-basis
 - Ensures that the DGS possesses its resources at the time of a triggering event
 - Ex ante funding is anti-cyclical
 - Opposed to ex post-funding (e.g. in Switzerland)
 - However, the DGS may also foresee ex post-funding (mainly if the fund is depleted) and emergency funding arrangements (government, CB and/or market borrowing)



Deposit Insurance

Reimbursement of Depositors (Principle 15)

- Reimbursement of most insured depositors within 7 working days
 - Switzerland: Law states 20 days; Insurer guarantees 5 working days
 - EU: 7 working days
 - UK: 7 working days
 - US: no absolute limit, but (see next slide)
- Mitigate the impact of bank failure on the most vulnerable depositors
 - Households, SMEs using only one bank
- Severely restricted/insufficient liquidity may be detrimental to households and the economy at large



US Federal Deposit Insurance Corporation (FDIC) – Case study

US federal law does not stipulate an absolute timeframe for when depositors must be repaid. It only requires that the FDIC reimburse depositors "as soon as possible".

Example: In practice, the FDIC will be informed by the depository institution's primary federal regulator 90 days before the institution is closed.

- Hence, the FDIC starts to determine the least-cost resolution method and to assess the structure and amount of insured deposits.
- Thus, the FDIC usually has sufficient time to prepare so that depositors will have access to their deposits the next business day, i.e. Monday since the authorities often close the bank (put it into resolution) on Friday afternoon.
- Repaying depositors is coordinated with bank resolution methods, such as purchase & assumptions, DINBs, or bridge institutions. However, a direct pay-off (by cheque) might not always be feasible
- Makes deposit insurance funds available to finance resolution measures on a least-cost basis



New Zealand: The Reserve Bank of New Zealand Act (amended 1996)

Traditional reliance on **strict public disclosure** by banks and **bank executive accountability regime**. Reserve Bank of New Zealand Act (amended 1996)

During the 2007-08 crisis, however, New Zealand set up a temporary scheme to protect depositors - the **Crown Retail Deposit Guarantee Scheme**. But was **terminated by end-2011**; and since then, New Zealand no longer operates a deposit guarantee scheme. Depositors may even be bailed-in as part of the **Open Bank Resolution (OBR)** framework.

This led to IMF criticism in its **2017 FSAP of New Zealand**. The IMF has advocated creation of an explicit deposit guarantee scheme - or at least the implementation of a de minimis-exception for deposits in the OBR framework.

At present, New Zealand is in the process of **overhauling the Reserve Bank of New Zealand Act**, the **establishment of an explicit deposit guarantee scheme** as well as **strengthening the executive accountability regime** (based upon the experience in Australia).

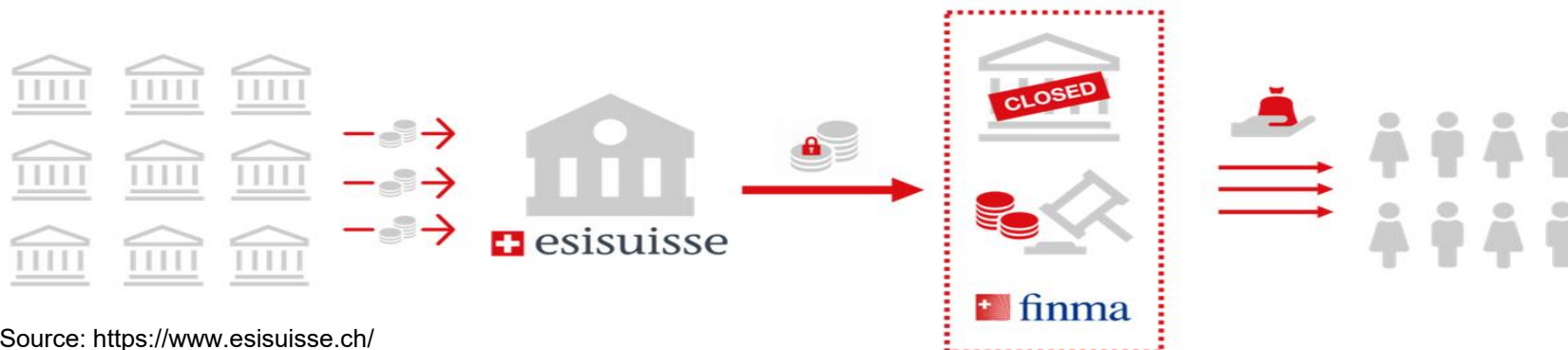
See statement by the NZ Minister of Finance summarising the proposal:

