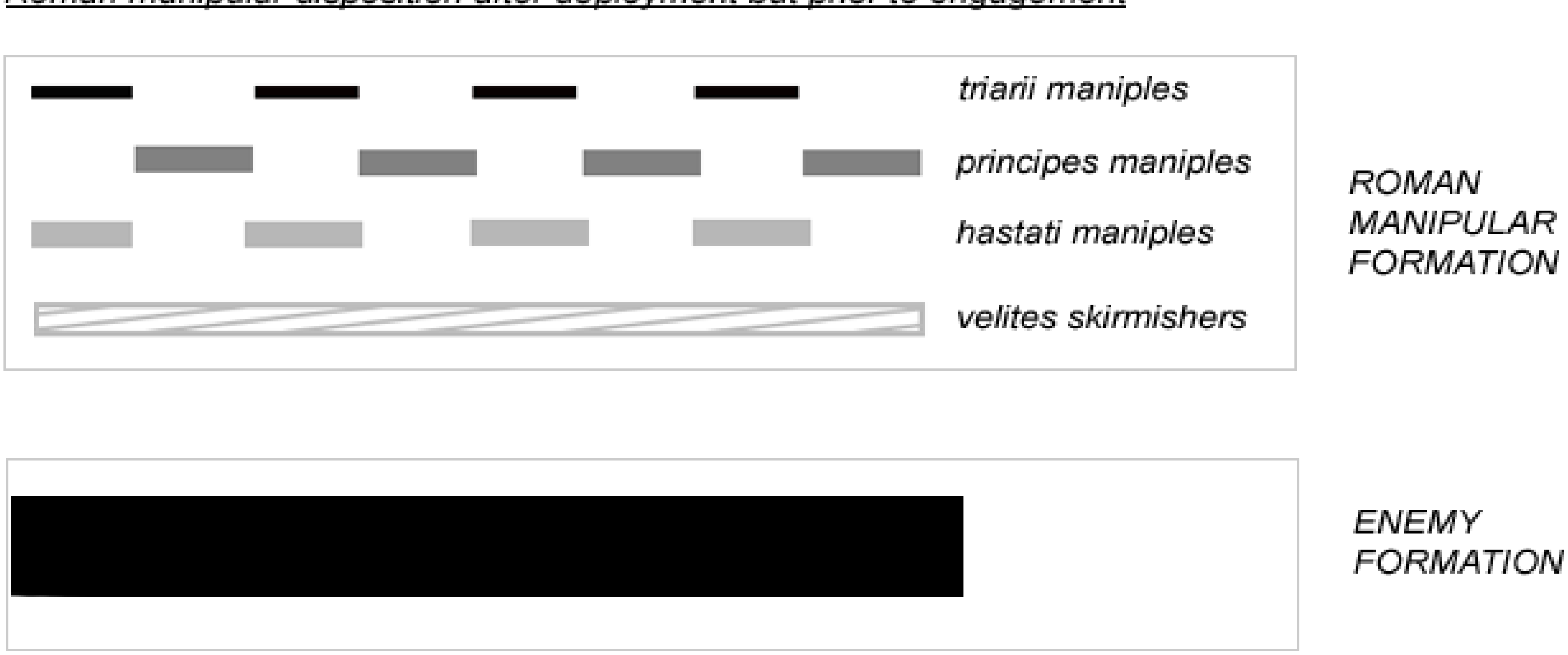
Contingency planning

Banks
- the first line of defense -

25.09.2013

A little bit of history

- Since, we always need to learn from the past, I would like to start my speach with a short history lesson and review, with your permission, the Roman infantry tactics.



A little bit of history

- During deployment in the Republican era, Roman fighting sub-units were commonly arranged in triplex acies (triple battle order): that is, in three ranks, with the hastati* in the first rank (that nearest the enemy), the principes in the second rank, and the veteran triarii in the third and final rank as barrier troops, or sometimes even further back as a strategic reserve.

- When the first line as a whole had done its best and become weakened and exhausted by losses, it gave way to the relief of fresh men from the second line who, passing through it gradually.

- **This does not presuppose an actual withdrawal of the first line, but rather a merging, a blending or a coalescing of both lines.**

**Roman soldiers: hastati, principes and triarii .*

Contemporary contingency plan

- Nowadays our enemy is the financial crisis and we need to develop our pre-battle maneuvers in *triplex acies*:
  - The first line of defense in case of a financial crisis rests with **sound and prudent management by the private financial institutions themselves.**
  - Crisis prevention policies in the areas of **regulation, supervision and financial stability monitoring** make up the second line of defense.
  - If these efforts fail, **public authorities may wish to intervene** - the third line of defense - to mitigate the risk of economy-wide effects. Any such intervention has to weigh carefully the need to preserve stability of the financial system against an often inevitable risk of moral hazard.

