THE 2023 BANKING TURMOIL:

PRELIMINARY LESSONS LEARNT

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European Banking: dynamics and structural changes

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Single Resolution Board

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1) The 2023 banking turmoil: a chronology

9 – 19 March (US)

- SVB lost over $40 bn of deposits in a single day (09/03);
- FDIC transferred all SVB deposits and assets to a bridge bank applying a systemic risk exception (12/03);
- FDIC used the same approach for Signature Bank (19/03).

19 March (CH)

- UBS acquired CS: (i) CS shareholders received CHF 3bn as compensation while 16bn of AT1s fully wiped-out (Coelho, Taneja and Vrbaski, 2023; Expert Group, 2023;; (ii) UBS received a government loss guarantee (up to 9bn, after initial loss of 5bn) and access to two public funding lines (up to 200bn jointly).

20 March

Following CS's AT1 base full wipe-out (see Annex II), SRB, SSM and EBA issued a joint statement to reassure on the EU Creditors Hierarchy – swiftly followed by other authorities (BoE; Bank of Canada; HKMA); Markets reacted positively.

1 May

FDIC agreed P&A with JPM over First Republic Bank, providing JPM with a Shared Loss Agreement which ensured capital relief and a 5 year fixed-rate $50bn loan.

11 May

FDIC proposed "special bank assessment" to repay the estimated cost to the DIF for SVB and Signature Bank ($15.8 bn) from all eligible deposit institutions

June – August

- UBS completed CS acquisition, to be followed by a restructuring and integration period (12/06);
- UBS announced termination of public liquidity backstops and solvency guarantee agreements (11/08)

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2) The relevant crisis management issues emerged during the crises

TOPIC	RELEVANT POLICY ISSUE TO BE FURTHER EXPLORED
Adequacy of the post GFC resolution framework: application of resolution frameworks and implementation issues	The recent banking turmoil has not put into question the FSB KAs (FSB, 6.07.2023 press release). In the CS case, while the application of the TBTF framework has not been executed, a fully operational resolution action was ready to be implemented (Report of the Expert Group on Banking Stability, 2023). The SVB case showed that an institution could be “non-significant in life but systemic in death” (De Cos, 2023; Barr, 2023; Gruenberg, 2023) - yet, the scope of prudential and resolution frameworks are different in the EU and US. Consideration of current practices in terms of assessment of “systemic significance”.
Funding in resolution: role of temporary public sector liquidity backstop	Recent crises showed the importance, for large banks, to have in place an effective temporary public support liquidity backstop (FSB Guidance, 2016). Reassessment of public sector liquidity backstop in the context of resolution (Grund, Nomm, Walch, 2020), in terms of (i) scope and features (size; conditionality; communication; collateral schedules); (ii) timing of intervention (pre-; during and/or post- resolution) and (iii) interaction with other types of liquidity facilities (ELAs; SRF; ESM backstop in the BU). The public sector backstop in the BU (D. Laboureix, 2023c).
Cross-border cooperation and coordination	In the CS case, the crisis management group made of authorities of relevant jurisdictions co-operated effectively. Important to involve other, also indirectly affected, foreign authorities, and enhance coordination. To enhance (i) practices on home-host coordination and communication and (ii) international cooperation arrangements and playbooks.
Flexibility and optionality in the use of resolution tool	Credit Suisse resolution plan foresaw the application of the bail-in tool at CS level (Expert Group on Banking Stability, 2023). To promote (FSB press release, 2023) optionality in implementation of resolution strategies. Reflection on the adoption and relevance of the tools according to different crisis scenarios (including liquidity-driven failures).