<https://www.beehive.govt.nz/release/keeping-banks-safe-and-holding-executives-accountable>



Deposit Insurance Scheme in Switzerland: Key Elements

- **CHF 100,000** per depositor and bank (Art. 37a BankA)
- All **banks must hold collateral** equivalent to 125% of the protected and preferential client deposits.
- Protected deposits have **preferential status in the event of bankruptcy**.
- The bank's liquidator appointed by FINMA uses the bank's available liquidity **to pay out the protected deposits**.
- The Swiss Banking Association levies funding on all Swiss banks: **banks are jointly and severally liable** up to the amount of their payment obligation.
- **esisuisse funds the payment for the protected deposits if the bank has insufficient liquidity** available. For this, the banks provide esisuisse with a maximum of 1.6% of all protected deposits in Switzerland (approx. CHF 8 billion).
- Half of these approx. CHF 8 billion must be secured for esisuisse by bank's collateral (securities or money)





Deposit Insurance

“A deposit insurance system is like a nuclear power plant.
If you build it without safety precautions,
you know it’s going to blow you off the face of the earth.
And even if you do, you can’t be sure it won’t.”
– L. William Seidman, Former FDIC Chairman



Too big to fail





Too big to fail and financial stability

- Bail-out and moral hazard problem: the image of subsidising bank failure
- Banking crisis and systemic risk relevance: avoiding spillover, bank runs, and addressing wider economy
- Regulatory consequences:
 - enhancing deposit guarantee schemes (compensating depositors' disadvantage of information)
 - putting special resolution regimes in place
 - shift from bail-out to the possibility of a market-based solution (preferably restructuring and/or resolving “from within”)



Introduction

– Crisis prevention

Supervisory authority in charge of ensuring adherence to regulatory requirements, if necessary with

- enforcement measures
- early intervention measures

– Crisis management/resolution

Resolution authority in charge of resolving or winding down a failing bank without adverse effects on financial stability

Regulation: interventions at both stages are rules-based



Bank collapses: winding up by insolvency law and proceedings?

- Inadequacy of insolvency procedures
 - conducted by judicial authority
 - may result in limiting banks' continuity of essential intermediary function
 - the going concern value
 - unlikely cross-border cooperation on internationally acting banks
 - ring-fencing



FSB Key Attributes

- In the past, authorities were faced with the alternatives of letting a bank go into potentially disorderly insolvency (Lehman) or bailing it out with taxpayer money
- Inadequate resolution frameworks, often relying on court-led general bankruptcy proceedings
- TBTF and resolution as key post-crisis policy objectives
 - FSB framework for reducing the moral hazard of SIFIs (the SIFI Framework), endorsed by the G-20 at the Seoul Summit in 2010
 - FSB Key Attributes of Effective Resolution Regimes for Financial Institutions adopted in October 2011, endorsed by the G-20 at the Cannes Summit in 2011



Bank resolution regimes: addressing moral hazard and banks' intermediary function

- Core objectives:
 - protection of financial stability
 - addressing global systemically important banks
 - continuity of banks' intermediary function
 - limited use of public funds
 - balance between investor rights and regulatory objectives vital to the wider economy



Bank Resolution Tools

- > Sale of business tool
- > Asset separation tool
- > Bridge institution tool
- > Bail-in tool



General strategy of FSB recommended principles

Resolution planning

1. Understanding the bank
2. Preferred resolution strategy
3. Financial and operational continuity in resolution
4. Information and communication plan
5. Resolvability assessment

Resolution scheme

1. Determination of resolution conditions
2. Adoption of resolution scheme
 - Which resolution tools?
 - How to finance resolution action?

preparation for





FSB Key Attributes

KA 1 – Scope

KA 2 – Resolution authority

KA 3 – Resolution powers

KA 4 – Set-off, netting, collateralisation,
segregation of client assets

KA 5 – Safeguards

KA 6 – Funding of firms in resolution

**KA 7 – Legal framework conditions for
cross-border cooperation**

KA 8 – Crisis management groups

KA 9 – Institution-specific cross-border
cooperation agreements

KA 10 – Resolvability assessment

KA 11 – Recovery and resolution planning

KA 12 – Access to information and information
sharing

Main characteristics of recommended
principles and tools:

