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1. Global solutions

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1.1 INTRODUCTION

Over the last 30 years, finance has become a truly global business. Driven by a desire for ever higher yields and facilitated by financial liberalization and technological innovation, large financial services providers operate on a global scale through extensive networks of subsidiaries and branches in many countries, managed along functional and product lines in disregard of national borders and legal entity boundaries.¹ Acting as systemically important nodes within global capital markets, bank business operations stretch across multiple currency and time zones with nearly instantaneous communication of market information through digital channels around the globe.² At the same time, national governments and regulatory authorities jealously guard their sovereignty and fiscal autonomy. Regulatory tools and supervisory mechanisms remain tied to events occurring within certain geographic boundaries and the direct³ reach of national measures is generally confined within jurisdictions.⁴ This is particularly pertinent when a global systemically important firm fails. Primary accountability to local constituencies – depositors, investors, taxpayers, politicians – requires domestic authorities to resolve the parts of a global firm within their jurisdiction in accordance with local interests and in disregard of any negative externalities that may be imposed on other parts of the group and in other

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¹ C Brummer, *Soft Law and the Global Financial System* (Cambridge: CUP 2nd edn, 2015) 10; L Baxter, 'Understanding the *Global* in Global Finance and Regulation' in R Buckley, E Avgouleas, and D Arner (eds), *Reconceptualising Global Finance and its Regulation* (Cambridge: CUP, 2016) 28, 38.

² IMF, *Resolution of Cross-Border Banks – A Proposed Framework for Enhanced Coordination* (11 June 2010) 7.

³ Of course, indirectly national measures may have (unintended) effects on other jurisdictions and may result in externalities, which may be positive – eg the recapitalization of a firm in one country revives the entire group; or negative – eg the seizing (ring-fencing) of parts of the firm in one country results in liquidity shortages in other parts of the firm.

⁴ Brummer (note 1 above) 23.

jurisdictions. As the bailout of the Dutch-Belgium Fortis group has demonstrated, even authorities that are used to working closely together during the good times may quickly reach the limits of their cooperative capacities when things go awry.⁵ Mervyn King's often-quoted 'Global banks are global in life but national in death'⁶ comes to mind.

Global solutions face a formidable obstacle in the 'financial trilemma', according to which global financial stability, enhanced cross-border financial integration and national regulatory and fiscal autonomy cannot all be realized simultaneously to their fullest extent.⁷ The current socio-economic reality requires the maximization of cross-border financial integration and national sovereignty at the cost of global financial stability. In respect of the latter, all that can be achieved for now is 'damage limitation' through enhanced coordination and cooperation⁸ on the basis of a weak form of global governance – at both macro- and micro-levels. In this respect, the Financial Stability Board's (FSB's) Key Attributes of Effective Resolution Regimes for Financial Institutions⁹ offer a soft-law framework at global level.

In this chapter, we first explore the 'financial trilemma' and its possible solutions (1.2), before we analyze the new international financial architecture as a weak form of global governance at the macro-level (1.3), and discuss the FSB's Key Attributes as the new 'international standards for

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⁵ BCBS, Report and Recommendations of the Cross-border Resolution Group (March 2010) 11.

⁶ P Thal Larson, 'Bank regulation needs straightening out' Financial Times, 30 March 2009.

⁷ S Claessens, R Herring, D Schoenmaker, 'A Safer World Financial System: Improving the Resolution of Systemic Institutions' Geneva Reports on the World Economy 12 (International Center for Monetary and Banking Studies, 2010) 32; D Schoenmaker, 'The Financial Trilemma' (2011) 111 Economic Letters 57–59.

⁸ Theoretically, coordination and cooperation may be distinguished. The former does not necessarily involve a mutual agreement between authorities; it requires that authorities unilaterally or multilaterally align their actions with those of other authorities. The latter entails an ex ante commitment to implement mutually agreed measures in a crisis scenario including the burden sharing; J-H Binder, 'Cross-border Coordination of Bank Resolution in the EU: All problems resolved?' (accessed 28 March 2019 at <http://ssrn.com/abstract=2659158>) 4–6. It is perhaps fair to say that in practice the boundaries between both concepts will be fluid.

⁹ FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2011; and October 2014).

resolution regimes'¹⁰ (1.4). We conclude with a tentative evaluation of the global resolution framework (1.5).

1.2 THE 'FINANCIAL TRILEMMA'

According to Dani Rodrik, the world economy faces a 'political trilemma': 'hyperglobalization'¹¹ cannot be realized together with both democratic governance and national sovereignty.¹² In a similar vein, the resolution of global systemically important financial firms poses a 'financial trilemma': global financial stability (i) cannot be easily combined with enhanced cross-border financial integration (ii) and national sovereignty in the form of regulatory and fiscal autonomy (iii).¹³ Despite its prevalence as an overriding policy objective, financial stability has remained an elusive concept.¹⁴ What matters here is 'global' financial stability, which may be defined as a state of affairs where the cross-border negative externalities of the resolution of a firm are fully taken into account and internalized by the acting resolution authorities.¹⁵ Cross-border financial integration in the present context is firm-specific and denotes a situation where a cross-border group is organized as a single economic unit along functional and market lines with centralized liquidity and services, disregarding national as well as legal entity boundaries to the greatest possible extent.¹⁶ The 'financial trilemma', and its possible solutions, emerge as follows:¹⁷

The combination of global financial stability (i) with cross-border financial integration (ii) leaves little room for national sovereignty (iii).

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¹⁰ G20, Cannes Summit Final Declaration – Building Our Common Future: Renewed Collective Action for the Benefit of All (November 2011) para 28.

¹¹ In a 'hyperglobalized' world 'all transaction costs have been eliminated and national borders do not interfere with the exchange of goods, services, or capital.'

¹² D Rodrik, *The Globalization Paradox: Why Global Markets, States and Democracy Can't Coexist* (Oxford: OUP, 2012) 200–205.

¹³ Claessens et al (note 7 above) 32; the 'financial trilemma' has been formally modeled by Schoenmaker (note 7 above).

¹⁴ M Schillig, *Resolution and Insolvency of Banks and Financial Institutions* (Oxford: OUP, 2016) 44–46 (para 3.11–3.14).

¹⁵ D Schoenmaker, *Governance of International Banking: The Financial Trilemma* (Oxford: OUP, 2013) 6.

¹⁶ Baxter (note 1 above) 38.

¹⁷ Claessens et al (note 7 above) 32; Schoenmaker (note 7 above) 57–59; Schoenmaker (note 15 above) 4.

In order to maximize both (i) and (ii), global systemically important financial institutions should be subject to a single and uniform resolution process encompassing all (relevant) subsidiaries and branches, governed by a global resolution framework and controlled by an integrated resolution authority that comprehensively assesses and takes into account the systemic risk implications of the resolution process, including cross-border externalities.¹⁸ This is the ‘global governance’ solution.¹⁹ The Eurozone’s Single Resolution Mechanism with its Single Resolution Board constitutes a (still incomplete)²⁰ regional example. At global level there is currently, and will be for the foreseeable future, neither the legal nor the institutional infrastructure necessary for this option.²¹ In the absence of a global resolution authority and a treaty-based uniform resolution framework, a ‘universal approach’ to resolution would be the ‘second best’ option for this combination. A single resolution process, controlled by the resolution authority of the country where the group is headquartered (home authority) would encompass the failing institution’s assets and liabilities on a worldwide basis;²² authorities in host states where the firm has a presence would facilitate the (foreign) resolution process by assisting the home authority in implementing resolution action within their territory; and also by proportionately sharing in the financial burden emanating from the resolution process.²³ The concept of ‘universalism’ is entity-specific and does not address the specific problems caused by corporate groups.²⁴ However, in the resolution context there seems to be no good reason why the concept should not be extended so as to cover subsidiaries as well.²⁵ In fact, the Single Point of Entry approach, under which resolution tools and powers are applied only at

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¹⁸ On the idea of a global banking regulator E Avgouleas, *Governance of Global Financial Markets: The Law, The Economics, The Politics* (Cambridge: CUP, 2012) chapter 8.

