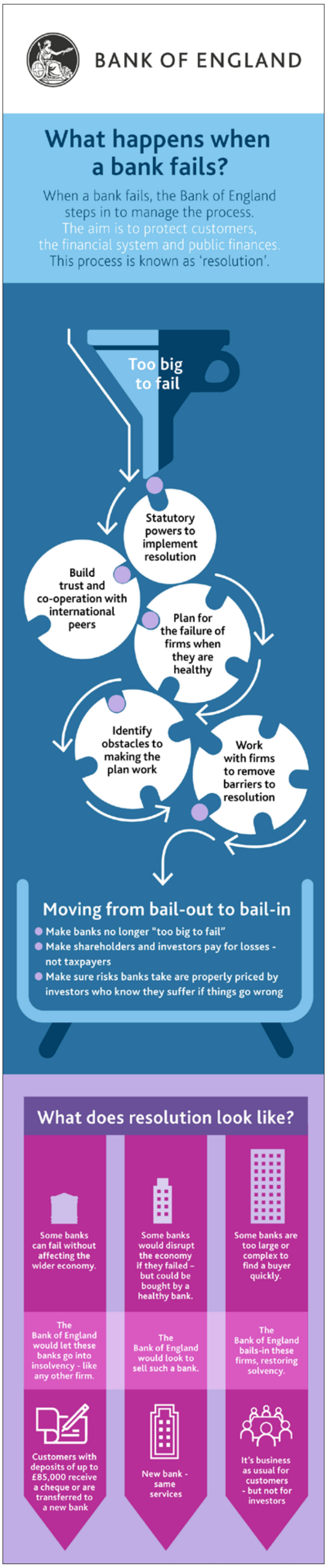
Bank of England steps up global bail-in drive

By Elisa Barwick

In a 29 September speech to the European Banking Union's Single Resolution Board Annual Conference in Brussels, Bank of England (BoE) Deputy Governor Jon Cunliffe launched a final effort to cement bank "bail-in" as the universal crisis-management mechanism. With a new global financial crisis brewing, there is a push to clarify the requirements for bank resolution in a crisis, even though most of them will not be fully implemented until 2022.

Cunliffe announced the bank's publication of an advisory paper (known as a "purple book" after the colour of its cover) titled "The Bank of England's approach to resolution", the purpose of which is "to set out very clearly the options that the Bank has, to deal with a failure of a bank and the way in which we would use our powers".

The purple book, based on lengthy and convoluted Bank for International Settlements (BIS) and Financial Stability Board (FSB) documents, lays out the decision-making process for dealing with collapsing banks, including when to put them into "resolution", which keeps them operating, and when to allow them to collapse into insolvency.



The resolution regime

First of all, whether a bank is a viable candidate for resolution depends on its status within the financial system: "This assessment will be influenced by the size and nature of the critical functions of the failed firms and conditions in the wider financial system at the point of failure", the purple book says.

As in the recent bail-in of Banco Popular in Spain, the resolution regime is triggered if a bank is deemed to be "failing or likely to fail". A bail-in is then conducted—or in the BoE's words, a "write-down of the claims of the bank's unsecured creditors (including holders of capital instruments) and conversion of those claims into equity as necessary to restore solvency to the bank". In the UK, the Financial Services Compensation Scheme (FSCS) protects deposits up to £85,000, but deposits above that would be coopted to save the bank, as would subordinated (junior) bonds, and so-called "bail-in bonds" (more on that later).

Any or all of the bank's business can then be transferred, without the consent of the bank or its customers, to a private-sector purchaser or to a temporary bridge bank controlled by the BoE, to maintain continuity of the bank's functions. A bank may then be eligible to access special liquidity facilities from the BoE.

This process shows that the bail-in regime actually perpetuates the Too-Big-To-Fail problem. Small banks can be sacrificed, but big ones must be saved at any cost. (See BoE infographic.) The US Federal Reserve allowed Lehman Brothers to collapse, Cunliffe said, which dramatically demonstrated that "for large banks that perform critical functions, insolvency is not a viable option".

Bail-in bonds

Speaking to media on 2 October, Cunliffe said British banks had to find an additional £4 billion as part of their total loss-absorbing capacity (TLAC), a requirement of BIS/FSB rules accepted by the Group of 20 nations in 2015. According to Reuters he said that ten years after the global financial crisis, it was time to slot the final pieces of the resolution regime into place.

Cunliffe said the bank was working on more details regarding the mandatory bail-in debt that banks must hold, but that £112 billion of existing bank debt would have to be "rebadged" so it could be written down in a crisis, and an additional £4 billion of such debt would have to be created. HSBC alone has issued or rebadged £80 billion of bail-in bonds in the last 18 months.

In the UK this debt is known as MREL—minimum requirement for own funds and eligible liabilities. The BoE has written to all banks advising them of their MREL requirements, which are required to be in place from 1 January 2022, with interim requirements by January 2020.

Will APRA follow?

In Australia, banks have been issuing "hybrid" bonds, totalling some $30 billion. Dangerously, bank supervisor APRA has allowed Australia's banks to sell them to unsuspecting "mum and dad" investors, who would not understand their complex risks. For instance, they start to incur losses if the bank's capital ratio falls below 8 per cent, and if the bank's capital ratio falls below 5.125 per cent, APRA can convert hybrids into bank equity (worthless in a failing institution), writing off their entire value.

In July APRA raised the target for Australian banks' capital ratio from 9.5 per cent up to "at least" 10.5 per cent, to be achieved by 2020, encouraging banks to meet it more quickly. This is supposed to meet the benchmark set by the 2014 Financial System Inquiry to provide "unquestionably strong" capital ratios. Further revision of this target is expected later this year, based on changes to the BIS Basel Committee on Banking Supervision's capital framework. Draft prudential standards for Australia to fit in with the global framework are expected by 2019, to take effect in early 2021, APRA stated in a media release.

APRA has not made a ruling on whether to include hybrid bonds in the banks' mandatory capital holdings and bail-in buffer (TLAC), as the BoE now has. Will APRA now follow suit? As those capital requirements are part of global TLAC rules imposed by the Bank of England/BIS/FSB cabal, it is likely that the BoE's decision to explicitly demarcate "bail-in debt" is a sign that the flag has been dropped on formalising those rules in all G20 jurisdictions, including Australia. In the meantime, as reported by this publication over the past two months, the Australian Treasury is attempting to give APRA emergency powers to take over any bank and control its assets during a crisis—which would give them full leeway to bail-in whatever liabilities they like.

As for whether any of this could actually save the financial system, in his Brussels speech, Cunliffe admitted: "For sure, if we were suddenly to find ourselves pitched back into the middle of a systemic crisis, with a number of major institutions having failed or on the point of failure and a complete breakdown of trust and confidence, orderly resolution of individual banks in itself is unlikely to be able to stabilise the system as a whole."

Furthermore, the Bank of England's purple book, echoing an earlier FSB report, admits the reason for the complicated resolution regime is to prevent national governments from taking steps to protect their own citizens: The bail-in resolution process "greatly simplifies resolution and reduces the incentive for host authorities to ring-fence local assets for the protection of local depositors and creditors." If not stopped, the City of London-Wall Street banking elite will destroy those depositors and creditors in a desperate attempt to preserve their system, rather than lose power to governments which would act to protect their constituents through such measures as Glass-Steagall, and national banking to fund physical reconstruction and development.