- Pro-active approach to resolving/restructuring
- Resolution planning to “understand the bank”
- Resolvability assessments



FSB Key Attributes

Scope (KA 1)

- All financial institutions that could be systemically significant or critical
- Including holding companies, non-regulated entities of a group/conglomerate, branches of foreign firms

Resolution authority (KA 2)

- *Administrative* authority/authorities to exercise resolution powers
- Objectives: (1) safeguard financial stability and continuity of critical functions; (2) protect depositor/insurance policy holder/investor; (3) avoid unnecessary destruction of value and seek minimization of resolution costs; (4) consider impact on financial stability in other jurisdictions
- Operational independence, transparent processes, sound governance, adequate resources, accountability mechanisms, expertise and resources



FSB Key Attributes

Resolution powers (KA 3)

- Entry into resolution: firm is (likely) no longer viable and no reasonable prospect of becoming so, but not yet insolvent
- General resolution powers: remove/replace management/directors, appoint administrator, restructure/wind down firm's operations, override shareholders' rights...
- Resolution tools: (1) transfer assets and liabilities; (2) establish bridge institution; (3) bail-in within resolution; (4) establish separate asset management vehicle

Safeguards (KA 5)

- Respect creditor hierarchy (with exceptions) and “no creditors worse off than in liquidation”
- Legal remedies and judicial action vs. speed and flexibility required in resolution; only ex post compensation (no reversal)



FSB Key Attributes

Funding of firms in resolution (KA 6)

- Availability of temporary sources of funding to maintain essential functions: DGS, resolution fund or other funding mechanism
- Strict conditions to minimize the risk of moral hazard: last resort, strictly necessary to achieve resolution objectives, allocation of losses to equity holders
- Recovery of any losses from uninsured creditors and, if necessary, from the industry

Resolvability assessments (KA 10)

- Regular evaluation of *feasibility* and *credibility* of resolution strategies
- Group resolvability assessments conducted by home authority in coordination with host authorities
- Measures to reduce complexity and costliness of resolution (as a going concern)



Improved resolution through *ring-fencing (structural regulation)*

- FSB Key Attribute 10.5:

“To improve a firm’s resolvability, supervisory authorities or resolution authorities should have powers to require, where necessary, the adoption of appropriate measures, such as changes to a firm’s business practices, structure or organisation [...] To enable the continued operations of systemically important functions, authorities should evaluate whether to require that these functions be segregated in legally and operationally independent entities that are shielded from group problems.”
- UK Banking Reform Act 2013: ring-fencing of retail deposits/small & medium-sized businesses activity from rest of the group; a backstop power option to enforce full separation of ring-fenced activities from the group
- Switzerland: No structural regulation requirements for bank resolution



FSB Key Attributes

Recovery and resolution planning (KA 11) Board approval

- Recovery plans (responsibility of management and supervisory authority): identifies options to restore financial strength and viability when firm comes under severe stress
- Resolution plans (responsibility of resolution authority): includes a substantive resolution strategy and an operational plan for its implementation
- Regular updates and review: at least annually and if material changes



Contents of Recovery and Resolution Plans (I)

- FSB Annex III, Point 2.1:
 - i. high-level substantive summary of the key recovery and resolution strategies and an operational plan for implementation;
 - ii. strategic analysis that underlies the recovery and resolution strategies;
 - iii. conditions for intervention, describing necessary and sufficient prerequisites for triggering the implementation of recovery or resolution actions;
 - iv. concrete and practical options for recovery and resolution measures;
 - v. preparatory actions to ensure that the measures can be implemented effectively and in a timely manner;
 - vi. details of any potential material impediments to an effective and timely execution of the plan; and
 - vii. responsibilities for executing preparatory actions, triggering the implementation of the plan and the actual measures.



