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**CONTINGENCY PLAN**

**THE POINT OF VIEW OF THE INDUSTRY**

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## CONTINGENCY PLANNING

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The concept is well described in the Bank of England's [Financial Stability Report \(June 2009\)](#), p. 43-44:

*“The Bank believes firms should also develop and maintain contingency plans for dealing with their own wind-down or restructuring in the event of problems. In effect, this would be asking banks to ‘write a will’. [...] Firms should provide the data underlying these plans to the authorities on an ongoing basis. They should be based on information on a legal entity, rather than business line basis and should include information that could be used by insolvency practitioners or resolution authorities in a wind-down”.*

## CONTINGENCY PLANNING: NOT A NEW IDEA

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G10 Report of January 2001 “[Consolidation in the Financial Sector](#)”  
(p 146):

*“What are the highest priority areas that policymakers should pursue...? ... First, management of [large, complex banking organisations] should develop contingency plans for winding down their organisations under conditions of severe stress. It seems likely that such plans, which should be reviewed as part of the examination process, could greatly reduce the costs and risks of an actual wind-down”.*

## INSOLVENCY PLANNING: THE IIF PROPOSAL

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**Recommendation 42.** *Cross-border crisis simulation exercises should be carried out on a regular basis and with strong participation by relevant authorities and market participants.*

**Such planning should be developed in close collaboration with supervisory colleges. This should include, for example, identifying events which would trigger the activation of pre-insolvency plans.**

## CONTINGENCY PLANNING: STRONG RATIONALE

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Developing contingent wind-down plans could:

- provide incentives to firms to avoid complex group structures and discourage practices that make wind-down more difficult and costly, such as not segregating clients' assets and funds from those of the firm.
- force management to contemplate failure in good times, thus encouraging them to implement more effective risk management procedures and to be better prepared in case of financial stress.
- provide the authorities with a richer data set with which to assess the systemic impact of a firm's failure.
- add in transparency, with the consequence that investors should be less likely to adopt investment strategies that assume the liabilities of large banks would receive government support.

## CONTINGENCY PLANNING: EASIER SAID THAN DONE 1

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- The effort to rationalise and simplify complex structures could imply remarkable costs for banks and could prove to be a very difficult exercise. In fact, in large complex institutions, a simplification of the corporate structure would compromising tax optimization.
- Different regulatory frameworks across Europe may create different incentives in the process of winding down a bank. For example, the decision to sell assets' stakes may depend - among other things - upon the regulatory treatment of the "available for sale (AFS) reserves". In some countries (i.e. UK), negative AFS reserves are not deducted from total bank capital for regulatory purposes and the cumulative loss is taken into account only when the stake is sold. In other countries on the other hand (i.e. Italy), the loss is accounted for regulatory purposes even before the sale of a stake.

## CONTINGENCY PLANNING: EASIER SAID THAN DONE 2

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- Disclosure to the market of contingency plans which may comprise sensitive information, such as for instance priority ranking in the sale of equity stakes, could have negative effects on equity prices.
- Disclosure of contingency planning could undermine stability by giving market counterparties a road-map to the firm's intentions, facilitating the taking of positions against it.

## BANK SPECIAL RESOLUTION AND CRISIS MANAGEMENT: UK AND ITALIAN LEGISLATIONS

The Italian and UK banking laws have a lot of similarities:

- **The goals are the same:**
  - Protect the stability of the financial system.
  - Protect public confidence in the stability of the banking system.
  - Protect depositors.
  - Protect public funds.
- **Same intervention before distress or insolvency** (UK: liquidity crisis)
- **Some stabilization tools are the same**
  - transfer to a private sector purchaser.
  - transfer to a bridge bank.
- **Same special administration:** a special administrator can replace the board of a bank for a period of up to one year, with the goal of understanding intimately the issues facing the bank.

## BANK SPECIAL RESOLUTION AND CRISIS MANAGEMENT ISSUES, DIFFERENCES AND EU LEVEL

- Rather than using temporary public ownership, Italy empowers the Bank of Italy to **subsidise** a private sector purchase through the use of public money to fill any loss (the gap between the distressed bank's own funds and the value of goodwill).

- How to avoid the dilemma “let it completely fail or bail it entirely out”? How to save just the “systemically relevant core”? How to reproduce market discipline, punishing not only managers, but also creditors and shareholders?

### **Open points for EU level.**

- Comparing the Italian and UK Banking legislation, which parts of the legislation are better applied to a European context? Which tools can authorities use to finance a crisis and how should the burden be shared?

## FISCAL BURDEN SHARING

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It is important to distinguish the case of an “early intervention”, aimed at supporting the viability of a sound financial institution during a serious financial turmoil, from the case of an individual “bail out” of an insolvent firm. The former refers not to “burden sharing” but to a risk sharing, whereby the parties may also benefit economically from the intervention which involves a group of institutions. The latter, involving actual losses, is effectively a burden sharing with tax-payers’ money employed across countries, supporting one institution.

Ex-ante fiscal burden sharing is difficult: crises are different, business models are different.

## FISCAL BURDEN SHARING

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- **Burden sharing arrangements (by CBSGs) should remain voluntary, be suited to the financial institution concerned (firm specific) and the details left to the discretion of the authorities concerned.**
- **The development of ex-ante burden-sharing arrangements would, however, benefit from terms of reference at EU level, which set out the particular criteria and procedures that authorities may wish to follow.**
  - **Such criteria may include: types of costs to be shared, the balance between retail and wholesale activities, assets and revenues, the share of payment system flows of the institution, as well as the relative importance and proportion of supervisory responsibilities.**
  - **The terms of reference should also include: simple procedures for defining ex-ante burden sharing arrangements; the involvement of deposit guarantee schemes; the relation with contingency plans; non-binding mediation mechanism to tackle disagreement.**