Resolving G-Sifis – a Q&A with Simon Lewis, chief executive of the Global Financial Markets Association on the joint paper released earlier this week by the Federal Deposit Insurance Corporation (FDIC) and Bank of England

Q: Can you outline what proposals have been issued earlier this week by the Federal Deposit Insurance Corporation (FDIC) and Bank of England paper?

The US Federal Deposit Insurance Corporation and the Bank of England issued a joint paper entitled ‘Resolving Globally Active, Systemically Important Financial Institutions’ which discusses how UK and US regulators plan to deal with global systemically important financial institutions – or G-Sifis - that fail across the two jurisdictions.

The paper focuses on ‘top down’ resolution strategies that involve a single resolution authority applying its powers to the top of a financial group – that is, at the parent holding company level – while keeping bank, securities and other operating subsidiaries out of resolution, insolvency or administration.

These strategies are designed to solve the ‘too big to fail’ problem by providing an alternative to the toxic choice between taxpayer-funded bailouts and liquidations that can destabilize the financial system. The broader goal is to produce resolution strategies that can impose losses on a firm’s shareholders and debtholders, rather than taxpayers, while maximizing the group’s franchise value and maintaining its systemically important operations. This will provide a credible alternative to the toxic choice between taxpayer bailouts and destabilization of the financial system.

Q: What’s the significance of these proposals?

Ever since the collapse of Lehman Brothers and the bailout of AIG and other firms four years ago, policymakers have been debating how best to develop a resolution framework that will effectively deal with a failing institution without a destabilizing liquidation like Lehman or a bailout like AIG.

In light of the fact that 12 of the world’s 28 G-Sifis are based in the UK or US, this paper is a major contribution to that debate.
Q: Do you agree with the approach taken in the paper?

Yes, we strongly agree with top-down resolution strategies, when they are appropriate. They can be effective in resolving most G-SiFis by imposing the losses of the G-SiFi on its shareholders and debtholders, instead of taxpayers, while maximizing its franchise value and preserving the systemic operations of its operating subsidiaries.

There has been some press comment suggesting that GFMA is not supportive of the top down approach to resolving G-SiFis. However, this is categorically not the case.

GFMA strongly supports the joint paper – our members believe that no financial firm should be ‘too big to fail’ or have to rely on taxpayer support for its survival.

The paper provides a helpful explanation of the approaches that each of the US and UK authorities would take to resolution of G-Sifis via a single point of entry route.

Although the main focus of the paper is on a ‘single point of entry’ resolution approach, the joint paper itself acknowledges that the US and UK would apply different versions of this approach because of the differing legal structures and funding approaches of their G-SiFis. It also points out that the top-down approach may “not necessarily be appropriate for all UK G-SiFis in all circumstances. Other strategies may be more appropriate depending on the structure of the group, the nature of its business, and the size and location of the group’s losses.”

We agree with this qualification as much as we agree with top down strategies, when they are appropriate. In other words, as we pointed out in our recent comment letter on the Financial Stability Board’s Consultative Document on Recovery and Resolution Planning, we do not believe that one size fits all financial firms. Different resolution models or ‘presumptive paths’ may be necessary, depending on a firm’s corporate structure, size, complexity, funding structure, or other characteristics or circumstances.

Q: So you think resolution authorities should have some flexibility in their approach?

Yes, although as we pointed out in our recent comment letter to the FSB, we think that pre-vetted resolution strategies are necessary to provide host-country regulators, depositors, creditors, equity holders, counterparties and financial market infrastructures, among others, with a reasonable degree of confidence of how a particular G-SiFi will be resolved in a failure scenario.

As the joint FDIC / Bank of England paper acknowledges, resolution authorities need some flexibility to deviate from the ‘presumptive path’ in order to adapt to particular circumstances at the time of a particular firm’s failure. The development of firm-specific cross-border cooperation agreements will be a key component to achieve the right balance between predictability and flexibility.

Any bilateral agreement between the UK and US could act as a framework for and supplement to individual firm specific cross-border cooperation agreements.

Q: How does the joint paper fit in with the other resolution programmes in development at G20 and European level?
Importantly this joint paper is set against the framework established by the Financial Stability Board (FSB) and is consistent with the FSB’s Key Attributes of Effective Resolution Regimes for Financial Stability. GFMA views the proposals as being in line with FSB, European Union and US resolution laws.

Q: What are next steps?

The proposals in the joint FDIC / Bank of England paper are likely to be discussed further with a view to developing cross-border cooperation agreements. In addition, we believe policymakers in other jurisdictions will be examining the proposals contained in the paper with great interest.