Source: IMF - Technical Note on Contingency Planning, Crisis Management and Bank Resolution

Contemporary contingency plan

- According to IMF, in a nutshell, **the contingency framework should serve two purposes:**

  (i) to act as an incentive to the private sector to find solutions well in advance because the public sector should not provide a bail out to shareholders or preserve managers' jobs

  and

  (ii) to act as a reassurance to depositors and other creditors (and indeed to borrowers) that authorities are capable of addressing bank failures without a widespread systemic disruption.

Source: IMF - Technical Note on Contingency Planning, Crisis Management and Bank Resolution

First line of defence – Financial institutions

- I am coming in front of you as **the representative of the first line of defense, banks.** I want to approach the today's organization, leadership and logistics should they use in order to assure a sound and prudent management and the threats that might spoil the balance.

- Yes, the need for a contingency plan is a must, but when developing the second and third line of defense, we need to do it in a way to preserve the first line of defense central role, that of **fuelling economic activity.**

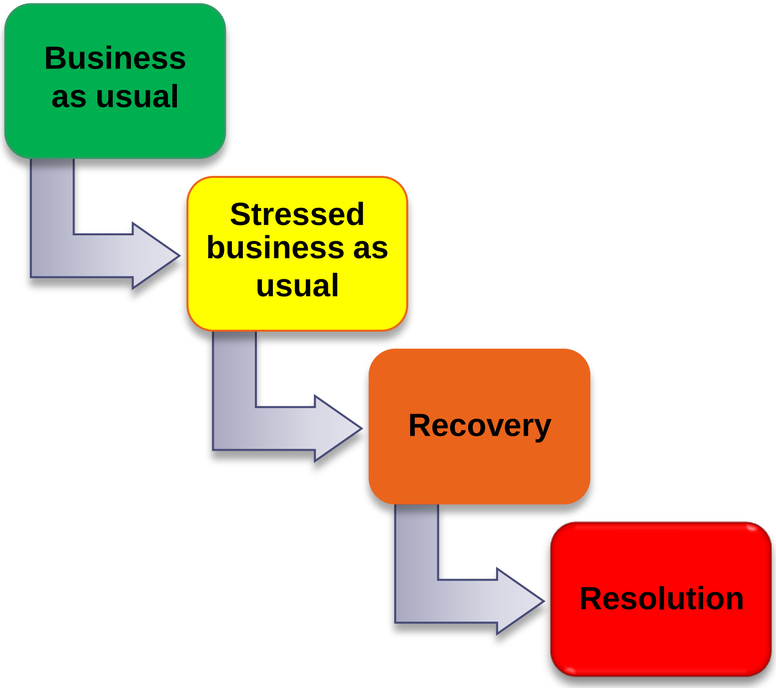
First line of defence
Financial institutions

- When developing the contingency framework, we need to take into consideration that requiring to retain increasingly large amounts of capital as surety in case of unforeseen crises, leaves banks with less liquidity for lending and this ultimately could hamper long term financing, growth and investment.

- We are dealing with many dynamic and unknown effects:
  - In the bank
  - Among banks and the providers of bank capital/funding
  - Between banks and the economy
  - Unable to know in advance what will happen in the interaction between capital, liquidity and funding in a stressed situation

Recovery and Resolution regimes

- We see the recovery and resolution system as a stair with 4 treads:



- What is important to clarify for banks in all this stages?

First stage
Business as usual

The step where all banks want to be

- The banks will prepare recovery and resolution plans (the so called in USA “living wills”) in order to be able to protect shareholders under any stress situation and to stay in control, but they need harmonized rules and clarity on systemic risk buffer needed.

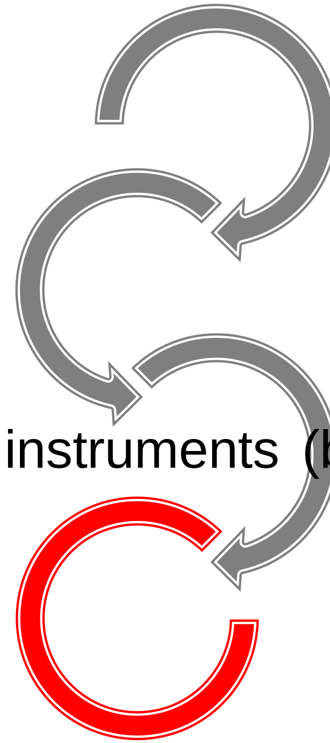
Second stage
Stressed business as usual

- Second stage will imply
  - Management in control
  - Dialogue with supervisors
  - Capital conservation measures
- What is important in this stage:
  - Clear definition of what happens when you breach the capital conservation buffer
  - Focus on actions to increase capital and liquidity/funding buffers
  - Supervisory measures and restrictions must be proportional and predictable