¹⁹ Rodrik (note 12 above) 10.

²⁰ Binder (note 8 above) 14.1–5.

²¹ Baxter (note 1 above) 45–16.

²² The EU Directive 2001/24/EC governing the reorganization and winding up of credit institutions and investment firms at regional (EU/EEA) level follows a strong universalist approach; Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions, OJ EC, 05.05.2001 L125/15.

²³ BCBS (note 5 above) 17–18; IMF (note 2 above) 10.

²⁴ BCBS (note 5 above) 18.

²⁵ Examples abound where the BRRD is sensitive to the group context: Art 33(1), (2) and (4); group-wide recovery and resolution planning; group resolution schemes under the Single Resolution Mechanism.

the level of the top-tier holding company by the home authority leaving operating bank and non-bank subsidiaries unscathed and fully functional,²⁶ can be seen as a particular emanation of universalism in the group context. Universalism entails a restriction of national sovereignty through deference to a foreign resolution authority for local parts of the failing group.

The combination of cross-border financial integration (ii) with national regulatory and fiscal autonomy (iii) is likely to sacrifice global financial stability (i). In the absence of a universally agreed and binding multi-national framework, every host authority involved is likely to adopt a territorial approach, ring-fencing the assets within their jurisdiction for the benefit of local depositors, creditors and taxpayers, with no regard for the negative externalities imposed on group entities and branches in other countries.²⁷ Without appropriate incentives to cooperate, national authorities will be primarily loyal to national taxpayers, politicians and voters.²⁸ The pursuit of resolution proceedings in one jurisdiction without regard to existing or impending parallel proceedings elsewhere is likely to increase the overall costs of the case to the detriment of creditors and failing institutions alike. The negative externalities imposed on foreign group entities and branches may render the global financial system less resilient.²⁹ ‘Territorialism’ as a concept of international insolvency law is also entity-based. Within the resolution context it should be understood more widely, also encompassing groups of companies. The Multiple Point of Entry resolution strategy, involving the application of resolution tools and powers by various resolution authorities to different parts of the group,³⁰ may be seen as a ‘territorialist’ approach to resolution.

Only by limiting cross-border financial integration (ii) may global financial stability (i) and national sovereignty (iii) be maximized. In

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²⁶ FSB, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies* (July 2013); Federal Deposit Insurance Corporation (FDIC), ‘Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy’ (2013) 78 Federal Register 76614; FDIC and Bank of England, *Resolving Globally Active, Systemically Important, Financial Institutions – A joint paper by the Federal Deposit Insurance Corporation and the Bank of England* (December 2012).

²⁷ BCBS (note 5 above) 16; IMF (note 2 above) 9.

²⁸ R Lastra, ‘International Law Principles Applicable to Cross-Border Bank Insolvency’ in R Lastra (ed) *Cross-Border Bank Insolvency* (Oxford: OUP, 2011) 161, 169 (para 7.22).

²⁹ IMF (note 2 above) 11–13.

³⁰ FSB (note 26 above).

order to prevent cross-border externalities, a financial institution's presence in any host jurisdiction must be structured in a way that local resolution action would not have any adverse effects on foreign group entities. This would generally seem to require the conduct of business in the host jurisdictions through separately capitalized subsidiaries, instead of branches.³¹ These subsidiaries would have to be independent from the rest of the group in terms of both liquidity and essential services. The various parts of the group would be managed separately and independently along jurisdictional and possibly legal entity lines. The failure of a local sub-group would have only limited cross-border effects on the rest of the group, which could continue to operate as normal. The failures of multiple sub-groups would be locally contained and the fiscal burden would fall on local authorities and taxpayers. Such 'deglobalization'³² might have significant benefits in terms of the reduction of global systemic risk; however, it would come at the cost of reduced efficiencies that are associated with running a large integrated business.³³

Each solution to the 'financial trilemma' constitutes a trade-off. At a normative level, policy makers in a perfect world would have to decide which of the three possible combinations is preferable to the other two. Methodologically this would require an empirical cost/benefit analysis for each alternative,³⁴ with all ensuing advantages and disadvantages adequately priced. In the real world, the political and economic realities restrict the available options to just one. At a time where the public memory of the last financial crisis, and with it the appetite for financial reform, is rapidly waning and where financial lobbyists have again almost unlimited access to political power,³⁵ it is simply unrealistic to assume that jurisdictions would impose a strict 'deglobalization' agenda. It is equally unrealistic to believe that at any time in the foreseeable future politicians would voluntarily limit national sovereignty by signing up to a robust global governance framework, with both the democratic legitimacy and fiscal resources to deal with a global financial firm in

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³¹ IMF (note 2 above) 14.

³² On 'sane globalization' in finance see Rodrik (note 12 above) 260–266.

³³ Baxter (note 1 above) 37–39.

³⁴ E Posner and E Weyl, 'Benefit-Cost Analysis for Financial Regulation' (2013) 103 *American Economic Review* 393–397.

³⁵ On the 'regulatory sine curve' see J Coffee, 'The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated' (2012) 97 *Cornell Law Review* 1019, 1029–1037.

distress.³⁶ The problems associated with the still incomplete Eurozone Banking Union provide a vivid example. Even universalism is problematic. Deferral to a foreign resolution authority and giving effect to foreign resolution action locally may be possible within limits. However, as soon as local financial resources would have to be applied for the benefit of foreign constituencies, universalism is likely to break down. The realization of global financial stability to a limited extent seems to be achievable only through a modified, pragmatic territorialism in the form of enhanced cooperation and coordination between national authorities. This requires some form of weak ‘global governance,’ both at the macro-level as a forum for establishing a general coordination framework, and at the micro-level, when in a concrete case resolution strategies have to be implemented and responsibilities allocated amongst the participating authorities.³⁷

1.3 WEAK GLOBAL GOVERNANCE AT THE MACRO-LEVEL: THE INTERNATIONAL FINANCIAL ARCHITECTURE

At the macro-level, the so-called International Financial Architecture has emerged since the 1970s and received its current shape in the aftermath of the Global Financial Crisis. It differs in important respects from traditional international organizations. The latter are typically established by international treaties between states, grounded in international legal obligations, with separate legal personality and specific enforcement mechanisms in the form of international courts or tribunals. By contrast, the main actors in the international financial sphere are largely the product of informal agreements with no sense of international obligation and no formal dispute settlement mechanisms.³⁸ Dominated by national regulatory authorities and officials, these international bodies are perhaps best described as Transnational Regulatory Networks (TRNs) where skilled technocrats negotiate common standards peer-to-peer and largely free from (uninformed) political interference. The results should be

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³⁶ Rodrik (note 12 above) chapter 10. Global governance may not even be desirable as it is likely to result in the least common denominator and a global race to the bottom.

³⁷ E Hüpkes, ‘Insolvency – Why a Special Regime for Banks?’, in 3 IMF Current Developments in Monetary and Financial Law (Washington DC 2003) 32.

³⁸ Brummer (note 1 above) 63–67.

applied and implemented domestically, not because of their legal force, but because of their inherent attraction and persuasiveness. Formal international institutions only have a peripheral role in monitoring domestic compliance.³⁹ This global governance framework is 'weak' in terms of both its legally binding force and its democratic legitimacy. Moreover, with the rise of nationalist political forces in countries around the world even a minimal global governance consensus can no longer be taken as a given.

