The bank safety net:
institutions and rules for preserving the stability of the banking system

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A. Introduction to administrative banking law (1/7)

1. Definition

The sum of institutions and rules adopted in order:

(a) to regulate and supervise banks (and other financial firms operating in the banking system) with a view to achieving specific policy goals, and *mainly*:

- to preserve the stability of the banking system
- to protect depositors

(b) to liberalise (at the international level) the freedoms to establish and provide cross-border services in other countries

A. Introduction to administrative banking law (2/7)

2. Administrative banking law as a branch of administrative financial law

- Administrative banking law
- Administrative capital markets law
- Administrative (private) insurance law
- Administrative financial conglomerates law
- Administrative payment and settlement systems law
- Administrative law on the protection of the economic interests of consumers dealing with financial firms
- Administrative law on combatting financial crime

A. Introduction to administrative banking law (3/7)

3. Policy instruments to ensure the stability of the banking system: the ‘bank safety net’

3.1 Prudential measures

- ‘Structural’ regulations: range of permissible activities for banks
- Rules on the authorisation of banks
- Rules on the micro- and macro-prudential regulation of banks
- Rules on the micro-prudential supervision of banks
- Macro-prudential financial oversight

A. Introduction to administrative banking law (4/7)

3. Policy instruments to ensure the stability of the banking system: the ‘bank safety net’

3.2 Crisis prevention measures

- Rules on recovery planning
- Rules on resolution planning – resolvability
- Rules on the reorganisation of banks

A. Introduction to administrative banking law (5/7)

3. Policy instruments to ensure the stability of the banking system: the ‘bank safety net’

3.3 Crisis management measures

(a) Solvency crises: the ‘trilemma’

- Recapitalisation of banks by public funds (‘bail-out’)
- Rules on the resolution of banks (including ‘bail-in’)
- Rules on the winding-up (liquidation) of banks - Operation of (explicit) deposit guarantee (insurance) systems

(b) Liquidity crises

Lending of last resort by the monetary authority

A. Introduction to administrative banking law (6/7)

4. Institutional aspects

Policy instruments	Competent institution	Attributes of the institution
Bank authorisation	Supervisory authority (in most cases)	Central bank *or* other administrative authority
Micro-prudential and macro-prudential regulation of banks	■ Parliament ■ Supervisory authority	■ Ordinary legislation ■ 'Delegated' rules
Micro-prudential supervision of banks	Supervisory authority	Central bank *or* other administrative authority
Macro-prudential oversight of the financial system (including the banking sector)	Typically: central bank (= monetary authority/ agency)	

A. Introduction to administrative banking law (7/7)

4. Institutional aspects (continued)

Policy instruments	Competent institution	Attributes of the institution
Bank resolution	Resolution authority	Central bank *or* other administrative authority – separation from supervisory authority
Deposit guarantee (insurance)	Deposit guarantee (insurance) system	‘Earmarked’ institution
Last resort lending of banks	Central bank (= monetary authority / agency)	

B. The individual elements of the bank safety net (1/12)

1. Prudential regulations

1.1 Micro-prudential regulations

1.1.1 Capital adequacy rules

- Credit risk
- Market risks
- Operational risk

1.1.2 Portfolio diversification rules (large exposures regulation)

1.1.3 Liquidity ratios

1.1.4 Leverage ratios

1.2 Macro-prudential regulations: building up of ‘buffers’

TABLE

A typical bank balance sheet

Assets		Liabilities	
Totally liquid assets: • cash • reserve requirements of the Central Bank • ‘deposit facility’ of the Central Bank	3	Liquidity provided by the Central Bank in the course of the conduct of the monetary policy through: • ‘open market operations’ • ‘lending facilities’	2
		Last resort lending from the central bank	
Loans and credit to: • businesses • households (mortgage and consumer lending) • institutions (public and private)	70	Deposits of: • businesses • households • institutions (public and private)	68

TABLE (cont.)

A typical bank balance sheet

Assets		Liabilities	
Capital market instruments issued by: • governments • other banks and financial firms • other corporates	15	Debt instruments not included in own funds Interbank deposits	20
Holdings in other banks, financial firms and corporates (including 'qualified holdings' and subsidiaries)	8	**Debt instruments included in regulatory own funds**	3
Real estate – other assets	4	**Share capital and provisions**	7
	100		**100**

B. The individual elements of the bank safety net (4/12)

2. Micro-prudential supervision: compliance of banks with prudential regulations and enforcement

2.1 Institutional aspects

2.1.1 The three main approaches to financial supervision

- Sectoral approach: three authorities for the three sectors
- Full integration approach: one authority (e.g., FINMA)
- Twin-peaks approach: two authorities

2.1.2 The central bank (monetary authority) as supervisor

- Separation principle (e.g. Switzerland)
- Integration with ‘Chinese walls’

Classification of members of the Basel Committee according to their competences in micro-prudential banking (financial) supervision

		Members of Basel Committee (reference to the relevant state)	
		National central banks (14)	**National administrative authorities (14)**
Approaches on micro-prudential financial supervision	**Sectoral approach**	Argentina Brasil Hong Kong SAR India Italy Russia Saudi Arabia Singapore South Africa Spain (SSM: euro area) United Kingdom	***Only for banking:*** China Turkey United States ***Both for banking and capital markets:*** Luxembourg Mexico

Classification of members of the Basel Committee according to their competences in micro-prudential banking (financial) supervision

		Members of Basel Committee (reference to the relevant state)	
		National central banks (14)	National administrative authorities (14)
Approaches on micro-prudential financial supervision	Functional approach	Belgium Netherlands	France
	Full integration approach	–	Australia Canada Germany Indonesia Japan Korea Sweden Switzerland

