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Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

SAFE Finance Blog

ECB Proposal: Bank Freezing Would Have an Adverse Effect

08/30/2017

Jan Pieter Krahenen calls for a definition of a bail-in maximum



On Friday, the news agency Reuters (<https://www.reuters.com/article/us-eurozone-banks-ecb-idUSKCN1B51QV>) reported that Danièle Nouy, Chair of the Supervisory Board of the Single Supervisory Mechanism (SSM) at the European Central Bank (ECB), has called for fresh powers to temporarily freeze payments at banks which are heading towards failure. The objective is to avoid a bank run if the situation of a bank deteriorates rapidly and to enable authorities to guide the bank into orderly resolution or a rescue.

There is good reason to be concerned about bank runs, given that bail-in is the new Leitmotiv of Europe's banking regulation. Within the TLAC/MREL universe the danger of a bank run can be neglected because liabilities in this category are typically longer-term, non-runnable securities. However, bank liabilities

outside the TLAC/MREL area, such as cash reserves of industrial firms or short-term deposits of institutional investors, may well be runnable, potentially posing a systemic risk.

In my opinion, the proposed moratorium is not a remedy to this problem. It would, instead of defusing the situation, effectively increase the danger of a bank run of the respective bank. This is, because creditors, knowing that a freeze of their holdings is possible, would constantly be on the lookout for signals of bail-in imminence. Therefore, powers to freeze payments of bank creditors are likely to accelerate rather than delay a potentially fatal outflow of liquidity. Even a small incident could cause creditors to question a bank's solvency which might then create a self-fulfilling prophecy.

Is there a better way to deal with this situation? Yes, there is: A more effective tool would be to clearly define the threshold up to which bail-in will definitely be enforced. Whether the 8-percent threshold is sufficient – as suggested by MREL –, needs to be discussed further. Apart from that, it should be clear for bank investors and bank creditors that a bail-out is guaranteed beyond the bail-in threshold and the public deposit insurance of up to 100,000 euros. Only a clear-cut line between bail-out and bail-in will eventually prevent bank runs in case of a looming bank failure.


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