IADI International Association of Deposit Insurers

Biennial
RESEARCH CONFERENCE

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Good morning,

Thank you for inviting me to address you here today. As many of you know I will join IADI as Secretary General starting on 1 August. Today, however, I am speaking to you as a member of the Financial Stability Board (FSB) Secretariat.

I have been with the FSB for close to 14 years. During that time, I have had the privilege to contribute to many important policy initiatives, most notably the regulatory reforms after the Global Financial Crisis (GFC) and the development of the Key Attributes of Effective Resolution Regimes for Financial Institutions (‘Key Attributes’) as new international standard for resolution.

One of the objectives of the post-crisis reforms was to ensure that taxpayers never again had to bail out “too big to fail’ institutions. The implementation of the Key Attributes was to enable authorities to handle the failure of a bank without taxpayer-funded capital or other extraordinary government support.

We adopted a so-called ‘bookends’ strategy which promoted capabilities both for crisis prevention and resolution. Heightened supervisory intensity coupled with strong capital requirements was to reduce the probability of failure and an effective resolution framework was to enable authorities to handle a failure if and when it occurs.

Every crisis so far has helped us to identify weaknesses in our frameworks and to undertake reforms to address them. However, making the system robust against specific risks revealed by past crises does not necessarily make it proof to future risks arising in other quarters or even to the same risks if they prove to be greater than expected or take on new forms.

The face of banking has changed substantially since the GFC. The Covid-19 pandemic accelerated the trend towards digitalisation that is transforming the way people transact

[1] The remarks reflect personal that do not necessarily reflect views of the FSB or of any of its members.

and access financial services. Bank runs now occur with a speed never seen before. The emergence of digital claims – whether crypto or central bank digital currencies (CBDCs) – might create attractive substitutes for traditional banking and payment services. We are entering a new era.

The recent spate of bank failures has shaken depositor confidence. They have given rise to questions about the evolving nature of banks' business models and the role banks play in a modern 'digital' society. They also gave rise to important questions about the post-GFC reforms, notably the effectiveness of regulatory and supervisory approaches, the international resolution framework, as well as the appropriate design and operation of deposit insurance arrangements: had authorities done enough to implement those agreed reforms in an effective manner? What lessons can we learn for their future application?

The FSB and other international bodies are in the process of undertaking comprehensive reviews of recent events and identifying any lessons learnt for internationally agreed policies and their implementation.[2]

While those reviews are still ongoing, it is possible to identify some issues and questions that we see emerging. Important lessons for supervision and prudential regulation, risk management and governance have been highlighted in recent speeches by senior officials.[3] My focus will therefore be on crisis management, resolution, and deposit insurance:

Depositors can run faster than ever before because of 24 h mobile banking and the ease with which one can make withdrawals on a smartphone. The speed with which information and misinformation can be disseminated over the internet and through social media contributes to the speed and size of runs. It took literally one Tweet to lead to the downfall of a global systemically important bank. Banks with equity or debt securities trading in public markets must make, timely disclosures about losses which can also act as catalyst for a further loss of trust and accelerate a downfall that may or may not have been inevitable. Increased volumes of activities and withdrawal requests place stress not only on banks' liquidity but also on their operational capacities. Operational disruptions can further aggravate stress and spur more speculation and, ultimately, outflows.

In these new circumstances, a question for authorities and firms is what they can do to monitor social media more closely to anticipate earlier potential issues, identify triggers for runs and possible mitigants; how they can prepare in advance for a rapid dissemination of speculation, sudden runs and surges in customer queries.

If the speed of bank runs is becoming more acute, a question arises whether more and earlier interventions are needed to address weaknesses in banks: do authorities need to

[2] https://www.fsb.org/2023/04/fsb-to-consider-lessons-learned-from-recent-banking-sector-turmoil/

[3] See for example the BIS General Manager's remarks at the EBF International Banking Summit https://www.bis.org/speeches/sp230601.htm

review their prudential regimes, in particular assumptions underlying the current liquidity requirements; does the existence of digital alternatives to traditional banking and the regulation (or lack thereof) affect the volatility and flightiness of deposits, and do they need to rethink the ways they define 'non-viability' and the points for early intervention and resolution.