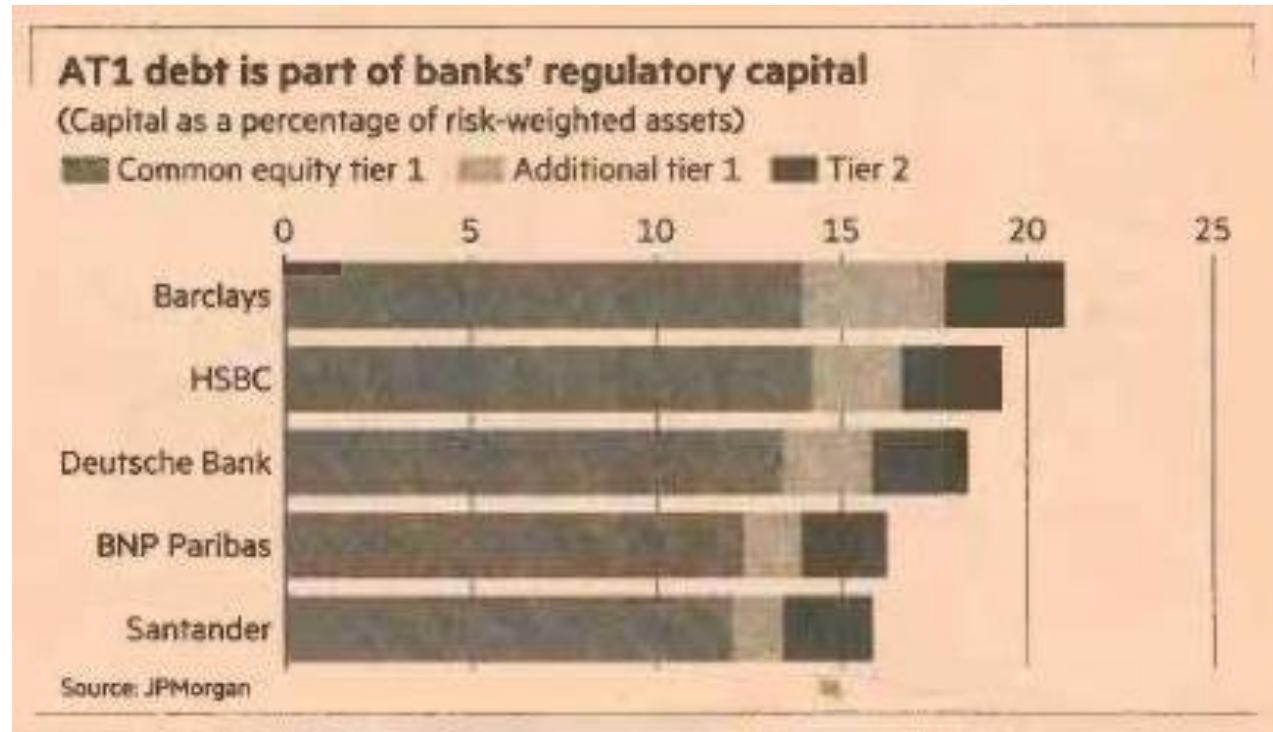
G-SIBs: TLAC – Total Loss-Absorbent Capital – 18% of risk-weighted assets (RWAs)

- G-SIBs must have financial instruments available to absorb losses in resolution and recapitalise “from within”
- Applies to G-SIBs only
- Determination of loss absorption by risk-weighted asset percentage
- Minimum regulatory capital to be met alongside the Basel III framework
- Eligible instruments: can be met with equity, debt capital, other unsecured long-term liabilities, minimum regulatory capital, *subordinated* debt liabilities that meet certain other criteria (contractual, statutory, structural subordination)
- TLAC requirement:
 - 18% of RWAs and 6.75% of leverage exposure measure as of January 2022



Financial Times (March 30th 2023)

„Credit Suisse AT1 wipeout tipped to cost banks dear“



Source: Financial Times, 30th March 2023



G-SIBs

FSB members apply heightened prudential requirements to G-SIBs:

- **Total Loss-Absorbing Capacity (TLAC):** TLAC standard must be met alongside the regulatory capital requirements set out in the Basel III framework, has been phased-in on 1 January 2019
- **Resolvability:** Group-wide resolution planning and regular resolvability assessments, including through FSB Resolvability Assessment Process (RAP)
- Higher **supervisory expectations:** Including for risk management functions, risk data aggregation capabilities, risk governance and internal controls



