"THE INTERNATIONAL FRAMEWORK FOR CROSS-BORDER RESOLUTION"
PREPARED STATEMENT OF
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Chairman Warner, Ranking Member Kirk, members of the Senate Subcommittee on National Security and International Trade and Finance, thank you for this opportunity to testify on the subject of cross-border resolutions. This is a complex, but critically important part of the international efforts to promote regulatory reform, and it is a privilege and honor for me to testify at this hearing.

I. G-20 and FSB framework

The financial crisis of 2007-09 and the subsequent European sovereign crisis revealed fundamental weaknesses in some global financial institutions. In the aftermath of a number of noteworthy financial firm failures, ranging from Lehman Brothers in the United States to Northern Rock in the UK to Dexia in continental Europe, the G-20 Leaders agreed at their meeting in Pittsburgh in 2009 to develop frameworks and tools for the effective resolution of financial groups to help mitigate the disruption from financial institution failures and reduce moral hazard in the future.

The G-20 Leaders turned to the Financial Stability Board (FSB) to oversee the implementation of their financial regulatory commitments. The FSB is a unique international regulatory policy body that comprises high-level policymakers from finance ministries, central banks, banking supervisors, and market regulators of all the G-20 countries and other key financial centers, plus key international bodies, such as the IMF, World Bank, and the Bank for International Settlements (BIS).

In October 2010, the FSB recommended a policy framework, which the G-20 Leaders subsequently endorsed, to address the moral hazard posed by global systemically important financial institutions (G-SIFIs) that consisted of four key prongs:

- a resolution framework to ensure that all financial institutions can be resolved safely, quickly and without destabilizing the financial system and exposing the taxpayer to the risk of loss;
- a requirement that G-SIFIs have higher loss absorbency capacity to reflect the greater risks that these institutions pose to the global financial system;
- more intensive supervisory oversight for financial institutions that may pose systemic risk; and,
- robust core financial market infrastructures to reduce contagion risk from the failure of individual institutions.

Today, I will discuss the first prong—the international resolution framework.

II. The overarching FSB framework for improving the resolution of financial institutions

All countries need to have effective national resolution systems to resolve failing financial institutions in an orderly manner, including a legislative and regulatory framework, legal powers, and institutional arrangements. An effective *national* resolution system is a necessary prerequisite to an effective *cross-border* resolution framework. At the same time, national resolution systems must be consistent with one another to facilitate the orderly cross-border resolution of G-SIFIs. Subjecting the same firm to conflicting legal rules, procedures, and mechanisms can create uncertainty, instability, possible systemic contagion, and higher costs of resolution.

Accordingly, following the call by the G-20 Leaders, the FSB laid out an approach to resolution that consisted of the following key elements:

- a new international standard that countries would implement to ensure a consistent national resolution framework for G-SIFIs and other financial institutions;
- making the new international standard, and resolution more generally, a top international priority to ensure that countries would devote the necessary resources to legislative, regulatory, and institutional changes to implement the new international standard;
- an international assessment process to ensure that countries would comply with the new international standard and implement it in a consistent manner across jurisdictions; and,
- a framework to resolve individual G-SIFIs.

The FSB's G-SIFI-specific framework, in turn, called for an individual crisis management group (CMG) for each of the G-SIFIs. The FSB has currently identified 28 G-SIFI banks. Each of the 28 corresponding CMGs would have supervisors and resolution authorities from the bank's home jurisdiction, as well as from 3-5 other key jurisdictions where the institution in question has a major presence. These CMGs would be tasked with developing recovery and resolution plans for individual firms and developing cooperation agreements among the relevant regulators to provide an ex ante agreement on how resolutions would be handled. Once planning is complete and cooperation agreements are in place, the CMGs would use a "resolvability assessment" process to determine what other steps are needed to make cross-border resolutions possible.

The above description comprises the G-20/FSB's general resolution framework. The FSB established a Resolution Steering Group, chaired by Bank of England Deputy Governor Paul Tucker and with active U.S. participation, to oversee the development of this framework and its implementation.

III. Progress in completing the new G-20/FSB framework/strategy

Much progress has been made, reflecting the high priority and considerable time and energy that countries are devoting to the new framework. The FSB's Resolution Steering Group developed a new international resolution standard, called the *Key Attributes of Effective Resolution Regimes for Financial Institutions.* The *Key Attributes* offer over 100 specific recommendations in 12 general areas, including resolution authorities and powers, recovery and resolution planning, funding, safeguards, segregation of client assets, cross-border cooperation, and information sharing. In July 2011, the Resolution Steering Group issued the *Key Attributes* for public comment and, in November 2011, the G-20 Leaders endorsed the new standard.