Large amounts of uncovered deposits appear to have accelerated the runs in the recent banking episodes. Against this background questions have been raised about the appropriate coverage level of deposit insurance both in terms of the nature of the depositor and the amount of coverage. Of course, greater coverage provides a greater incentive to take risk. As stated in the FDIC's report on options for deposit insurance reform "changes to deposit insurance must consider both the financial stability benefits of more coverage and the possible implication for risk taking in the banking system". Complementary and alternative approaches to enhancing depositor protection have been proposed, for example requiring the collateralisation of uninsured deposits or limiting the convertibility of large uninsured deposits. A proposal - made by the former BoE Governor Mervyn King and the former deputy governor Paul Tucker - could reduce the need for deposit insurance.[4] It would require banks to preposition collateral at the central bank to cover their runnable liabilities, so that liquidity provision would be guaranteed.

The resolution of the US bank failures demonstrated how the application of sale of business strategies involving the transfer of deposits to an acquirer with the support of the deposit insurer can achieve the protection of not only covered deposits but also uncovered deposits.

We have seen that a bank's collapse can cause havoc, even if it is not particularly large, interconnected or engaged in the provision of essential functions. The FSB's Key Attributes of Effective Resolution Regimes apply to "any financial institution that could be systemic in failure". Almost any bank could be systemic in failure depending on circumstances – for example through contagion and the wildfire-like spread of doubt about its safety and soundness. There are thus good reasons for all banks to be subject to a regime that provides for the powers and tools set out in the Key Attributes which include both stabilisation and wind-down powers. The choice of the tools will depend on the size and systemic importance of the financial institution and the circumstances of failure.

To date, authorities have engaged in resolution planning mostly only for systemically important financial institutions, in particular globally systemic banks. The FSB Thematic Peer Review of 2019 on resolution planning stated that more efforts were needed beyond

[4] We need a new approach to bank regulation | Financial Times (ft.com)

G-SIBs. Focusing on banks currently identified as systemically important at a domestic level may not be enough. Even the smallest ban can be systemic if the cascade of information, misinformation and doubt unleash a flight for safety at similar firms.

This raises the question of whether we need to review our approaches to identifying systemic significance for purposes of resolution planning and extend the resolution planning requirements to a broader set of institutions.

The recent bank turmoil included the failure of a global systemically important bank (G-SIB), the most significant failure since 2008. While the Swiss authorities' actions that resulted in the merger between UBS and Credit Suisse facilitated through emergency legislation contributed to safeguarding financial stability, they gave rise to the question why authorities did not rely on their resolution powers and preferred resolution strategy. For more than a decade, key authorities – including central banks, prudential supervisors, and resolution authorities – had engaged in resolution planning in institution-specific crisis management groups for G-SIBs on the basis of their resolution frameworks. It will therefore be important to identify any lessons for the robustness of our international resolution framework. Reviews of the event are ongoing within the FSB's Resolution Steering Group (ReSG) and Working Group on Cross-border Crisis Management for Banks (bank CBCM). Among the questions to be explored that are relevant for our international resolution framework that need to be addressed are the features of an adequate public liquidity backstop arrangement; whether certain resolution strategies may be better than other in safeguarding financial stability; how authorities can be better prepared to respond flexibly to a range of potential failure scenarios, whether there are any resolution tools may be better than others in addressing systemic impacts; and how confidence of customers and markets can be restored in a time frame compatible with existing resolution strategies.

The many open questions and issues may give the impression that all our resolution planning work over the last decade has been for naught. This is not so. Recent events have also demonstrated the many benefits of the work done over the past decade: banks have made themselves more resolvable by simplifying their structures; systemic banks had issued bail-inable capital instruments to absorb losses in a resolution; contracts were structured in ways that support operational continuity and continued access in resolution to financial market infrastructures. Firms had strengthened their capabilities to identify, monitor, and estimate funding needs in resolution. Importantly, authorities had powers to act in a crisis and they had plans. Even if the preferred plan ultimately was not implemented, the planning process helped to enhance authorities' crisis preparedness. The most significant benefit was probably the close cooperation and coordination of authorities within CMGs. Personal contacts had been formed over years, so officials knew and could trust one another. They had developed mutual understandings of their objectives and approaches not only through CMGs, but also through the FSB ReSG, chaired by the FDIC Chairman Martin Gruenberg, and the bank CBCM, chaired by the SRB Board Member Sebastiano Laviola.

Conclusion

To conclude, there is an obvious and continuing need for improvements of our legal and regulatory frameworks in the face of evolving financial systems. It is important that we analyse the recent banking turmoil closely and draw potential lessons, particularly as regards the design of depositor protection and bank failure management techniques that facilitate the resolution of banks in a manner that minimises losses for uncovered deposits and safeguard financial stability. Recent events and their analyses will provide for a rich research agenda for the coming years, and I look forward to the discussion at today’s and future IADI research conferences.