The Euro Area Financial Safety Net: An Assessment

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The IMF's Assessment of the Euro Area Bank Resolution and Crisis Management Arrangements at a Glance

- 7 country-level FSAPs
- 8 national resolution authorities
- 7 pertinent Euro Area authorities
- 11 lessons learned from recent actions
- 33 recommendations
A Timeline of the Euro Area’s Progress

“Despite the establishment of the SSM and the SRM, fragmentation along national lines persists.”

Lessons From Recent Bank Interventions

- precautionary recapitalization from Italian government with Commission approval
- liquidated with state aid under Italian law with Commission approval
- sold to Santander
- voluntary liquidation

There is a need:
- to align the conditions and triggers of the resolution, state aid, and liquidation regimes—subject to introducing adequate flexibility;
- to strengthen liquidity support before and in resolution; and
- to "pre-schedule" resolution
Mandatory bail-in without exceptions, difficulty to access SRF financing, and inconsistencies between regimes may create incentives and means to ‘escape’ the resolution regime.

**Recommendations: Architectural Design**

- **Financial stability exemption**
  - for mandatory bail-in to access SRF funds

- **Pared back state aid oversight**
  - for SRB resolution decisions and the use of the SRF and DIS funding on a least cost basis

- **Consistency of conditions and triggers**
  - e.g., solvency assessments and the geographic scope of financial stability

- **Consistency of burden-sharing requirements**
  - creditors should not be better off in liquidation than in resolution (after alternative flexibility with a financial stability exemption has been introduced)
Recommendations: Financing Resolution

- **MREL**
  - expedited MREL buildup, prioritizing large banks
  - internal MREL in material subsidiaries of groups with SPE resolution strategies

- **Liquidity in resolution**
  - multiple sources through ELA, DIS, and SRF
  - clarity needed on liquidity support for banks in resolution

- **SRF funds**
  - operationalization, including through guarantees that could be used as collateral for ELA

- **EDIS & SRF backstop**
  - risk pooling through EDIS
  - ESM could backstop both EDIS and the SRF

Recommendations: Operational Agility

- **Early intervention**
  - supervisors should take decisive action to prevent unnecessary value erosion

- **Advance resolution preparation**
  - resolution authorities should be involved early on to ensure ample time for resolution preparation

- **Administrative liquidation tool**
  - an administrative liquidation tool should complement resolution authorities’ toolbox

- **Resolution decision-making**
  - SRB needs autonomous rule- and decision-making power
Without improvements, it is unclear whether the current bank-by-bank resolution framework would be able to effectively manage a system-wide crisis in the euro area.

Contact Info and References

Atilla Arda: AArda@IMF.org / Jan Nolte: JNolte@IMF.org

Euro Area FSAP Technical Note on Bank Resolution and Crisis Management
https://www.imf.org/~/media/Files/Publications/CR/2018/cr18232.ashx

IMF Blog: Five Actions to Strengthen the Euro Area Banking Union

IMF News: The Euro Area Financial System: On-going Transformation

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