The new International Financial Architecture may be analyzed as a four-level process.⁴⁰ The first level is characterized by the formulation of broad international political agendas. As a result of the Global Financial Crisis, the more inclusive⁴¹ Group of 20 (G20)⁴² has emerged as the dominant global agenda setter in economic and financial matters.⁴³ The G20 meets at the level of finance ministers and central bank governors, and, since the Global Financial Crisis, also at the level of heads of state or government.⁴⁴ Thus, the G20 combines technocratic expertise and political clout. Decisions are made on the basis of consensus.⁴⁵ In the resolution context, since the Washington DC Leaders' Summit of November 2008, the G20 has repeatedly called for regulators to strengthen cross-border crisis management arrangements,⁴⁶ develop a contingency and recovery planning framework, as well as an effective system of resolution tools and powers to restructure or resolve all types of financial institutions in crisis without having to rely ultimately on taxpayers' money.⁴⁷

Level two consists of the promulgation of best practices and standards by international groupings and networks of technocratic authorities with the relevant expertise and experience, the so-called international standard

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³⁹ *ibid* 67–69; Baxter (note 1 above) 33–34.

⁴⁰ DW Arner and R Buckley, 'Redesigning the Architecture of the Global Financial System' (2010) 11 *Melbourne Journal of International Law* 1, 18–19.

⁴¹ On the groupings of G7, G8 and G10 see Brummer (note 1 above) 72–73.

⁴² Members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the UK, the US and the EU.

⁴³ Arner and Buckley (note 40 above) 23; Brummer (note 1 above) 72–74.

⁴⁴ Arner and Buckley (note 40 above) 23; Brummer (note 1 above) 73.

⁴⁵ Brummer (note 1 above) 73.

⁴⁶ G20, Declaration of the Summit on Financial Markets and the World Economy (15 November 2008).

⁴⁷ G20, Leaders' Statement: The Pittsburgh Summit (24–25 September 2009); G20, The G20 Toronto Declaration (27 June 2010) para 21; G20, The G20 Seoul Summit Leaders' Declaration (11–12 November 2010) 2.

setters.⁴⁸ Sectoral standard setters deal with banking – the Basel Committee on Banking Supervision (BCBS), securities markets – the International Organization of Securities Commissions (IOSCO), and insurance – the International Association of Insurance Supervisors (IAIS). In addition, there are specialized standard setters for accounting (International Accounting Standards Board), clearing and settlement systems (Committee on Payments and Market Infrastructures), money-laundering (Financial Action Task Force), and deposit insurance (International Association of Deposit Insurers), to name but a few.⁴⁹ For bank resolution another international body has emerged as the main international standard setter. In 2009, the Financial Stability Board (FSB) became the successor institution to the Financial Stability Forum (FSF),⁵⁰ with an extended mandate including assessing weaknesses in the global financial system, advising regulators on the implications for regulatory policy,⁵¹ and driving the international reform agenda.⁵² The FSB has become the key forum for international economic coordination and for implementing the G20's policy agenda.⁵³ In this coordinating role, the FSB provides an interface between the G20 and the international standard setters. Its membership is very broad and includes, in addition to the G20 ministries of finance, central banks and regulatory agencies, also the international standard setters, as well as the International Monetary Fund, the World Bank and the OECD. The represented economies account for about 85 per cent of global economic output.⁵⁴ Building on the previous work of

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⁴⁸ Arner and Buckley (note 40 above) 19.

⁴⁹ Brummer (note 1 above) 76–92; see also D Zaring 'Financial Regulation's Overlooked Networks', in R Buckley, E Avgouleas, and D Arner (eds), *Reconceptualising Global Finance and its Regulation* (Cambridge: CUP, 2016) 67.

⁵⁰ G20, London Summit – Leaders' Statement (2 April 2009) para 15. The FSF had been established in 1999 following the Asian crisis.

⁵¹ Charter of the Financial Stability Board, June 2012, accessed 28 March 2019 at <http://www.fsb.org/wp-content/uploads/FSB-Charter-with-revised-Annex-FINAL.pdf>.

⁵² J Gordon and W-G Ringe, 'Bank Resolution in Europe: the Unfinished Agenda of Structural Reform' ECGI Law Working Paper No 282/2015 (January 2015) 4.

⁵³ Baxter (note 1 above) 33; Brummer (note 1 above) 73.

⁵⁴ D Arner and M Taylor, 'The Financial Stability Board and the Future of International Financial Regulation' in R Buckley, E Avgouleas and D Arner (eds), *Reconceptualising Global Finance and its Regulation* (Cambridge: CUP, 2016) 52, 53.

the FSF,⁵⁵ the IMF and World Bank,⁵⁶ as well as the BCBS' Cross-border Resolution Group,⁵⁷ the FSB has issued, in 2011, the Key Attributes of Effective Resolution Regimes for Financial Institutions,⁵⁸ which subsequently have been endorsed by the G20 Heads of State and Government as the 'new international standards for resolution regimes.'⁵⁹ Taking into account further guidance on the implementation of specific Key Attributes and sector-specific considerations, the Key Attributes have been republished in 2014 with the additional guidance documents incorporated as annexes.⁶⁰ Since then the FSB has issued a range of further documents that complement the Key Attributes, notably Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution,⁶¹ on the Cross-border Effectiveness of Resolution Actions,⁶² on the temporary funding needed to support the orderly resolution of G-SIBs,⁶³ on the operational continuity in resolution, including access to financial market infrastructures,⁶⁴ and further on bail-in execution and funding strategy elements of implementable resolution plans.⁶⁵

These best practices and standards issued by the international standard setters are of a pure 'soft law' nature and have no legally binding force.⁶⁶

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⁵⁵ FSF Principles for Cross-border Cooperation on Crisis Management (April 2009).

⁵⁶ IMF and World Bank, An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency (17 April 2009); IMF (note 2 above).

⁵⁷ BCBS (note 5 above).

⁵⁸ FSB (note 9 above).

⁵⁹ G20 (note 10 above) para 28.

⁶⁰ FSB (note 9 above); the initial 12 Key Attributes remain unchanged.

⁶¹ FSB, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution – Total Loss-absorbing Capacity (TLAC) term Sheet (9 November 2015); also FSB, Guiding Principles on the Internal Loss-absorbing Capacity of G-SIBs ('Internal TLAC') (6 July 2017).

⁶² FSB, Principles for Cross-border Effectiveness of Resolution Actions (3 November 2015).

⁶³ FSB, Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank ('G-SIB') (18 August 2016).

⁶⁴ FSB, Guidance on Arrangements to Support Operational Continuity in Resolution (August 2016); FSB, Guidance on Continuity of Access to Financial Market Infrastructures ('FMIs') for a Firm in Resolution (6 July 2017).

⁶⁵ FSB, Principles on Bail-in Execution (21 June 2018); FSB, Funding Strategy Elements of an Implementable Resolution Plan (21 June 2018).

⁶⁶ C Brummer, 'Why Soft Law Dominates International Finance – And Not Trade' (2010) 13 *Journal of International Economic Law* 623, 627–628.