G-SIBs

Single Point of Entry (SPE) group resolution

- All resolution action applies to a single entity at the top of the banking group (holding company/top level)
- Group's home authority is responsible for executing resolution strategy
- Host authorities are expected to recognise resolution action within their jurisdictions
- Possibility of avoiding resolution for operating subsidiaries

Multiple Point of Entry (MPE) group resolution

- Resolution measures are implemented at various operating entities or subsidiaries
- Group structure is broken along operational and/or jurisdictional lines
- Multiple resolution authorities are in charge of executing resolution
- Risk of subsidiaries suffering losses
- Risk of competitive resolution/insolvency, ring-fencing

SPE preferred by host countries to large global banking groups/G-SIBs (e.g. U.S., U.K. and Swiss authorities); SPE popular in countries that do not host headquarters of large global banking groups



EU Directive on Bank Recovery and Resolution

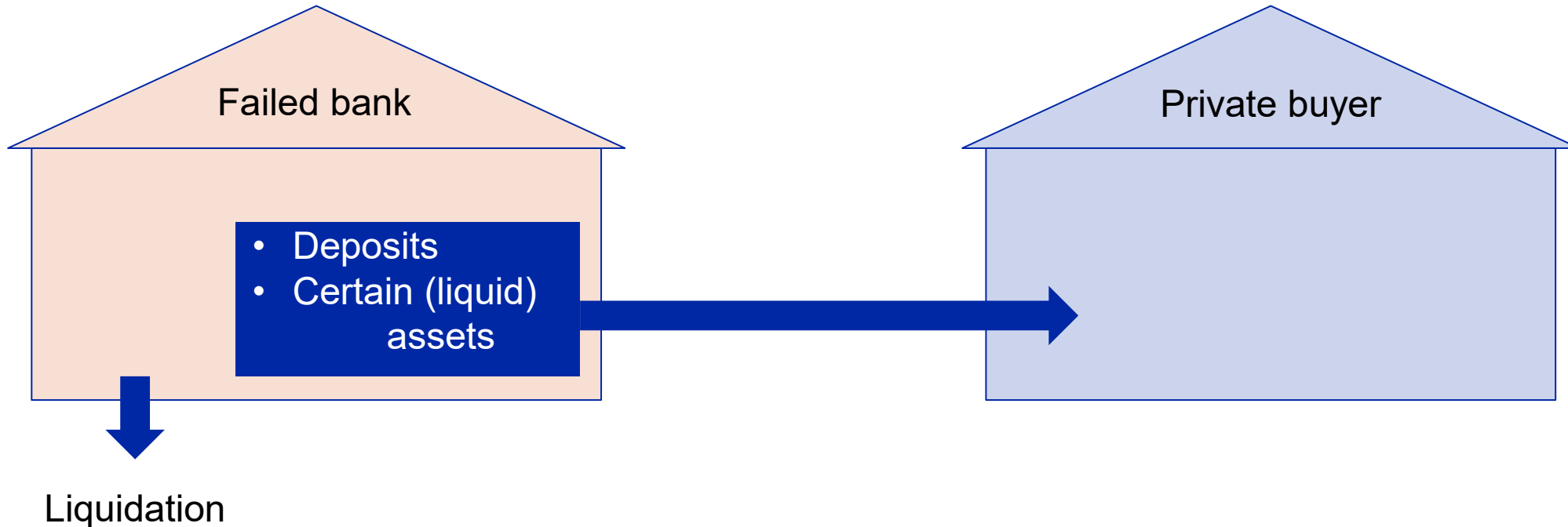
- Scope identical to that of Capital Requirement Directive (= credits institutions, financial groups and conglomerates, certain investment firms)
- Member States must designate a resolution authority with set of “minimum” resolution tools:
 - Sale of business tool
 - Asset separation tool
 - Bridge institution tool
 - Bail-in tool
- However minimum harmonisation Directive: discretion of MS whether to adopt stricter recovery and resolution tools
- Authority has power to veto intra-group financial support agreements, but also power to enforce them once concluded (relation to ring-fencing?)
- Competent authority reviews RRP, can adopt measures to overcome deficiencies or potential impediments to the plan’s feasibility



Resolution tools

- wide range of resolution tools
- resolution authorities' discretion wide
- no clear guidance on their use or readjustment in case of changing circumstances