Third stage
Recovery

- Third stage consists in
    - Implementation of recovery plan
    - Close cooperation with supervisors
    - Special management might be appointed to replace management
- Important to clear establish:
    - What happens when this level is breached
    - The level of this trigger will be decisive for the cost to the system
    - Plan for how to handle the liquidity and funding problem
    - Supervisory measures must be proportional and objective

Last stage
Resolution



- Where neither of us wants to be
  - Replacement of management
  - Resolution authorities in control
  - Implementation of resolution plan
  - Capital write-down
  - Write-down/conversion of subordinated capital instruments (bail-in)
  - Bridge institution
  - Sale of business
  - Senior debt bail-in

- What is important in this stage:
  - Clarity on how the four resolution tools are to be used: bridge bank, sale of business, debt writedown and bail-in
  - Harmonized insolvency laws between countries
  - Burden sharing agreements to be executed

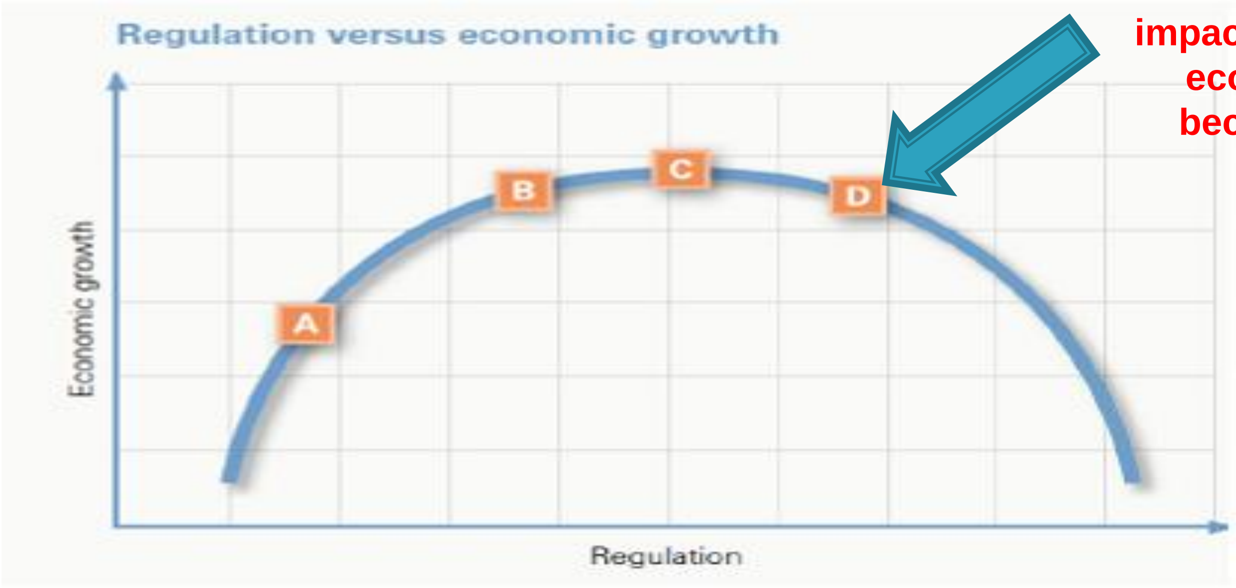
Optimal contingency plan

What turns these stages into an optimal contingency framework?

A harmonized, transparent and consistent regulatory framework. All financial regulations should come together in one framework.

But… in developing this plan, we agree with the European Banking Federation on what becomes vital for banks:

Vital



impact of regulation on economic growth becomes negative

Source: KPMG

- not to move from the optimal point of regulation to the point where excessive regulation is damaging the wider economy;

- the important role of banks needs to be preserved by creating favorable conditions for banking business; a failure to strike the right balance it will be to the detriment of Europe's economic recovery.

Vital

“Banks certainly need an effective and efficient banking supervisory framework, but if they are truly to become like the phoenix rising from the ashes, they also need to have some room for manoeuvre. Business should remain in the hands of the business people, not policy-makers.”

Questions?

Thank You

Source:

- *International Monetary Fund - Financial Sector Assessment Program Update - Technical Note on Contingency Planning, Crisis Management and Bank Resolution*
- *EBF - Recovery and Resolution regimes - Key principles and messages*
- *The cumulative impact of regulation – KPMG 2013*
- *EBF - Banks at a crossroads*
- *Wikipedia*