Consequently, at the third level standards and best practices need to be transposed into ‘hard law’. This takes place at national and/or regional level.⁶⁷ National implementation of international soft-law standards is incentivized by market discipline and market access considerations in the sense that sound regulatory structures signal to market participants that the financial system and its institutions are more stable.⁶⁸ Firms operating in non-compliant jurisdictions may experience adverse cost of capital consequences. Non-compliance with international standards may also affect a national regulator’s reputation within the respective TRN and significantly impede its ability to create future coalitions and alliances. A further ‘compliance-pull’ may emanate from sanctions largely in the form of ‘naming and shaming,’ which requires, at the fourth level, implementation monitoring.⁶⁹ In addition to informal ‘peer review’ processes conducted by the standard setters themselves, the IMF and World Bank, as traditional international organizations, have established a formal peer review process in the form of an enhanced Financial Sector Assessment Program (FSAP).⁷⁰ Anticipating the Key Attributes, the US Dodd-Frank Act of 2010 has introduced the Orderly Liquidation Authority for covered financial companies in respect of which certain systemic risk determinations have been made. In the EU, the Bank Recovery and Resolution Directive was adopted in 2014, and had to be implemented in the Member States by 1 January 2016. For the Eurozone, the Single Resolution Mechanism has been operational as of the same date.⁷¹

1.4 PRAGMATIC TERRITORIALISM: INTERNATIONAL STANDARDS FOR RESOLUTION REGIMES

In an attempt to solve the ‘financial trilemma’, the Key Attributes adopt a form of pragmatic territorialism: Whereas resolution decisions and the taking of resolution action remain the exclusive responsibility of national (or regional) resolution authorities, the Key Attributes seek to establish a

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⁶⁷ Arner and Buckley (note 40 above) 19.

⁶⁸ Arner and Buckley (note 40 above) 19.

⁶⁹ Brummer (note 1 above) 120.

⁷⁰ *ibid* 93–98, 171–179. For the purposes of peer reviews and reviews in the FSAP context, the FSB has issued the Key Attributes Assessment Methodology for the Banking Sector: Methodology for Assessing the Implementation of the Key Attributes of Effective Resolution Regimes for Financial Institutions in the Banking Sector (19 October 2016).

⁷¹ For details Schillig (note 14 above) chapter 1.

framework that facilitates coordination and cooperation between national authorities, from the planning stage to actual crisis management and resolution. The ‘international standards’ comprise three core elements: (i) a broad range of resolution powers at national level that are meant to be internationally compatible so as to ensure a minimum of predictability in the cross-border context; (ii) a framework for international coordination and cooperation as a form of weak global governance at the micro-level; and (iii) a regime for the allocation of losses.⁷²

1.4.1 Comprehensive Resolution Powers

Effective cross-border cooperation and coordination requires at a minimum the compatibility of the available resolution tools and powers.⁷³ Consider a financial group that operates in its Home State A and maintains a banking subsidiary in Host State B. Whereas A has in place a comprehensive resolution regime that allows the resolution authority to seize the institution and transfer its assets and liabilities free and clear to a different entity, B may rely on standard corporate insolvency law which may be court-based and slow, with any transfer requiring shareholder and perhaps (secured) creditor consent. In this scenario, a speedy restructuring of the group as a whole could be very difficult even if authorities in State A and State B were keen to cooperate.⁷⁴ Consequently, the Key Attributes provide a range of resolution powers, applicable to systemically important financial institutions,⁷⁵ on which national legal systems should seek convergence.⁷⁶

Resolution powers should be available to the designated resolution authority in each jurisdiction,⁷⁷ and resolution should be initiated, as

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⁷² IMF, Cross-Border Bank Resolution: Recent Developments (June 2014) 7.

⁷³ BCBS (note 5 above) 26–27; IMF (note 2 above) 19.

⁷⁴ IMF (note 2 above) 19.

⁷⁵ The domestic resolution regime should be applicable to any financial institution the failure of which could result in systemically significant disturbances, including the holding companies of firms, significant non-regulated operational entities within a group and branches of foreign firms. The recovery and resolution planning requirement, including resolvability assessment and institution-specific cross-border cooperation agreements, should apply at least to all domestically incorporated global SIFIs; FSB (note 9 above) 5 (KA 1.1, 1.3).

⁷⁶ FSB (note 9 above) 6–10 (KA 3); see also BCBS (note 5 above) 22–24; IMF (note 2 above) 20.

⁷⁷ Each jurisdiction should designate one or more resolution authorities with operational independence and adequate resources and governance structures;

soon as a firm is no longer viable or likely to be no longer viable with no reasonable prospect of recovering. In order to facilitate early entry into resolution, this should be defined as occurring at a time well before the firm becomes balance-sheet insolvent or equity has been wiped out.⁷⁸ Given the significance of the resolution trigger for the efficacy of a resolution regime, it is somewhat surprising that the Key Attributes leave it so vague. A difference in the resolution triggers of affected jurisdictions may seriously impede cross-border cooperation. Consider again our example: if country A's resolution trigger is based on, say, the falling of regulatory capital below the minimum capital requirements, and country B's on regulatory capital being wiped out, a comprehensive resolution of the group based on cooperation between A's and B's authorities may be impeded by B's inability to take resolution action early enough. Many domestic resolution regimes rely on a 'regulatory threshold' based on minimum capital adequacy requirements, which generally allows the competent authorities to intervene before the emergence of illiquidity or a negative net worth.⁷⁹ Such a regulatory threshold meets the requirements of the Key Attributes, but also introduces the weaknesses of a capital-based approach to risk mitigation into the resolution framework. The global financial crisis has shown that regulatory capital ratios are prone to manipulation and uninformative when it comes to predicting financial distress.⁸⁰ In the context of the 'regulatory threshold' this introduces significant uncertainty.⁸¹

The Key Attributes provide a long list of general resolution powers that resolution authorities should have at their disposal.⁸² In an attempt to cater for all eventualities the list is somewhat repetitive and lacks a clear structure. The powers may perhaps be assigned to four thematic groups: (i) governance and control; (ii) transfer powers; (iii) (re-)capitalization powers; and (iv) ancillary powers. In terms of governance and control (i), resolution authorities should have the power to remove and replace senior management and to claw back bonuses; to appoint an administrator to

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resolution authorities should have the capacity to enter into agreements with resolution authorities of other jurisdictions; FSB (note 9 above) 5–6 (KA 2.1, 2.4, 2.5).

⁷⁸ FSB (note 9 above) 6–7 (KA 3.1).

⁷⁹ IMF and World Bank (note 58 above) 21.

⁸⁰ A Haldane, 'Capital Discipline', Speech given at the American Economic Association, Denver, 9 January 2011, 4, accessed 7 March 2019 at www.bis.org/review/r110325a.pdf; Avgouleas (note 18 above) 345–346.

⁸¹ Schillig (note 14 above) 247–248 (para 9.57).

⁸² See also BCBS (note 5 above) 22–24.

take control of the firm and manage it with a view to returning it to viability; or to operate and resolve the firm directly, including the power to terminate, assume or assign contracts and take any other action necessary to restructure or wind down the firm's operations; further, authorities should have the power to require other group entities or the residual entity to (temporarily) continue to provide essential services; the power to override shareholder rights in order to effectuate structural changes; and the power to close down and liquidate the firm or parts of it with a timely payout to insured depositors.⁸³ The transfer powers (ii) include the power to transfer any assets or liabilities, including deposits, to a third-party institution, a newly established bridge institution or a separate asset management vehicle. A transfer should not require the consent of any interested party or creditor and should not constitute an event of default under the relevant documentation.⁸⁴ Resolution authorities should have the power to establish bridge institutions for taking over certain critical functions and viable operations.⁸⁵ Non-performing loans and difficult to value assets may be transferred to an asset management vehicle for orderly wind down. As for the (re-)capitalization powers (iii), resolution authorities should have the power to carry out bail-in within resolution, with either a view to recapitalizing the institution in resolution or to capitalizing a newly established bridge institution. Bail-in entails the write down or conversion into equity, as the case may be, of capital instruments and unsecured and uninsured creditor claims in accordance with the applicable order of priorities.⁸⁶ As ancillary powers (iv), resolution authorities may impose a moratorium entailing a suspension of payments to unsecured creditors and customers (other than a Central Counterparty) and a stay on creditor action to seize assets or collect money from the firm.⁸⁷ Moreover, although resolution action should not trigger statutory or contractual set-off, termination or close-out rights,⁸⁸ where resolution action still has this effect, the resolution authority should have the power to stay temporarily such rights provided they arise by reason of resolution action only. Such a stay should be strictly limited in time, subject to safeguards that protect the integrity of financial

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⁸³ FSB (note 9 above) 7–8 (KA 3.2 (i), (ii), (iii), (iv), (v), (xii)).