Sale of business

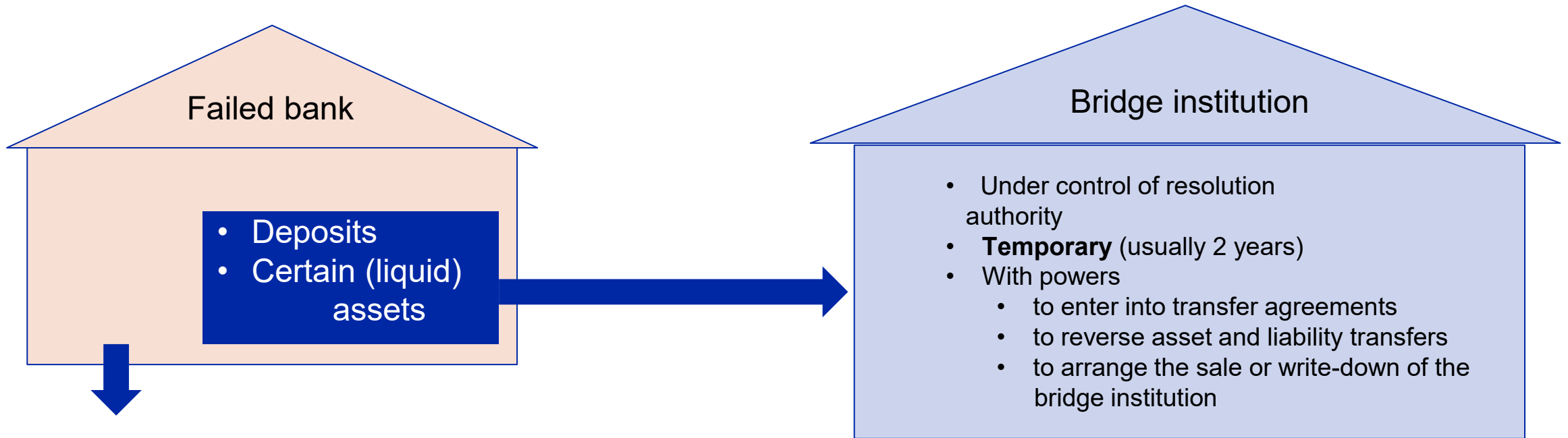


Example: Banco Popular Español bought by Santander (2017) and UK SVB bank bought by HSBC (2023)



