Executive Summary

Corporate Structures, Transparency and Resolvability
of Global Systemically Important Banks
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Before the global 2008 financial crisis, most officials appeared not to have anticipated the problems that would need to be addressed if a large cross-border bank should need to be resolved. During and after the financial crisis, this issue surged to the top of the policy agenda. Events made clear that several institutions had become too big and too complex to fail: new rules were needed to make resolution of global banks possible, without cost to taxpayers or damaging spillovers to the economy. After the crisis, the G-20 gave the Financial Stability Board (FSB) a mandate to identify Global Systemically Important Banks (G-SIBs) and to ensure that each had a credible recovery and resolution plan.

This study investigates the complexity of the 29 institutions that have been designated as G-SIBs in 2013. Eight of these are headquartered in the United States. The size, complexity and global reach of these institutions can be illustrated by noting that G-SIBs had:

- an average of $1.587 trillion in assets (with a high of $3.100)
- an average of 1,002 majority-owned subsidiaries (with a high of 2,460)
- nearly half the subsidiaries classified as non-financial
- an average of 60% of subsidiaries located outside the headquarters country (high of 95%)
- at least one majority-owned subsidiary in 44 different countries (a high of 95)
- an average of 12% of subsidiaries located in off-shore centers (with a high of 28%)

The complex structure and opaque connections among G-SIBs impeded oversight by the authorities before the crisis and greatly complicated crisis management. The study examines the various factors influencing the complexity of banks, presents measures of the evolution of complexity and discusses various policy reforms aimed at simplifying and improving the transparency of G-SIBs.

Chapter 1 examines why G-SIBs prefer to adopt a considerable amount of legal complexity and emphasizes the credibility challenge facing the authorities in persuading markets that G-SIBs are not too big (or too complex or too interconnected) to be resolved in a way that does not cause loss to taxpayers. It concludes that better disclosure is needed to enable the public to monitor progress, which would enhance the credibility of the considerable efforts underway to improve resolution policy.

Chapter 2 presents data on the global and industrial structure of G-SIBs, provides a detailed analysis of bank resolution plans and investigates the implications of complexity for cross-border resolution policy. Despite substantial efforts by the FSB and the national regulators to enhance resolution policies and procedures, the cross-border aspects of resolution remain a challenge.
Chapter 3 presents new data showing how the corporate structure of G-SIBs evolved from 2002 to 2013. On average, complexity as measured by the number of majority-owned subsidiaries has doubled since 2002 and has not declined since 2007 (the year before the crisis). Indeed, the complexity of several G-SIBs has increased markedly because of the mergers and acquisitions encouraged by the authorities. Although the broad patterns of the evolution of the complexity of G-SIBs are evident, troubling gaps and inconsistencies remain in the available data.

Chapter 4 focuses on the FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions. Assuming (optimistically) that the attributes of effective resolution policies are adopted, serious obstacles remain. These include the size of G-SIBs, the degree of interconnectedness among G-SIBs, the difficulty customers would experience in finding substitutes for the services provided by a G-SIB, the complexity of a G-SIB’s assets and off-balance-sheet positions, and the extent of cross-jurisdictional activity. The complexity of legal structures adopted by G-SIBs presents additional obstacles including misalignments of the legal structure with lines of business, interdependencies among subsidiaries within the G-SIB, the number of jurisdictions in which the various entities reside, and the opacity of the organizational structures to regulators and the market.

Chapter 5 reviews several recent policies which may be expected to encourage G-SIBs to reduce their corporate complexity (and perhaps their size) over time. These include the requirement for more and higher quality regulatory capital, an increase in the risk weights in the risk-adjusted capital ratio, and the international adoption of a leverage ratio. The most important innovation focused on G-SIBs, however, is the capital surcharge applied to each designated G-SIB proportional to its perceived systemic threat. In the United States enhanced supervision, particularly the CCAR requirement, has increased the cost of operating through complex corporate structures and the Volcker rule may force some divestitures. The living will requirements provide a structure for direct conversations between G-SIBs and the resolution authorities regarding the impediments to an orderly resolution.

Chapter 6 summarizes policy recommendations from the study. First, increased efforts should be made to collect and disclose data in a way that facilitates understanding of bank corporate structures and monitoring of progress in enhancing the resolvability of G-SIBs. Second, emphasis should be placed on removing the incentives that encourage banks to adopt complex structures. Although efforts are underway to induce G-SIBs to simplify their corporate structures, regulatory and tax incentives that encourage and sometimes require that G-SIBs create a substantial number of separate entities have been largely ignored. While each tax or regulation may have had a logic when introduced, the cumulative impact is remarkably byzantine and undoubtedly exacerbates the complexity of G-SIBs. Third, subsidiarization may enhance the clarity of the corporate structures of G-SIBs and facilitate an orderly resolution, but it cannot provide a complete solution to the problem of corporate complexity. Subsidiaries can be organized on the basis of their location (which facilitates resolution by the host authority) or on the basis of the kind of business conducted (which facilitates resolution by the home country authority), but these approaches often conflict. While the trend toward subsidiarization may help clarify some of the cross-border challenges, officials must still find some reliable (and predictable) mode of cooperation and make a convincing case that G-SIBs can be subject to resolution like other smaller, less complex, less global institutions.