⁸⁴ *ibid* 7–9 (KA 3.2 (vi), (vii), (viii), 3.3).

⁸⁵ *ibid* 8–9 (KA 3.4).

⁸⁶ *ibid* 7, 9 (KA 3.2 (ix), 3.5).

⁸⁷ *ibid* 8 (KA 3.2 (xi)).

⁸⁸ *ibid* 10–11 (KA 4.2).

contracts, and must not affect termination rights based on events of default not related to resolution action.⁸⁹

These resolution powers may be applied in isolation or in combination, simultaneously or sequentially. Different powers may be applied to different parts of the firm. In any case, the resolution authorities should take into account the possible impact of any resolution action on the group as a whole and on the financial stability in other jurisdictions, with best efforts to avoid adverse consequences elsewhere in the group or abroad.⁹⁰ Creditors are protected by the ‘no-worse-off’ principle: creditors have a right to compensation for the difference where they receive less in resolution than what they would have received in a hypothetical liquidation of the firm under applicable corporate insolvency law.⁹¹

In respect of the reform of national bank resolution regimes, much has been achieved since the promulgation of the Key Attributes, and even before. In the US, the Orderly Liquidation Authority under Title II of the Dodd-Frank Act of 2010 introduces a resolution regime for bank holding companies and systemically important financial companies, previously subject only to the US Bankruptcy Code. The political risk that this new framework may be repealed has now largely disappeared. In the EU, the available resolution tools and powers have been harmonized at a considerable level of detail; in the Eurozone, under the Single Resolution Mechanism resolution is an integrated process. Across the FSB membership, however, the picture is more mixed.⁹² Only the members that are home jurisdictions to G-SIBs have in place a comprehensive set of resolution powers in accordance with the Key Attributes. Bail-in powers and powers to impose a temporary stay on early termination rights are the ones most often lacking. In respect of the scope of application of domestic resolution regimes significant differences remain.⁹³ Overall, given the vagueness of many of the concepts that resolution tools and powers are built on, notably the resolution triggers, and the significant discretion afforded to the relevant authorities, there is still considerable

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⁸⁹ *ibid* 8 (KA 3.2 (x), 4.3 and I-Annex IV); see also BCBS (note 5 above) 40–42.

⁹⁰ FSB (note 9 above) 9–10 (KA 3.8, 3.9).

⁹¹ *ibid* 11 (KA 5.1, 5.2).

⁹² IMF (note 72 above) 9.

⁹³ FSB, *Ten years on – taking stock of post-crisis resolution reforms*: 6th Report on the Implementation of Resolution Reforms (6 July 2017) 17; FSB, *2018 Resolution Report: ‘Keeping the pressure up’* Seventh Report on the Implementation of Resolution Reforms (15 November 2018) 1 with Annex 1.

room for deviation in individual cases with a potentially negative impact on cross-border cooperation.

1.4.2 Cross-border Cooperation

In accordance with the idea of a pragmatic territorialism, the Key Attributes seek to encourage and institutionalize cross-border coordination and cooperation.⁹⁴ Consequently, national law should empower and strongly encourage resolution authorities to seek wherever possible a cooperative solution with foreign resolution authorities, whilst national sovereignty is preserved. Resolution authorities should remain free to take independent action on a discretionary basis in order to achieve domestic financial stability, taking into account, however, the impact such action may have abroad. Resolution authorities should have resolution powers over local branches of foreign firms, which allow the national authority to either support a foreign resolution process or take independent action if the measures of the foreign resolution authority are deemed to be inadequate. Creditors should not be discriminated against on the basis of their nationality, location of their claim or the jurisdiction where it is payable.⁹⁵

A key element of the international cooperation framework – and (weak) global governance at micro-level – is the establishment of Crisis Management Groups (CMGs) for all G-SIFIs.⁹⁶ CMGs provide the forum in which home and key host authorities collaborate with a view to enhancing preparedness for, and the management of, the resolution of a cross-border group in financial distress. Membership should include the supervisory authorities, central banks, resolution authorities, ministries of finance, and deposit guarantee schemes of jurisdictions that are home and host to group entities that are material to its resolution. A close cooperation should be established with authorities in other jurisdictions where the group has a systemic presence. CMGs are not decision-making bodies, but merely a platform for coordination and information sharing, in particular in respect of the recovery and resolution planning process and the resolvability assessment of G-SIFIs. In order to facilitate access to information and information sharing, jurisdictions should remove any legal, regulatory or policy impediments that hinder the appropriate

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⁹⁴ BCBS (note 5 above) 27–36.

⁹⁵ FSB (note 9 above) 12–3 (KA 7.1, 7.2, 7.3, 7.4).

⁹⁶ *ibid* 14 (KA 8.1, 8.2); see also IMF (note 2 above) 25–27.

exchange of information between relevant authorities and CMG members, subject to appropriate confidentiality requirements.⁹⁷ This requires the setting up of ‘legal gateways’ that authorize national authorities to disclose information in a timely manner to other domestic and foreign authorities for resolution purposes.⁹⁸ CMGs have been established for all G-SIBs⁹⁹ designated as such by the FSB.¹⁰⁰

The cooperation process in CMGs should be governed by institution-specific cross-border cooperation agreements (CoAgs), to be concluded between the home and relevant host authorities that need to be involved in the planning and resolution process. CoAgs are meant to facilitate institution-specific crisis management planning with a presumption for cooperation in the event of a firm’s resolution.¹⁰¹ They should establish a framework for the development of recovery and resolution plans, on the basis of pre-crisis resolvability assessments, and for the cooperation and coordination in a crisis in accordance with the agreed plans. The objectives and processes for cooperation through CMGs should be set out, including a commitment to cooperate as well as commitments to addressing the legal and operational impediments to cross-border implementation of resolution actions. None of these commitments will be enforceable. The roles and responsibilities of participating authorities should be defined and the process for the sharing of information before and during a crisis should be determined, including the arrangements for protecting confidentiality. CoAgs should further include procedures that ensure the timely mutual consultation and information sharing between home and host authorities in case of a significant deterioration in a firm’s financial situation.¹⁰² CoAgs are currently in place for more than three-quarters of designated G-SIBs,¹⁰³ and are otherwise at various stages of development.¹⁰⁴ Thus far, their content remains rather limited,

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⁹⁷ FSB (note 9 above) 18–19 (KA 12.1). As a corollary, firms are required to maintain Management Information Systems (MIS) that allow the generation of the necessary information on a timely basis, in normal times during the recovery and resolution planning process as well as in a crisis scenario and in resolution (KA 12.2).

⁹⁸ *ibid* 23–29 (I-Annex 1).

⁹⁹ FSB, 2018 list of global systemically important banks (G-SIBs) (16 November 2018).

¹⁰⁰ IMF (note 72 above) 9.

¹⁰¹ FSB (note 9 above) 14–15 (KA 9.1, 9.2 and I-Annex 2); see also BCBS (note 5 above) 34–36; IMF (note 2 above) 27.

¹⁰² FSB (note 9 above) 31–35 (I-Annex 2).

¹⁰³ FSB 2018 (note 93 above) 1 with Annex 3.