Resolution tools

Bridge institution



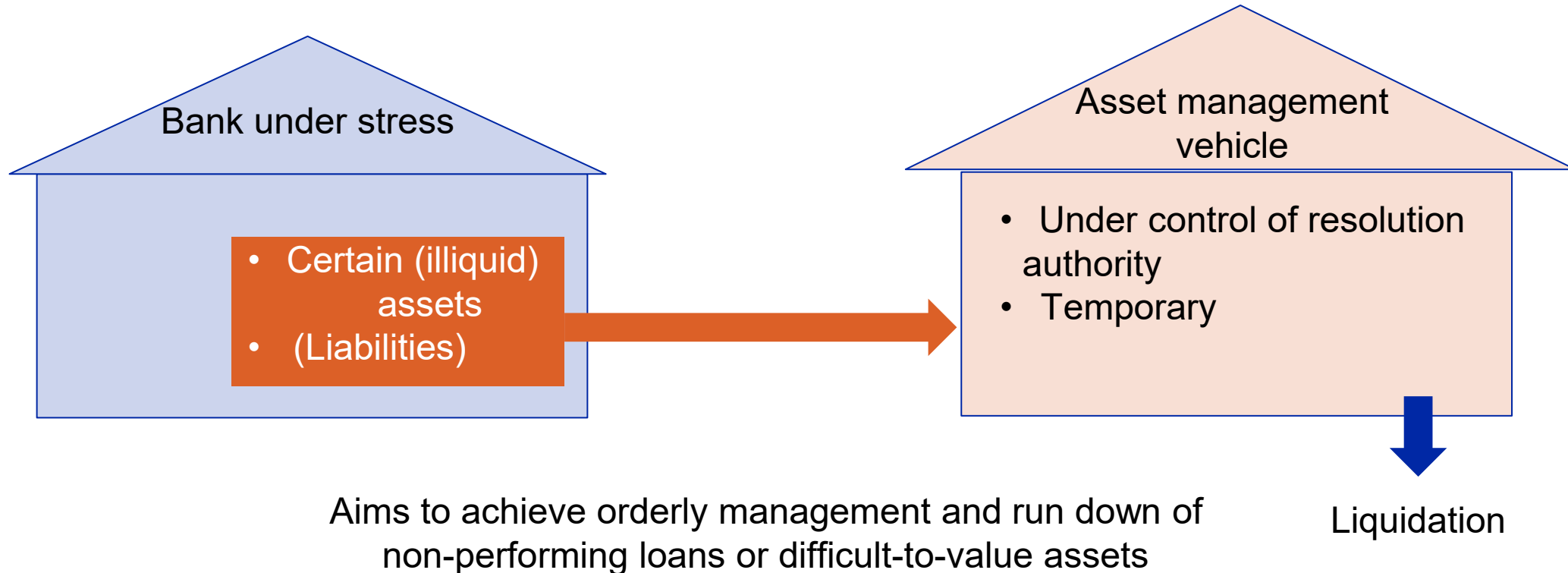
Liquidation

Aims to continue operating certain critical functions
and viable operations of a failed firm's transferred
business/functions



Resolution tools

Asset separation





Resolution tool: bail-in under the BRRD

Bail-in

Losses borne primarily by bank's shareholders and creditors

- Determination of amount needed to restore bank to viability (meeting regulatory requirements and enjoying market confidence)
- Insolvency ranking applies (in reverse order), pari passu treatment
- DGS may contribute to the extent it would have contributed in an insolvency proceeding

Exemptions

- Deposits up to EUR 100,000
- Interbank loans (maturity up to 7 days)
- Salaries/pension benefits...

