



Crisis Resilience of Financial Markets

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Financial Sector Authorities & Resilience

- The resilience of financial markets is not independent of the capacity of the financial sector authorities
 - Bank and non-bank supervisors
 - Central bank
 - Deposit insurance and investor protection regimes
 - Finance ministry
- Capacity to detect and respond, *individually and collectively*, to emerging problems and potential systemic distress
- Key relevant capacities
 - Prompt corrective action
 - Failure resolution (non-systemic and systemic)

Prompt Corrective Action

- Capacity to identify funding or capital problems early-on
- Legal capacity - can supervisory action be brought to bear to force a private sector solution before deterioration becomes acute?
 - Before direct and indirect contagion to other financial institutions and markets
- Capacity to act - will legal powers be used?
 - Institutional capacity and incentives
 - Political will

Failure Resolution

- Non-systemic institutions
 - Capacity to intervene a bank (or non-bank) in a manner least disruptive to depositors, creditors and the economy
 - Efficient failure resolution
 - Through liquidation/payout, insured deposit transfer, etc.
- Systemic institutions
 - Banks with systemic consequence, or that cannot be handled in the normal course of business (eg, exceeds the financial capacity of the deposit insurer)
 - Capacity to bring to bear central bank resources and/or public funds to facilitate an efficient resolution
 - Eg, financial assistance to a suitable acquirer, partial or full nationalization
 - Requires a coordinated, collective government response

The Reality in Many MICs & LICs

- Inadequate legal powers, eg:
 - To force corrective action
 - To efficiently intervene
- Incomplete and lax policies
 - When and how to use legal powers to mitigate or reduce impact of problems
- Inadequate supervision
 - Especially with respect to credit risk
 - Problems detected too late
- Inattention to the details of the processes that will have to be executed
 - Lack of documented procedures
 - No contingency planning
- Failure to test capacity and plans
 - Eg via periodic simulation exercises

Enhancing Resilience

- Use simulation exercises periodically to test institutional and/or collective response capacity
 - Identify and prioritize weaknesses and gaps in context of perceived, evolving vulnerabilities
- Undertake formal contingency planning
 - Intra-agency
 - Inter-agency
 - Bank de-risking and contingency funding plans
- Test and strengthen failure resolution regimes
- Strengthen problem identification and response as part of improved routine supervision