¹⁰⁴ IMF (note 72 above) 9.

dealing only with the procedural aspects of cooperation, like the sharing of information, instead of setting out substantive resolution strategies.¹⁰⁵

Within the CMG/CoAg governance framework, G-SIFIs should be subject to regular resolvability assessments conducted for a financial group by the home authority, coordinated within the firm's CMG and taking into account the host authorities' assessments. Resolvability assessment seeks to evaluate the 'feasibility' and 'credibility' of resolution strategies, considering the likely impact of a firm's failure on the financial system and the overall economy.¹⁰⁶ Thus, a firm is 'resolvable' where its resolution is both 'feasible' and 'credible' in a way that protects systemically important functions without severe systemic disruptions and without exposing taxpayers to loss.¹⁰⁷ Resolvability assessment is a three-stage process. The first stage is marked by the identification of a set of resolution strategies that would be 'feasible,' given the current resolution tools available, the resolution plan for the firm, and the authorities' capacity for implementation on short notice. It takes into account the robustness of cross-border cooperation and information-sharing arrangements. Stage 2 determines the 'credibility' of all feasible resolution strategies by capturing the likely impact of the firm's failure and resolution on global and national financial systems and real economies. This entails an assessment of the extent to which critical functions can be maintained. Stage 3 is dedicated to improving resolvability where changes are deemed to be necessary to the resolution plan or the structure and operations of the firm.¹⁰⁸

Resolvability assessment should inform the recovery and resolution planning process, which applies to all G-SIFIs and other firms that the home authority deems to be systemically significant.¹⁰⁹ The recovery and resolution planning process is part of the overall supervisory process and

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¹⁰⁵ *ibid.*

¹⁰⁶ FSB (note 9 above) 15–16 (KA 10.1, 10.2); see also BCBS (note 5 above) 29–31.

¹⁰⁷ 'Feasibility' means that authorities have the necessary legal powers and practical capacity for their application with a view to ensuring the continuity of critical functions. 'Credibility' requires that the application of resolution tools does not itself give rise to unacceptable adverse consequences for financial stability and the broader economy; FSB (note 9 above) 37 (I-Annex 3).

¹⁰⁸ *ibid* 37–38 (I-Annex 3). In order to improve resolvability where it is found wanting, supervisory or resolution authorities should have the necessary powers to require the firm to adopt adequate measures such as changes to the firm's business strategy or corporate structure; *ibid* 16 (KA 10.5).

¹⁰⁹ *ibid* 16 (KA 11.1); see also BCBS (note 5 above) 31–34.

involves the resolution authorities and all other relevant authorities.¹¹⁰ Taking into account the circumstances of individual firms, notably their nature, complexity, interconnectedness, level of substitutability and size, recovery and resolution plans provide mere guidance to firms and authorities in a crisis scenario; they are not binding and authorities may implement a different strategy where this seems to be appropriate. Recovery plans are drawn up by the firms themselves as a guide for identifying its options for restoring viability should the firm come under severe stress. Credible options need to address both idiosyncratic and market-wide stress scenarios, as well as capital shortfalls and liquidity pressures.¹¹¹ Resolution plans are developed by resolution authorities with a view to facilitating the effective use of resolution powers. For G-SIFIs, the home resolution authority leads the development of a group resolution plan in coordination with all members of the firm's CMG. Host authorities may maintain their own resolution plans for the firm's presence within their jurisdiction, which should be compatible, as far as possible, with the group resolution plan. Resolution plans should contain a substantive resolution strategy and should be regularly updated and at least annually reviewed within the firm's CMG.¹¹² The 2018 Resolvability Assessment Process (RAP) has come to the conclusion that significant progress has been made in respect of recovery and resolution planning for all G-SIBs, notably with steps to strengthen loss-absorbing capacity, ensuring operational continuity and cross-border enforceability of a temporary stay on termination rights through adhering to the 2015 ISDA Universal Resolution Stay Protocol. Weaknesses remain in respect of the execution of CoAgs and institutions' capacity for a rapid and effective valuation in a resolution scenario.¹¹³ Overall, recovery and resolution planning for individual G-SIBs seems to be a slow and challenging process,¹¹⁴ likely due to the sheer complexity of the institutions concerned and also the number of authorities involved.

A further important element of an effective cooperation and co-ordination framework is the ability and willingness of national resolution authorities to give effect to foreign resolution action domestically,

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¹¹⁰ FSB (note 9 above) 43 (I-Annex 4).

¹¹¹ *ibid* 16 (KA 11.5 and I-Annex 4); I-Annex 4 contains detailed provisions for the general outline and the essential elements of a recovery plan.

¹¹² *ibid* 17 (KA 11.6, 11.7 and I-Annex 4); the essential elements and overall structure of a resolution plan are explained in I-Annex 4.

¹¹³ FSB 2018 (note 93 above) 1–2.

¹¹⁴ IMF (note 72 above) 9.

provided equitable treatment of creditors in the foreign resolution proceeding is ensured.¹¹⁵ The issue arises, for example, where a firm undergoes resolution in its home jurisdiction and operates a branch or subsidiary in a foreign host jurisdiction, and also where a firm holds assets, liabilities or contracts governed by the law of a jurisdiction other than the firm's home jurisdiction.¹¹⁶ Ideally, foreign resolution action may be given effect domestically on a statutory basis. This may come in the form of a recognition process, a process for the granting of supportive measures, or a combination of both. Through a recognition process, a jurisdiction would, at the request of the foreign resolution authority (or other party), recognize – judicially or administratively – the commencement of a foreign resolution proceeding and enforce foreign resolution measures on its territory. Where recognition is granted, the host authority does, in principle, not take any resolution action itself, but gives effect to foreign resolution measures, to the extent that this is compatible with domestic law. For example, where the foreign resolution action concerns the transfer, conversion or write-down of an asset or liability governed by the law of the host jurisdiction, the host authority may require the parties involved to take all the necessary steps in order to ensure that the transfer, conversion or write-down takes effect in accordance with the applicable law. The granting of supportive measures entails the taking of resolution action under the national resolution framework by the domestic host authorities in order to support, and give effect to, the resolution action taken by a foreign resolution authority. The domestic authority may act at the request of the foreign authority, or may, on its own motion, take action consistent with the foreign measures, but always limited to measures available under the domestic regime. Recognition and supportive measures may complement each other, and their combination may even be required in order to achieve the desired outcome.¹¹⁷ In any case, the process for giving effect to foreign resolution action should be speedy and predictable. The grounds for refusing to give effect to foreign resolution action should be limited to cases where the foreign measure would have adverse effects on local financial stability, contravene local public policy, or have material fiscal implications. Reciprocity should generally not be a requirement.¹¹⁸ The equitable treatment of creditors should be the guiding principle; because any perception of creditor discrimination may adversely affect authorities' incentives to

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¹¹⁵ FSB (note 9 above) 13 (KA 7.5); see also BCBS (note 5 above) 27–29.

¹¹⁶ FSB (note 62 above) 5.

¹¹⁷ *ibid* 5–6.

¹¹⁸ *ibid* 11–13.

cooperate in the resolution context.¹¹⁹ So far, only a limited number of jurisdictions have implemented robust processes to give effect to foreign resolution action in accordance with the Key Attributes.¹²⁰ The BRRD establishes an elaborate framework for coordination and cooperation in respect of cross-border group resolutions involving more than one Member State.¹²¹ It also addresses the issue of cooperation with third countries as well as the recognition and enforcement of third-country resolution action.¹²² The SRM modifies the respective provisions, largely to the effect that the SRB represents the national resolution authorities of participating Member States in the relevant decision-making processes.¹²³ By contrast, the contribution of the US Dodd-Frank Act on these issues remains rather modest.¹²⁴

In the absence of a statutory regime, contractual recognition may provide a workable solution. This is particularly relevant for a temporary stay of early termination rights in financial contracts, and the bail-in of eligible liabilities, governed by a law other than the law of the home jurisdiction. The governing law may not recognize the resolution measures imposed by the home jurisdiction, which may jeopardize the implementation of the overall resolution strategy.¹²⁵ A contractual solution may take the form of a clause in a financial contract according to which the parties would be bound by temporary stays on early termination or a bail-in imposed under the resolution regime applicable to the counterparty. Relevant authorities may incentivize firms to adopt contractual recognition clauses by making their inclusion a prudential requirement, a requirement for loss-absorbing capacity, or a requirement for improving resolvability.¹²⁶ Contractual recognition clauses may support and reinforce statutory solutions; however, on their own they will be reasonably effective only if they are adopted widely. In this respect, industry endorsement plays an important role. Pursuant to the ISDA Resolution Stay Protocol, counterparties can contractually opt into provisions within certain resolution regimes that limit the exercise of termination and close-out rights so as to make the respective resolution

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¹¹⁹ *ibid* 13.

