Crisis Management. Commission Conference 19 March 2010

This is an important and complex issue.

The ECON committee is already preparing a report responding to the Commission consultation, and our Rapporteur Elisa Ferreira is speaking to you later today. Our report is not yet finished so the points I make here are my own.

There are many ways into this subject and paths within it, so in order not to get lost I will present the subject by the route through which I encountered it.

This starts with Solvency 2, before the crisis, and the proposal for Group Support, where the idea was to be able to optimise use of capital at Group level by being allowed to move some of the prudential capital around the group, but with the ability to 'call in' a top up into a particular subsidiary should local conditions require it.

It soon became clear that while the process would work during good times, maybe when one member of the group needed to call on capital to meet a local problem, the picture looked slightly different at times of wider stress at the group level.

Now we are still talking pre financial crisis discussions here - but supervisors were already concerned that they would not always get funds into their local subsidiaries when called should there be a general capital shortage in the group, or worse an insolvency situation.

So we tried to include text to require binding legal agreements to transfer funds that were the fair share, over time, that belonged to a particular member of the group. A kind of living will if you like. Still there was no confidence that the proposed instruments would actually work to overcome 'suspensive actions' that might happen to prevent transfer of capital from one subsidiary to another and especially out of one member state to another.

Various mechanisms were mooted: memorandums of understanding were dismissed as not 'legal enough' in extremis. Our best shot seemed to be letters of credit, but somehow the involvement of banks began to look less attractive when the financial crisis started. One can also imagine the interesting and exotic ways in which such instruments might be hedged.

Whilst discussing the topic with insolvency practitioners I was also pretty shocked by the way in which expressions such as 'policyholder' - and for banks you could substitute depositor - were viewed as only relevant within national boundaries. And this was *after* the Equitable Life problems when the Commission had already made it clear that there had to be non discriminatory treatment of all policyholders. Indeed I began to wonder if the single market had been invented yet.

So when the Group Support proposal had to be shelved, pending better solutions, I became convinced that cross border insolvency, and near insolvency, had to be tackled. I know it is difficult - I do also sit on the legal affairs committee - but the more I think about it the more it seems a serious omission from the whole concept of the single market.

In the general sense - for any company - we have the ability to trade within the single market. We are now addressing measures such as cross border debt recovery and attachment of bank accounts. We place high store by having common consumer interfaces in areas such as payment services and conduct of business measures in consumer credit. So why should a single market approach fall apart when we get to the point of insolvency.

So from this you will see that I was in favour of dealing seriously with insolvency and near insolvency situations in a coordinated way, even without the driving force of the financial crisis. Now, following the crisis, and some real examples of how unprepared we all were, I am all the more enthusiastic.

Now I know it is ambitious to talk about single market insolvency for all companies as I did a moment ago, and certainly we can not get there in one bound, but we need to look at steps upon the way and the first signpost comes directly from the crisis. We need to find special measures for the banking sector.

And of course what we do within the EU will help our understanding of where and how far we can find workable solutions with third countries, which clearly has to be the case for the major international banks.

Some tools have already been proposed to meet various problems.

Too big to fail. We have to do something about this because we can not afford it. There is a tsunami of legislation aimed at prevention of failure and early warnings. I am not entirely convinced that clever enough tools are yet being used overall, but that is for another time.

Some people advocate separation of utility and investment banking. Through CRD 3 we may well reduce the size of proprietary trading which goes in the same direction, but we can not really remove interconnection and exposure to securities markets, even for utility banking. However I do not see why we can not have 'escape modules' for such important things as the continuation of payment services. This should be something that goes hand in hand with deposit guarantees to ensure that in the event of a bank failure there are continuing facilities for day to day living.

I welcome the work that is being done on living wills because this is another way to tackle too big to fail, making some kind of orderly wind up and selective or modular rescues possible. Of course so far they are mainly centred on Member States because that is where they start, but an outward, cross border perspective is needed. As we know from recent experience, even if supervisors talk to one another other actors or countries may not. So doing the cross border part of living wills at least gets everyone talking.

