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Resolution regimes: There is progress, but more needs to be done

After the 2008 global financial crisis, policymakers focused on implementing and enhancing resolution regimes governing global systemically important banks ("G-SIBs"). The objective was to prevent two untenable outcomes: a taxpayer-funded bailout; or a Lehman-style bankruptcy. Much progress has been made in various ways, including changes in legislation and the development of resolution plans. While some policymakers assert that G-SIBs can now be safely resolved, others find more work is needed. A key resolution objective is to ensure the bank in resolution can retain access to systemically important financial market infrastructures ("FMIs") such as CLS, which is the primary settlement service for the global FX market and settles a daily average of USD5.5 trillion in payments. Because of the credit and liquidity benefits CLS provides, a G-SIB in resolution losing access to CLS would likely adversely impact the resolution's success.

Fortunately, resolution of a G-SIB is designed to be a rare occurrence under these new regimes. So how can the robustness of such regimes be tested? One way is through a well-designed "war game" that tests key aspects of a resolution scenario. CLS recently conducted a war game based on the resolution of a hypothetical G-SIB. The scenario benefited from the participation of many CLS members and input from central banks and certain resolution authorities.

While the war game confirmed progress in some areas, it also revealed shortcomings and potential impediments to resolvability that merit attention, including:

- Multicurrency liquidity challenges – Nostro agents of a bank in resolution are less likely to fund on that bank's behalf in the relevant currencies without prefunding or collateral. Despite G-SIBs' extensive international activities, there continues to be an overwhelming focus on ensuring sufficient liquidity in the home currency during a bank resolution, with less consideration as to how to ensure funding in relevant foreign currencies. Per the Financial Stability Board's June 2018 *Funding Strategy Elements of an Implementable Resolution Plan*, resolution plans should address how funding obligations in all relevant currencies will be met, including any potential shortfalls. This may be challenging over a resolution weekend.
- Procyclicality concerns – The majority of market participants are still likely to have procyclical responses (e.g., significantly reducing or effectively eliminating credit limits) to a bank's entry into resolution, which may jeopardize the resolution's success. In addition, authorities' use of "moral suasion" on market participants in order to bolster confidence in the resolution may not be as effective as expected.
- Enhancing communications – Timely and effective communication is critical to fostering market confidence in a resolution, especially from the resolution authority and central banks. For example, the hypothetical G-SIB's nostro agents indicated their desire for information from their own regulators regarding the resolution. Communication plans and information-sharing arrangements (e.g., crisis management groups) should consider how to address these needs.

Successfully addressing these issues will require coordinated, proactive efforts across a variety of stakeholders.