¹²⁰ FSB 2017 (note 93 above) 17; IMF (note 72 above) 9.

¹²¹ BRRD, Arts 87–92.

¹²² BRRD, Arts 93–98.

¹²³ SRM, Art 31(2), 32(1).

¹²⁴ D Skeel, *The New Financial Deal: Understanding the Dodd-Frank Act and its (Unintended) Consequences* (Hoboken, NJ: Wiley & Sons, 2011) 183.

¹²⁵ FSB (note 62 above) 4–8.

¹²⁶ *ibid* 13–16.

provisions effective on a cross-border basis.¹²⁷ Most designated G-SIBs now adhere to the 2015 ISDA Universal Stay Protocol.¹²⁸ However, whether this approach will pass muster in front of the competent courts remains to be seen.

1.4.3 Allocation of Losses

According to the Key Attributes, an effective resolution regime should allocate losses to shareholders as the firm's owners, as well as unsecured and uninsured creditors in accordance with the applicable order of priority of claims. There should be no reliance on public solvency support, and no expectation should be created that public solvency support will be available.¹²⁹ The allocation of losses to shareholders and creditors, and indeed the implementation of the appropriate resolution strategy for any firm – 'single point of entry' or 'multiple point of entry' – will crucially depend on whether there is sufficient loss-absorbing capacity at the parent company level, or the sub-group level at which bail-in is to be applied.¹³⁰

Under the FSB's Principles on Loss-absorbing and Recapitalization Capacity of G-SIBs in Resolution, each 'resolution entity' within a G-SIB to which resolution tools would be applied will be required to meet a minimum amount of total loss absorbing capacity (TLAC), in addition to minimum regulatory capital requirements. TLAC may consist of instruments that would count as regulatory capital, as well as unsecured subordinated debt with a remaining maturity of at least one year not held by other G-SIBs.¹³¹ Each resolution entity has to maintain, as of 1 January 2019, a minimum TLAC of 16 per cent¹³² of the group's Risk Weighted Assets (18 per cent as of 1 January 2022) and at least 6 per cent of the Basel 3 Tier 1 leverage ratio denominator (6.75 per cent as of 1 January 2022). Material foreign subsidiaries that are not themselves resolution entities will be subject to an 'internal TLAC requirement' of 75–90 per cent of the TLAC requirement that would apply to the

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¹²⁷ ISDA 2015 Universal Resolution Stay Protocol (November 2015).

¹²⁸ FSB 2018 (note 93 above) 7.

¹²⁹ FSB (note 9 above) 3: (iii) and (iv).

¹³⁰ FSB (note 26 above); FDIC and Bank of England (note 26 above).

¹³¹ FSB 2015 (note 61 above).

¹³² Presumably, 16 per cent of TLAC would consist of 8 per cent own funds and 8 per cent eligible liabilities that could be bailed in so as to restore the 8 per cent own funds requirement; S Schelo, *Bank Recovery and Resolution* (Alphen aan den Rijn: Kluwer Law International, 2015) 130 fn 500.

subsidiary on a standalone basis.¹³³ In accordance with general resolution objectives, home authorities of resolution entities may, in consultation with the CMG, apply additional firm-specific requirements above the common minimum TLAC. The FSB expects that at least 33 per cent of the TLAC requirement will be held in the form of debt capital instruments and eligible liabilities.¹³⁴ ‘TLAC eligible instrument’ may be any capital instrument, debt instrument, liability or other item, provided it is stable, long-term (remaining maturity of at least one year) and not repayable on demand or at short notice. ‘Operational liabilities’ on which the performance of critical functions depends are not TLAC eligible, neither are liabilities that cannot be written down or converted without giving rise to a material risk of falling foul of the ‘no creditor worse off’ principle. As a consequence, TLAC eligibility requires contractual, statutory or structural subordination to (excluded) operational liabilities.¹³⁵ G-SIBs will be required to deduct from their own TLAC their exposures to eligible external TLAC liabilities issued by other G-SIBs.¹³⁶ This seeks to address the risk of contagion. A majority of G-SIB home jurisdictions have made substantial progress in implementing the required framework into national law; many G-SIBs already meet or are close to meeting the 2019 external TLAC requirements, whereas the setting of internal TLAC requirements remains a work in progress.¹³⁷

A remaining issue in this context is the lack of coordination at international level of the orders of priority of creditor claims. The Key Attributes provide very limited guidance in this respect: equity should absorb losses first, thereafter creditors in accordance with the national order of priority subject to an ‘absolute priority rule’; creditors of the same class should be treated equally except where a deviation is necessary in order to ensure financial stability.¹³⁸ National laws and regulation should not discriminate against foreign creditors.¹³⁹ The idea of insured depositor preference is inherent in the feature that only ‘uninsured’ and unsecured creditors should participate in bearing losses.¹⁴⁰ Where the ranking of a class of creditors in the home jurisdiction differs significantly from the ranking in the host jurisdiction,

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¹³³ See further FSB 2016 (note 61 above).

¹³⁴ FSB 2015 (note 61 above) 10, 12, 19.

¹³⁵ *ibid* 6–7 and 15–16.

¹³⁶ *ibid* 17.

¹³⁷ FSB 2018 (note 93 above) 4.

¹³⁸ FSB (note 9 above) 11, (KA 5.1).

¹³⁹ *ibid* 13 (KA 7.4).

¹⁴⁰ *ibid* 3: (iii).

the host authorities may be reluctant to cooperate and, instead, adopt a ring-fencing strategy in order to protect local creditors from a treatment in the foreign resolution that would be worse than under local law. Also, a deviation in the foreign resolution from the local order of priorities may trigger the ‘no creditor worse off’ principle, increase the risk of litigation and render the resolution overall more expensive and protracted.¹⁴¹ The BRRD has harmonized the ranking of depositors and deposit guarantee schemes to some extent. Pursuant to BRRD, Art 108, eligible deposits of natural persons and SMEs have a higher priority under national law than ordinary creditors; covered deposits rank even higher, with the Deposit Guarantee Scheme subrogating to the ranking of covered depositors. In addition, the new Art 108(2) has introduced the asset class of non-preferred senior debt, which has a ranking below ordinary unsecured claims and above capital instruments, thereby extending the partial harmonization of creditor hierarchies.¹⁴² Several European jurisdictions are in the process of adopting, or already have adopted, amendments to the statutory order of priority with a view to ensuring the effective subordination of TLAC-eligible instruments.¹⁴³

Although the write down and conversion of debt to equity may reduce leverage and restore a firm’s balance sheet, its effect on liquidity, by removing maturing debt and interest payable, is likely to be insufficient for addressing a possible funding shortage. Where capital markets cannot be easily accessed, the necessary funding will have to come from the relevant authorities. As a consequence, the Key Attributes require jurisdictions to have policies in place so that authorities are not constrained in relying on ‘bail-out’ funds or public ownership for resolving failing firms.¹⁴⁴ However, before any public sector backstop mechanisms can be accessed for temporary funding needs, a failing firm’s internal liquidity sources must have been exhausted; thereafter, private markets should be the preferred source of funding in resolution.¹⁴⁵ Only where neither of these primary sources is available, may public sector backstops be accessed with a view to providing the funding necessary for maintaining the continuity of critical functions in resolution.

