SVERIGES
RIKSBANK

[redacted]

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Introduction

- Operational contingencies
- Financial distress
- Constructive ambiguity not an argument
- Inadequate planning risks less efficient crisis management
- UK Tripartite Standing Commission

Why contingency planning?

- Costs of a crisis
- Part of framework:
- - Adequate preconditions
- - Effective regulation and supervision

Definitions

- Contingency planning
- Contingency measures
- Crisis management
- Crisis resolution

Planning categories

- Operational or financial
- Examples: Back-up, routines, staff, institutions.
- Examples: Chapter 7/11; Creation of FDIC
- Include systems and institutions
- Alternative channels and agents
- Legal backing and practical arrangements for winding-up. Avoid gridlock.

What needs to be protected?

- Functions:
- - Payment services
- - Savings and lending
- - Risks
- Different characteristics:
- - P.s.: Time-critical.
- - Savings and lending: Less time-critical
- - Risk management: Partly time-critical

What needs to be protected (2)

- Vulnerability of functions:
- - P.s. often centralised. Not easy to replicate quickly. Savings, lending and plain vanilla risks – performed by many.

Types of contingency measures

- Payment services:
- - Liquidity support to avoid gridlock
- - Shift to other agents in the system

- Savings:
- - Deposit insurance system
- - Purchase and assumption transaction

Types of contingency measures (2)

- Lending:
- - Existing loans could stay or be sold
- - New loan may require new bank. Would the new bank be more reluctant?
- Sell the loan portfolio or transfer to an AMC. Requires legal backing and rules for objective valuation.Organisational structures. US: Bridge bank solutions.

Types of contingency measures (3)

- Risk management:
- - Rapid divestment may cause volatility and knock-on effects (LTCM)
- - Legislation; preagreed documentation
- - Well-balanced and coordinated transparency measures
- - Circuit breakers

Why focus on functions?

- Focus on overriding objective of macro economic development and stability
- Reduces moral hazard risk
- Provides better incentives to crisis survivors
- Easier to close non-viable institutions
- Easier for authorities to withstand undue pressures

Riksbank example

- Short analysis of functions. Result: No bank (even at 25% market share) could à priori be seen as systemic. Maybe, if simultaneous crisis in two or more banks.

From individual to systemic crisis

- Basic contingency measures are applicable to small and large problems.
- Need for specific measures for systemic problems, e.g. ELA, solvency support, blanket guarantee.
- Ex ante preparations for disclosures in a crisis, e.g. coordination issues.

Cross-sector and cross-border

- LCFIs may require specific measures
- Countries may have conflicting interests
- EU (also the Nordics) has started cross-border contingency planning, e.g. MoUs.

Conclusions

- Operational and financial distress planning
- Crisis management becomes more effective if there has been cont. planning
- Focus on functions, not institutions
- LCFIs calls for more potent measures
- National and cross-border planning
- Increasing interest for contingency planning – due to integration

What to do

- Start a ”no-bounds” analysis of what is needed in your country.
- Bilateral discussions with close neighbours.
- Participate in the global discussion.