2) The relevant crisis management issues emerged during the crises

TOPIC	RELEVANT POLICY ISSUE TO BE FURTHER EXPLORED
Bail-in operationalization	Cross-border recognition and execution of bail-in actions may encounter legal challenges (Expert Group on Banking Stability, 2023). More in general, promotion of better knowledge of potential impact of bail-in on financial markets (see FSB KAs).
Bank-runs: reassessment of role and design of deposit guarantee systems ?	The magnitude and speed of the bank-run on SVB reached levels dramatically high (see Annex I). Re-assessment of current deposit guarantee schemes in terms of: (i) features (current coverage levels; pros and cons of differentiating coverage level according to deposit status – i.e., operational v. investment, see Bailey, 2023); (ii) effectiveness in preserving financial stability (impact and consequences of high levels of uninsured depositors and incentive to run – Gruenberg, 2023; Rose 2015) and (iii) interaction with resolution framework (TLAC as a buffer for LGD on deposits – Gruenberg, 2023; FDIC, 2023c; Berner, Schoenholtz, White, 2023). The SVB bank-run more idiosyncratic than general.
Bank-runs: the digitalisation challenges - from old to new types of deposit-runs (Diamond-Dybvig 1983; Rose 2015) ?	Digital innovation an important factor to be taken into consideration in supervision and crisis management. Assessment of the challenges stemming from digital innovation (mobile banking; fast payments app) and social media on the pace of bank-runs (FDIC, 2023; De Cos, 2023); monitor the phenomena and explore ways to improve communication practices by authorities (FSB, 2023).

3) The recent banking turmoil: some preliminary take-aways for resolution

“The **resolution planning** conducted by authorities over the past decade and close collaboration between authorities across jurisdictions through their crisis management groups had positioned the authorities to **handle** the failures of financial institutions” (FSB press release, 2023):

- In the **Swiss case**, the framework established by the Key Attributes “provided the Swiss authorities with an executable alternative to the path that was eventually chosen.”
- In the **US cases**, shareholders lost their investments; unsecured creditors (excluding depositors) took losses; the boards were removed and bridge banks operationalized. The costs stemming from the application of the systemic risk exception were borne by the banking industry.

- **N.B.** The crisis cases also highlighted some preliminary lessons for **regulation and supervision** (De Cos, 2023; Barr, 2023; Enria, 2023; GHOS, 2023; Tuckman 2023; Adrian et al, 2023). The Basel Committee stocktake of the regulatory and supervisory lessons of the banking turmoil (GHOS, September 2023) underlined the following: *(i)* importance of banks’ risk management practice and governance arrangements; *(ii) role of strong and effective supervision in overseeing the safety and soundness of banks, in order to early and effectively identify and promptly correct weaknesses in banks practices; (iii) importance of prudent and robust regulatory framework to safeguard financial stability (assessment of specific features of liquidity risk and interest rate risk in the banking book in the Basel framework).*

3) The recent banking turmoil: some preliminary take-aways for resolutiom

Some **implementation issues** (FSB press release, 2023) of the international resolution framework deserve attention:

- The role of **public sector liquidity backstops in resolution**.
- **Optionality** in implementation of resolution strategies should be further explored (D. Laboureix, 2023b) – especially in light of the different failure scenarios that could arise (e.g., liquidity crises).
- **Execution of bail-in across borders could be enhanced**: securities laws may pose legal and operational issues to a smooth application of bail-in (Report of the Swiss Experts Group on Banking Stability, 2023). Proper *ex-ante* preparation and close home/host cooperation is necessary.
- **Scope** of resolution planning (assessment of banks' systemic significance in failure) and **loss-absorbing capacity requirements** (long-term debt as an additional layer for loss absorption, shielding uninsured deposits, see Gruenberg 2023).
- **Improvement of cross-border cooperation outside of** CMGs in crisis situations in order to avoid indirect effects (e.g., SRB and other authorities' communication on Additional Tier 1 instruments, see D. Laboureix, 2023b).
- Interaction of **deposit insurance systems and** resolution; **impact of digital innovation** on resolution preparedness.

In addition, some other aspects have to be addressed: (i) **harmonization of insolvency laws in the EU** (see Unidroit initiative on bank-insolvency) and (ii) a **monitoring** and **regulation framework of Non-Bank Financial Intermediation,** with the aim to also increase its transparency (FSB, 2022).

