

**“FORM FOLLOWS FUNCTION” – A
NEW ARCHITECTURE FOR
REGULATING AND RESOLVING
GLOBAL FINANCIAL INSTITUTIONS**

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Disclaimer

In a nutshell

- Large cross-border institutions perform functions that are critical for financial systems and the real economy
- They have become “too systemic to be allowed to fail”
- We need effective means to safeguard critical functions

Three Policy Approaches

(1) Reducing the likelihood of failure

- More capital
- More liquidity
- Better risk management

(2) Reducing the systemic impact

- Macro-prudential supervision and systemic risk regulator
- Stricter regulation of systemically significant institutions
- Reducing systemic relevance : narrow banking, new Glass-Steagall, limiting size through regulatory, market structure, competition or tax rules

(3) Creating a resolution regime for cross-border financial groups

- International agreement on a “universal resolution framework” or creation of a supranational resolution authority
- Alternative: Adapting corporate structure to existing (but improved) resolution frameworks



“Move the chair closer to the piano or the piano closer to the chair?”

“The piano...”

- Entity-centric, sector specific and nationally-based resolution frameworks
 - Diversity of national crisis resolution arrangements gives rise to multiple conflicting national proceedings
 - Regulatory, corporate and insolvency law provisions hamper intra-group transfers of liquidity and collateral in a crisis
 - Corporate separateness makes it difficult to preserve critical functions operated by multiple group entities
 - Divergent interests of national authorities prevent effective cross-border resolutions

“Moving the piano...”

- ...would require a binding international agreement on
 - the cross-border recognition of resolution measures (e.g., transfer of assets and liabilities to a bridge bank)
 - a group support regime (intra-group transfer of assets in a crisis)
 - burden sharing
 - common criteria for substantive consolidation („piercing the corporate veil“)

“ The chair”

- Large cross-border groups consist of entities regulated and unregulated, related through ownership, business interests and reputation
- Operations are closely intertwined and critical group-wide functions are centralised
- Choice of corporate form is determined by regulatory, corporate and tax laws

“Moving the chair...”

-means making group structures less complex and easier to wind down by
 - Reducing the number of legal entities (e.g., consolidating unregulated entities with regulated entities)
 - Introducing structural separability of subsidiaries
 - Aligning legal form and economic function
 - Insulating critical functions from failure through bankruptcy remote structures (e.g., CLS, CCPs)
- Contingency planning to become an integral part of regulation and supervision (“corporate estate planning”)

EU Perspective

- Facilitate the resolution of financial groups under existing directives by
 - Reducing the number of entities to be wound up (operations through branches instead of subsidiaries)
 - Separating the entities that remain (reducing interdependencies)
 - Strengthening home/host cooperation

Conclusion

“It may be easier to move the chair than to move the piano”

- Complexity is costly and possibly unnecessary
- Legal form should follow economic function
- This is a feasible and practical way to address the „too complex to fail“ and „too interconnected to fail“ problem

Further study

- What are the reasons for complexitiy?
- Are there any reasons – apart form escaping burdensome supervisory restrictions – why financial institutions create subsidiaries that are not prudentially supervised?
- How significant are the tax advantages that arise from the creation of separate entities?
- How can practical problems to the separate reorganisation or liquidation of the indivdidual components of a goup be mitigated *ex ante*?
- How can a group be structured so that its components can be resolved separately ?
- What changes to the law governing the resolution of financial groups would be necessary?
- What powers are necessary to achieve the continuity of critical functions provided by a failing institutions?
- How can resolution powers (e.g., transfer of business, creation of bridge banks) be made effective across borders?