The FSB's Resolution Steering Group is now developing an assessment methodology that independent assessors can use as a yardstick to measure jurisdictions' progress in implementing the *Key Attributes*. In cooperation with the FSB, the IMF and the World Bank have launched a pilot project to test the methodology in two jurisdictions. Lessons learned in these pilot assessments will feed into the final methodology. Once this process is complete, we expect that the FSB will add the *Key Attributes* to its list of 12 key international standards and codes. The key standards and codes represent minimum requirements for good practice in areas such as banking supervision, securities regulation, accounting, and anti-money laundering that countries are encouraged to meet or exceed. The FSB has identified these standards as meriting priority implementation by all countries. This, in turn, would mean that the IMF and the World Bank could add the *Key Attributes* to their regular analysis of a country's financial sector through their Financial Sector Assessment Program, which they apply to 190 or so countries worldwide.

The FSB itself has recently completed the first of many peer reviews to measure progress across its 24 member jurisdictions in implementing the *Key Attributes*. FDIC Chairman Martin Gruenberg chaired the FSB's review, which found that the United States is leading the globe in implementing its own effective resolution regime that was created under Title II of the Dodd-Frank Act. The FSB peer review also found that outside the United States, implementation of the *Key Attributes* remains at an early stage, and many jurisdictions still lack the necessary powers and institutions to resolve effectively either G-SIFIs or other financial institutions.

Still, while other jurisdictions lag behind the United States, progress is occurring. In Europe, major jurisdictions, including France, Germany, the Netherlands, Switzerland, and the UK, have proposed or passed legislation for resolution frameworks that are largely consistent with the *Key Attributes*. The European Commission is working to finalize its own Bank Recovery and Resolution Directive in June of this year, which all 27 member states in the European Union would be expected to implement. The European Union is also working on a larger European effort to develop a true banking union, with a single supervisory mechanism and a single resolution authority for the euro area.

In Asia, jurisdictions including Japan, Singapore, and Hong Kong have proposed, or are preparing to propose, resolution reforms, while other jurisdictions are still considering their approach.

In addition to developing the *Key Attributes*, the FSB's Resolution Steering Group is continuing to work on specific aspects of cross-border resolution, including the treatment of client assets, the scope and prerequisites for information sharing between different authorities, and the resolution of derivatives central counterparties. The latter is expected to become vital linchpins of the financial system as derivatives reforms begin to take effect in major jurisdictions.

The FSB and national authorities have also made important progress in enabling the resolution of individual firms. Most FSB member countries that are home to G-SIFIs have developed high-level national resolution strategies and discussed these with key host authorities in their CMGs. To date, CMGs have been established for each of the 28 G-SIFIs, and nearly all CMGs have already met at least once. Each CMG is working to develop recovery and resolution plans for its respective institution and to negotiate cooperation agreements, or "COAGs," among all of its member authorities. Resolvability assessments are scheduled for 2014 to determine what we have achieved so far and what remains to be done to make each G-SIFI resolvable.

IV. Next steps

While much has been accomplished, there is much more still to do. The United States has 75 years of experience in resolving financial institutions, but many countries have only recently realized the need to implement an effective resolution regime. They must develop and operationalize the principles contained in the *Key Attributes* if the resolution of G-SIFIs with cross-border operations is to be made credible. Our focus is currently on three interrelated efforts: first, finalizing cooperation agreements and building trust between national regulators, so that we can successfully cooperate to resolve large international institutions across borders with minimum disruption to the global financial system; second, encouraging foreign jurisdictions to build more flexibility into their resolution frameworks to allow coordinated resolutions to become feasible; and third, establishing strong lines of communication and information-sharing among relevant national authorities.

In addition, the FSB Resolution Steering Group continues to work in the following areas:

- completing the resolution planning process and finalizing cooperation agreements for each G-SIFI;
- developing supplemental guidance containing clear principles to address: (i) information sharing for resolution purposes; (ii) the protection of client assets in resolution; (iii) the resolution of financial market infrastructures (FMIs); and, (iv) the resolution of insurers;
- finalizing the *Key Attributes* Methodology (public consultation, pilot assessments);
- following up on the recommendations of the peer review on resolution regimes; and,
- planning for a resolvability assessment process for G-SIFIs that should be launched in early 2014.

The experience with the recent bank failures in Cyprus, including an initial proposal to haircut insured depositors, has refocused attention within Europe on the importance of an effective resolution framework. Cyprus had no resolution statute and its parliament was required to draft and approve legislation in only a few days, which in the event did not impair insured depositors. However, this has reinforced the need in Europe to make progress on implementing resolution systems, including a depositor preference regime. It is important that the FSB build on the *Key Attributes* and include specific depositor preference and creditor hierarchy.

V. Conclusion

Keeping our focus on these efforts is vital. The financial crisis made clear that the failure of large, international financial firms can result in systemic damage that does not stop at national borders and can directly impact the day-to-day lives of people around the world. This risk and the complexity of today's global financial system make international cooperation and understanding among national regulators absolutely necessary. The FSB is playing a vital role in bringing domestic and foreign regulators together to build the capacity, the mutual trust, and the communication networks necessary to make possible the resolution of systemic financial institutions without the risk of systemic damage, a risk we now know is all too real.