THANK YOU

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Annex I

Deposit outflows for large US institutions during 2008 crisis (Rose, 2015) v. SVB

Institution	Start of outflow	Duration of outflow	Size of outflow	Deposit base	Percent outflow	Monthly rate (hypothetical)
Wachovia	15/4/2008	2 weeks	$15b	$414b	3.6%	7.8%
	15/9/2008	5 days	$8.3b		2.0%	11.8%
	26/9/2008	8 days	$10b		2.4%	9.0%
Washington Mutual	11/7/2009	23 days	$9.1b	$186b	4.9%	6.5%
	8/9/2008	**16 days**	$18.7b		**10.1%**	18.6%
National City	15/3/2008	**2 days**	$5b	$98b	**5.1%**	55.6%
	11/7/2008	5 days	$4.5b		4.6%	25.3%
	15/9/2008	25 days	$4.5b		4.6%	5.7%
Sovereign	11/7/2008	?	$0.74b	$47b	1.6%	
	1/9/2008	1 month	$2.9b		6.2%	6.2%
IndyMac	27/6/2008	2 weeks	$1.55b	$18.5b	8.4%	17.6%
SVB	**9/3/2023**	**1 day**	**$42bn**	**$173b**	**24%**	**100%**

Annex II

Loss absorbing features of AT1 under the EU framework

FEATURE	CET1	AT1	LEGAL BASIS
Activation of loss absorbing capacity in going-concern	Losses covered “as soon as these occur”.	Losses covered once (and only when) the trigger is hit.	CRR artt. 26(1); 52(1)(n); 54.
Nature of the trigger	N/A	EU AT1s triggers are all anchored to CET1 ratio level (max 7%) – **quantitative trigger** (R. Coelho, J. Taneja and R. Vrbaski, 2023). CRR permits different triggers <u>in addition</u>.	CRR art. 54(1)(a), (b).
Loss absorption mechanism	Automatic via write-down.	Automatic via either (i) conversion or (ii) write-down (full or partial, permanent or temporary).	CRR art. 54(1) to (7); DR 241/2014 art. 21.
Loss distribution / allocation in going-concern	CET1 claims absorb the first and proportionately greatest share of losses. *Pari passu* / joint exposure to losses of CET1 and AT1 claims, when the AT1 trigger is activated, is possible – deviation from a strict application of Absolute Priority Rule (which is, anyway, an “insolvency principle”). Yet unlikely given the low thresholds of the trigger (5.125% CET1). Resolution rules and insolvency hierarchy applies (Coelho, Taneja and Vrbaski, 2023)		CRR artt. 28(2)(i); 54(1)(a).
Subordination (insolvency)	Subordinated to all claims.	Subordinated to Tier 2.	CRR artt. 28(2)(j); 52(1)(d).

Annex II

AT1 and Credit Suisse

FEATURE	CS AT1 (total of 13 securities subject to WD)	OBSERVATION(S)
Activation of loss absorbing capacity in going-concern	Three different (alternative) automatic trigger-event clauses, anchored to: (i) CET1 ratio; (ii) Swiss regulator determination that AT1 write-down, jointly with junior or *pari passu* write-down/conversion, is necessary from a solvency perspective; (iii) regulator's determinations of infeasibility of customary measures to improve the firm's capital position or necessity of solvency public support measures to avoid insolvency or illiquidity.	In Europe, standard AT1 contracts do not have a contractual trigger anchored to an "authority determination" (**qualitative trigger**, see Coelho, Taneja and Vrbaski, 2023). FINMA confirmed its actions have been based on the third trigger - as well as on a 16/19 March Federal Council's Emergency Ordinance.
Nature of the trigger	First trigger is a standard quantitative trigger. Second and third trigger are **qualitative** – and possibly discretionary – triggers.	See above.
Loss absorption mechanism	full and permanent write-down once the trigger is hit.	Not an unusual feature for a write-downable instrument.
Loss allocation / distribution between CET1/AT1	AT1 fully wiped-out despite CET1 maintaining a diluted stake in UBS. Risk factors in the AT1 contract hinted at such possibility.	Deviation from APR (which is anyway an insolvency loss-allocation principle). The public sector support triggered the full write-down of all AT1 instruments issued by CS under the contractual terms governing those instruments (see also Coelho, Taneja and Vrbaski, 2023).

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