When the living will suggestion was first made some banks complained that it would require them to simplify their structures - and I said in response to that 'good'! For alongside too big to fail we have the issue of too complex to manage: and too complex to audit, too complex to supervise and too interconnected for their own good. That is not to say that banking models have to be dismantled, because that would be another burden right now at a time when it can not easily be absorbed, but if some simplification, streamlining and cleavage planes are indicated in consequence of looking at living wills, then it should not be ducked.

This brings us back to the Group issue and that if groups are how banks are operating, then resolution and winding up mechanisms also need to operate at group level, at least within the EU. There must also be a way to deal with conglomerates. It is not helpful that there is not even a harmonised legal concept of a Group within the EU.

Many say all this can go nowhere until there are burden sharing arrangements. But based on what? It seems to me that any burden sharing has to be based around the way in which a particular group has operated, sourced its business and distributed its profits and tax payments. This means transparency and the possibility to achieve an equitable distribution over time including claw back. If a formula can be constructed for the basis of calculation that would be helpful for certainty. Bit it sounds very similar to where I went before on Solvency 2 - admittedly without the interest and backing of that comes post-crisis - and we came up against problems of legal instruments.

When it comes to breaking off modules or partial rescues, it makes economic sense that these should be economic units, not just ring fenced national pieces.

I recognise the difficulty that insolvency law has grown up very differently in different member states, but surely now at the very least for cross border financial institutions we must work towards an enforceable common European insolvency regime.

So ultimately I come back to my original point. If over the EU we are tightening up rules about what constitutes core capital, about when hybrids and other convertible instruments are usable, looking at contingent capital and how losses can be absorbed: and we are in a single market, with single market rules about fund management and a risk averse culture to loss and differences in standards, it is simply perverse not to address where shareholders and creditors rights rank across the EU and perverse not to end differences in how standards and procedures in winding up occur.

This may go further than what is immediately do-able but we should not lose sight of it or put it from our minds when some interim solution is found, such as via living wills.

What I have said so far deals mainly with the end case of an institution distressed to the point of full or partial failure. Attention should also be given to the pre-resolution phase, or recovery phase, because whatever is planned needs to interface properly with that. Early intervention to enable recovery may often be desirable but this should not mean bail outs with taxpayer money. Again there may be hurdles of company law and shareholder rights to resolve. Certain standards such as property rights under the European Convention on Human Rights will need to be observed, and their impact clarified if need be.

Clearly the sooner a problem is flagged up, the sooner preventative or rescue or recovery operations can be taken. Exchange of supervisory information is of course paramount and colleges and the new supervisory architecture have their part to play. The common rule book and other guidelines should ensure consistency of approach.

With regard to 'triggers' they have a role, but some flexibility or range is probably needed to ensure that false triggering does not happen. Prevailing circumstances and the risk of contagion may advance or retard the appropriate trigger points. In Solvency 2 a ladder of intervention was used, with time periods for making recovery plans, and some similar ideas could be used but taking into account the different and rather faster nature of banking decline.

Finally, how should supervision and resolution and insolvency to join up? To me it seems a little pessimistic to have a Resolution Authority - as if we expect it to have a lot of work which would be quite a disaster after all the legislation we are putting in place. Also I am not a fan of having a spare Agency on standby. Possibly, and if we are to have a resolution fund, how resolution fund is structured might have a bearing on any agency. Fund collection and management is clearly not the same as insolvency, but knowledge of asset transfer might fit within that frame.

What is clear is that there is an early - urgent - need to bring in insolvency expertise to supplement supervision expertise. It would be appropriate also for this insolvency expertise to be used in reviewing and approving the living wills or other such plans that are put in place, which will need regular updating and should form part of ongoing governance.

It looks inviting to say this insolvency advice should fit somewhere in the new supervisory architecture. Maybe it could start off as an additional facility within the Banking Authority because early formative work should be done in close cooperation, but in time it could expand to cover other types of financial institutions. I can also see a role in linking to the systemic risk board from the point of contagion. I note the call for setting up of an insolvency group of experts by the Commission and this is a good step in the right direction.

To conclude, my suggestion is to be ambitious, in the long term it is what the single market deserves, but not forgetting that it is also essential to build bridges to an international framework.