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¹⁴¹ IMF (note 72 above) 13–14.

¹⁴² Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy, OJ EU 27.12.2017 L345/96.

¹⁴³ FSB, Resilience through resolvability – moving from policy to implementation: 5th Report to the G20 on progress in resolution (18 August 2016) 17.

¹⁴⁴ FSB (note 9 above) 12 (KA 6.1); see also IMF (note 2 above) 23.

¹⁴⁵ FSB (note 63 above) 6–7.

Private funding solutions should be relied on as a first choice and may take the form of financial sector consortiums, pooling resources and risk in order to fund a G-SIB in resolution. Guarantees furnished by the public sector may encourage private actors to come forward; such guarantees should be priced appropriately and limited in time so as to encourage a speedy return to normal market practices.¹⁴⁶ Where private funding is unavailable, a public sector backstop should be available to cover any shortfalls. Public sector backstop liquidity may be provided by resolution funds, deposit insurance funds, resolution authorities, central banks and/or finance ministries. Any line of liquidity must be readily available at short notice and must be sufficiently large. It should be extended for no longer than what is necessary for maintaining the continuity of critical functions and for achieving an orderly resolution.¹⁴⁷ The risk of moral hazard should be reduced by making the provision of temporary funding subject to a strict necessity assessment with a view to maintaining financial stability and allocating losses to shareholders and creditors as appropriate. Thus, where public sources of funding are made available, any losses should be recovered from shareholders and unsecured creditors subject to the 'no worse off' principle and, where necessary, from the financial industry as a whole. This may take the form of *ex ante* contributions to standing funds, *ex post* recoupment of any extended amounts, or a levy of premiums which may be partially or fully risk-calibrated.¹⁴⁸ As a last resort remedy for maintaining financial stability, jurisdictions may provide for a power to temporarily take a firm into public ownership with a view to seeking a permanent private sector solution.

Stopping short of mandating a binding burden sharing agreement,¹⁴⁹ the FSB requires home and host authorities to establish a clear division of responsibilities for providing temporary funding for a G-SIB in resolution in accordance with the preferred resolution strategy. In a single point of entry resolution, the home authority should not only be responsible for the application of resolution powers, but also for the coordination of the provision of temporary liquidity. Under a multiple point of entry strategy, each authority is responsible for the coordination of the provision of liquidity for the part of the group to which its resolution entity belongs. The CMG provides the forum within which home and host authorities coordinate the allocation of funding responsibility for a

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¹⁴⁶ *ibid* 9–11.

¹⁴⁷ *ibid* 11–2.

¹⁴⁸ *ibid* 12–4.

¹⁴⁹ But see IMF (note 2 above) 24–25.

G-SIB, its foreign branches and subsidiaries before a resolution takes place.¹⁵⁰ In respect of the existing practice and approaches to resolution funding within CMGs, the FSB is working with CMG authorities to support the development and implementation of resolution funding plans.¹⁵¹ Currently, there seems to be considerable trans-Atlantic divergence. Whereas the EU and Eurozone rely on standing industry-financed resolution funds, the Orderly Resolution Fund under the Dodd-Frank Act is merely a mechanism that allows the FDIC to borrow from the Treasury, with any amounts to be recouped *ex post* from financial companies. On the other hand, the BRRD sanctions the introduction or retention of ‘government financial stabilization tools.’ Under the Dodd-Frank Act’s anti-bailout philosophy, the sources of public financial support to failing firms outside of FDIC receivership have been severely restricted.¹⁵² These discrepancies may significantly impede a coordinated cross-Atlantic approach.

1.5 CONCLUDING REMARKS

Whether and to what extent the ‘international standards for effective resolution regimes’ and the supporting governance framework will be able to protect global financial stability should a G-SIB fail remains to be seen. Only practical experience can provide the empirical material that is vital for assessing the effectiveness of the global solutions propagated by the Key Attributes. However, there are a number of reasons that would suggest caution.

Although significant progress has been made in respect of the implementation and convergence of national resolution powers, beyond the G20 members that are home to G-SIBs the implementation of the full range of powers remains patchy.¹⁵³ The resolution powers’ inherent vagueness leaves considerable room for national deviations. Moreover, cooperation and coordination in any given case remain a voluntary exercise. The cooperation and information exchange process during the resolution-planning phase may result in heightened awareness of cross-border issues and potentially earlier detection of trouble. It may also enhance trust and confidence among participating authorities. However, national authorities remain predominantly accountable only to local

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¹⁵⁰ FSB (note 63 above) 17–18.

¹⁵¹ FSB (note 93 above) 14.

¹⁵² Schillig (note 14 above) chapter 12.

¹⁵³ Arner and Taylor (note 54 above) 63.

constituencies. Unenforceable cooperation commitments are unlikely to overcome embedded incentives for adopting local solutions. The best working relationship between authorities is likely to break down where the money of national taxpayers and depositors and the wider national interest appear to be at stake. *Ex ante* burden-sharing commitments will remain unenforceable in any crisis scenario.¹⁵⁴

When, in October 2016, Deutsche Bank faced the prospect of a USD14bn fine in the US, the German newspaper *Die Zeit* reported that officials in Berlin, Frankfurt, and Brussels were secretly preparing a rescue package for Deutsche Bank for the eventuality that the lender would require recapitalization.¹⁵⁵ The German government flatly denied the report. However, speculation in the financial press continued for several weeks, showing a lack of market confidence in the new regime. By the end of 2016 Italian lender Monte dei Paschi di Siena faced a capital shortfall of EUR8bn.¹⁵⁶ Following the failure of a private sector solution, the Italian government approved an EUR20bn bailout package on the basis of a 'precautionary recapitalization,'¹⁵⁷ subsequently also approved by the EU Commission and the ECB. The resolution of Banco Popular under the Single Resolution Mechanism, regarded by many as a textbook resolution, was an 'easy' case that, on the basis of a preliminary valuation, very conveniently did not require the bail-in of any senior unsecured liabilities – the amount of identified losses almost exactly matched the nominal value of capital instruments; and as a result of the

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¹⁵⁴ *ibid.*

¹⁵⁵ M Schieritz and A Storn, 'Was wäre, wenn ...' *Die Zeit* Online (13 October 2016) (accessed 8 March 2019 at <http://www.zeit.de/2016/41/deutsche-bank-aktie-krise-rettungsplaene>).

¹⁵⁶ J Politi, 'Monte dei Paschi shortfall hits €8bn, says ECB' *Financial Times* (26 December 2016).

¹⁵⁷ J Politi and R Sanderson, 'Italy's cabinet approves Monte dei Paschi bailout' *Financial Times* (23 December 2016). This is a loophole in the EU resolution framework that allows the injection of public money in order to address capital shortfalls established in a stress test, provided the recipient institution is solvent, the recapitalization is necessary to remedy a serious disturbance in the economy and to preserve financial stability. The recapitalization cannot be used to offset losses and is subject to EU state aid rules; Bank Recovery and Resolution Directive, Art 32(4)(d). It is very doubtful whether any of these prerequisites applied in the case of MPS: the bank was relatively small and there were serious concerns about its solvency and overall viability. However, some of the bank's junior debt is held by small retail investors who could have lost a significant amount of their savings, which increased the political pressure to bypass the resolution regime.

application of the sale of business tool the purchaser, Banco Santander, has become significantly bigger. On that basis, the effectiveness of the global resolution framework at least for now remains doubtful.¹⁵⁸

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¹⁵⁸ Baxter (note 1 above) 46.