Discretionary exemptions

In pursuance of resolution objectives
→ “no creditor worse off” principle

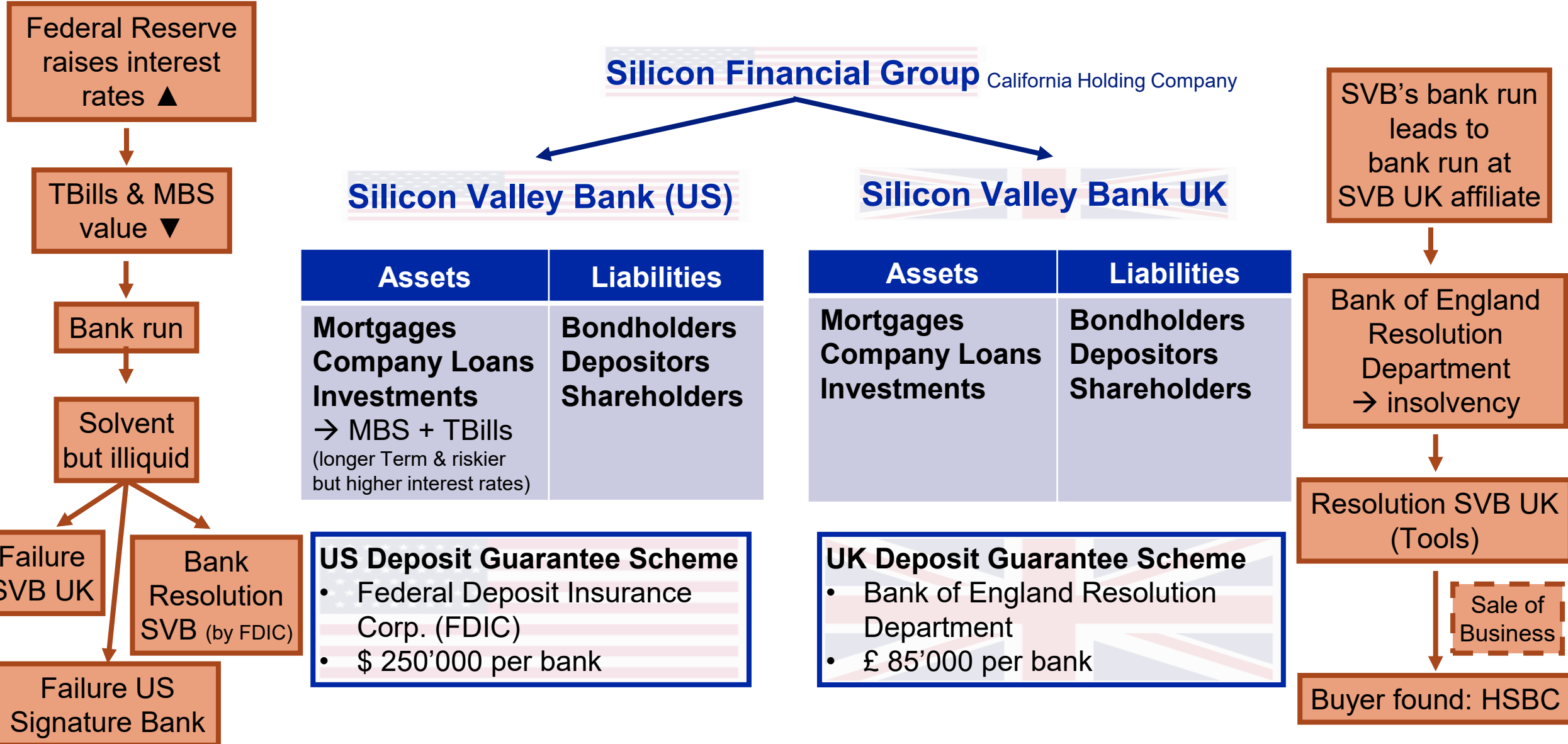


Bail-in: discretion as to its use

- Wide discretion of authorities regarding creditors to be bailed in
- Bail-in can be used in conjunction with other resolution tools
- Lack of guidance as to which resolution tool should be applied in what circumstances
- Institutional and operational handling varies across countries
 - Legal questions coming with it:
 - Risk of infringing on investor rights / shareholder rights
 - Restricting property rights and other fundamental rights constrained by legal principles:
 - ECHR: seeks balance between shareholder interests and state's prerogative to crisis intervention
 - CJEU: applies principle of proportionality



2023 Silicon Valley Bank Collapse





Failure Silicon Valley Bank

Failure Silicon Valley Bank

Failure Signature Bank

Failure SVB UK

Bank resolution by FDIC

Deposit Insurance Fund

- Full protection of all depositors
- Uninsured depositors recovered by special assessment on banks (i.e. amount over \$250,000)
- No losses borne by taxpayer (covered by bank's insurance premia and NEW Bank Term Funding Program BTFP)
- No protection of shareholders and certain unsecured debtholders

NEW Bank Term Funding Program BTFP

- Loans up to 1 year to banks
- Collateral: Pledge of US Treasuries, agency debt, MBS and other qualifying assets
- These assets will be valued at par
- \$25 billion from the Exchange Stabilization Fund as a backstop for BTFP

FDIC Administration: Senior management has been removed

Bank resolution by Bank of England Resolution Department

**Resolution Tool:
Sale of Business**

HSBC buys UK arm of SVB for £1

- Loans of around 5.5 billion pounds
- Deposits of around 6.7 billion
- Total balance sheet size of around 8.8 billion pounds
- Assets and liabilities of the parent company were excluded from the transaction



Banks' recovery and resolution planning in Switzerland (overview)

- Systemically important banks must have financial regulator (FINMA)-approved recovery and emergency plans in place
- FINMA also prepares a resolution plan for these institutions
- These plans lay the groundwork for these financial institutions to be restructured or resolved without the loss of their systemically important functions

Financial & markets regulation

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Rules for winding up big banks do not work, Swiss finance minister warns

Karin Keller-Sutter says following the protocols 'would have triggered an international financial crisis'



Source: <https://www.ft.com/content/2cfaaf47-101c-4695-92e5-b66b6abe777e>



Conclusion – Key take-aways

- Deposit guarantee schemes goal to protect retail depositors but attempts to prevent moral hazard. SVB Bank case an example of bail-out and contributes to moral hazard?
- TBTF and bank resolution as key international policy priorities
- FSB has immediate influence on regulation, supervision and resolution of *individual* global systemically important banks (G-SIBs)
- G-SIBs must meet heightened prudential standards and are subject to more rigorous supervision
- Bail-in a core new resolution tool in Europe, UK and Switzerland to impose losses on creditors (bondholders) and shareholders. Bail-in only used ad hoc manner in US.