B. The individual elements of the bank safety net (7/12)

2.2 Attributes of micro-prudential financial supervision

In order to ensure the stability of capital markets and in general the financial system (in terms of prudence and not crisis management) and the attainment of the other goals underlying (public) capital markets law, of essential importance are the quality and targeting (and not the quantity) of regulations, as well as the following five (5) elements pertaining to financial supervision:

- micro-prudential **supervisory effectiveness**, including the appropriate staffing of supervisory authorities in order to ensure the quality of the supervision exercised *(in this context, the 'theory of public choice' addresses the important aspect of supervisory 'capture', which may result in weak public responses),*
- the efficient and unobstructed exercise of supervisory authorities' **sanctioning powers**,

B. The individual elements of the bank safety net (8/12)

2.2 Attributes of micro-prudential financial supervision (cont.)

- the substantial safeguarding of **supervisory authorities'** institutional, personal, financial, and functional **independence** (following the model of central banks as bodies responsible for the definition and implementation of monetary policy), and concurrently the safeguarding of proper **accountability**,
- the establishment of an appropriate framework on **supervisory authorities' responsibility** *vis-à-vis* investors, as well as supervised entities and their shareholders, and
- the effectiveness of **cooperation arrangements** between national supervisory authorities both in the same country and internationally in relation to cross-border issues.

B. The individual elements of the bank safety net (9/12)

3. Resolution of banks

3.1 Resolution tools

3.1.1 Gone-concern tools

- Sale of business tool
- Bridge bank tool

3.1.2 Going concern tools

- Bail-in of debt (including unsecured deposits)
- Asset separation tool (creation of a ‘bad bank’)

B. The individual elements of the bank safety net (10/12)

3. Resolution of banks

3.2 Resolution objectives

(i) Ensure the continuity of critical functions of the bank under resolution.

(ii) Avoid significant adverse effects on financial stability, in particular by preventing their contagion, including to market infrastructures and by maintaining market discipline.

(iii) Protect public funds by *minimising reliance* on extraordinary public financial support

(iv) Protect depositors and investors covered by deposit and investment guarantee schemes respectively.

(v) Protect client funds and client assets, which are considered off-balance sheet items.

TABLE
Resolution requirements

	Case 1	Case 2	Case 3
The institution is failing or is likely to fail	✓	✓	✓
A resolution action is necessary in the public interest	✓	✓	✗
No reasonable prospect that any alternative private sector measures taken would	✗	✓	✓
	Recapitalisation of the institution with use of private funds	• Resolution of the institution • Possible use of the resolution fund's available financial means	• DGSs repay covered depositors • Winding up of institution under normal insolvency proceedings

B. The individual elements of the bank safety net (12/12)

4. Deposit guarantee (insurance) systems

4.1 Functions

(i) Protect depositors

(ii) Preserve stability in the banking sector

(iii) Contribution to the financing of resolution gaps

4.2 Level and extent of coverage

4.3 Financing arrangements (*ex ante vs. ex post*)

4.4 Procedure for payment of compensation ('pay-out')

4.5 Administration (role of banks – central bank – Government)

4.6 Depositoirs' information

C. Global administrative financial law (1/4)

1. The four levels of making and enforcement

Levels	Actors
Political decision making	G-7, G-10, G-20
Adoption of rules	**(a)** Standard-setting bodies **(international financial standards – soft law):** Significant role of the Bank for International Settlements ('BIS') – the 'Basel Process' **(b)** In particular: the rules of the World Trade Organisation ('WTO') on trade in services
Coordination	Financial Stability Board ('FSB')
Enforcement	1. Peer group pressure: "Comply or explain" 2. IMF (indirectly) **3. Assessment programs (e.g. 'RCAP' by the Basel Committee)** • Monitoring implementation of 'Basel III' framework • Jurisdiction and thematic consistency assessments 4. IMF-World Bank *Financial Sector Assessment Program* ('FSAP') 5. Thematic and country peer reviews (FSB)

C. Global administrative financial law (2/4)
2. International *fora* (in chronological order of establishment)

Forum	Year of establishment	Seat	Regular Membership	Objective
CGFS	1971	Basel	Central banks	Study of financial systems
IASB	1973	London	Accountancy	International accounting standards
BCBS	1974	Basel	Banking supervisory authorities	Banking regulation and supervision
IFAC	1977	New York	Professional accounting associations	International auditing standards
IOSCO	1983	Madrid	Capital markets' supervisory authorities	Capital markets' regulation and supervision

C. Global administrative financial law (3/4)
2. International *fora* (continued)

Forum	Year of establishment	Seat	Regular Membership	Objective
FATF	1989	Paris	G7 States, the European Commission and the Gulf Cooperation Council	Combating money laundering and terrorist financing
CPSS	1990	Basel	Central banks	Oversight of payment and settlement systems
IAIS	1994	Basel	Supervisory authorities for the insurance sector	Insurance sector regulation and supervision
Joint Forum	1996	Basel	BCBS, IOSCO, IAIS and national supervisory authorities	Regulation and supervision of financial conglomerates
IADI	2002	Basel	Deposit guarantee organisations	Operation of deposit guarantee systems

C. Global administrative financial law (4/4)
3. Governance of the 'Basel process'

Oversight body	Fora oversighted
Group of Governors and Heads of Supervision ('GHOS')	Basel Committee on Banking Supervision
Global Economy Meeting ('GEM')	CGFS CPMI Markets Committee
All Governors' Meeting	Central Bank Governance Forum Irving Fisher Committee on Central Bank Statistics
No oversight body	FSB IAIS IADI