Public support and the use of the Resolution Fund under BRRD

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Key objectives of BRRD

• **Maintain financial stability** by ensuring the continuity of critical banking functions and pursue public interest

• **Minimise costs for taxpayers** and ensure that shareholders and creditors bear part of the losses

• **Avoid disorderly insolvency**
Funding resolution: from bailout to bail-in

Guiding principles

• Shareholders/creditors should bear their fair share of losses of an institution before external financial support can be granted

• If a bank cannot maintain viability/liquidity/solvency without public support it should in principle be considered failing or likely to fail (FOLF)
  • Exception: liquidity facilities, precautionary recapitalisation

• Protection of deposits: covered deposits will not be affected, as exempted from bail-in and the DGS will step in their shoes

• Compliance with State Aid framework
  • Burden sharing rules
  • Administrative procedure implies notification requirements for approval by Commission
Available tools

Liquidity facilities
State guarantee of newly issued liabilities
Precautionary recapitalisation

Resolution financing arrangements
- Single Resolution Fund in Eurozone
- National resolution funds outside Eurozone

Outside resolution

In resolution

Alternative financial sources

Government Financial Stabilisation Tools
- MS option
- Entities outside scope of SRMR

Deposit Guarantee Scheme
- Payout
- Finance resolution
- In insolvency
Liquidity facilities/State guarantee/Precautionary recapitalisation

*Forms of state/central bank intervention which do not trigger FOLF provided conditions are satisfied:*

- Remedy serious disturbance in the economy of a Member State and preserve financial stability
- Issued in favour of a solvent institution
- Cover capital shortfall (stress test)
- No coverage likely/incurred losses (i.e. adverse scenario in stress test)
- Approval under SA rules
  - Remuneration (vs. Market price, incentives to State exit in time)
  - Burden sharing (up to subordinated debt)
  - Provision of a restructuring plan
Public support in resolution

• If the bank satisfies the conditions for resolution (FOLF, public interest, no available private solution) the resolution authority identifies the most appropriate resolution strategy
  • Tools: sale of business, bridge bank, asset separation, bail-in
• Resolution financing arrangements can be used in this context
  – As a means to support resolution tools (guarantee/purchase assets, loans to the institution under resolution,...)
  – As contribution (cover losses, contribution to recapitalisation) in lieu of the bail-in of certain liabilities provided that specific conditions are complied with
• RFAs must not directly cover losses but may cover part of the losses indirectly resulting from their use for the purposes above and only after minimum bail-in
• If RFAs are not sufficient, other tools can be available
  – Alternative financing sources (GFST where foreseen)
Use of resolution financing arrangements in case of bail-in

RFAs can be accessed when bail-in tool is used if:

- A minimum bail-in of shareholders/creditors has been executed
  - 8% total liabilities including own funds
  - Measured at the time of valuation
  - Following hierarchy of creditors under BRRD

- RA can make the determination that certain liabilities should be exempted in exceptional circumstances:
  - Bail-in not possible in reasonable time
  - Necessary to preserve critical functions
  - Necessary to avoid contagion
  - Risk of destruction in value (losses borne by other creditors would be higher if liability is bailed-in)

Delegated Act 2016/860 on exclusions contains detailed examples

In this case RFA can make a contribution in lieu of write-down/conversion of exempted liabilities (in line with State Aid rules)
RFA contribution and additional funding sources

• **RFA contribution up to 5% of total liabilities including own funds**

• *If RFA intervention is insufficient, RA can resort to additional funding in extraordinary circumstances:*
  
  a) **alternative financing sources**
    - European Stabilisation Mechanism
    - Other public funds
  
  And/or

  b) **further contribution from RFA with resources raised from unused ex-ante contributions**

• **Condition for both options: all unsecured non-preferred liabilities (except eligible deposits) are bailed-in/converted**
Public support in resolution - Recap

1. 8% internal loss absorption

8% of total liabilities to be absorbed by shareholders and creditors before the use of the resolution financing arrangement.

2. 5% Resolution financing arrangement

Resolution financing arrangement may provide loss absorption or capital injection of up to 5% of total liabilities.

3. Alternative financing sources

Only after 5% of the financing arrangement's cap has been reached, and all unsecured and non-preferred liabilities other than eligible deposits have been bail-in.

DGS (covered deposits)

- Households, micro, SMEs >€100,000
- Senior debt & corporate deposits >100,000
- Subordinated debt
- AT1 & T2
- CET1

More bail-in, alternative financing sources

Resolution financing arrangement 5% of liabilities

Internal absorption 8% of liabilities
Government Financial Stabilisation Tools

• **GFST are means of direct financial support from national public funds which can be granted only where strict conditions are met:**
  
  • **Last resort tool to avoid systemic crisis:**
    - Resolution tools exploited to the maximum extent practicable
    - Further use of resolution tools would not suffice to avoid significant adverse effect on financial system/to protect public interest
  
  • 8% minimum bail-in contribution
  
  • Compliance with State Aid framework

• **Available measures**
  
  • Public equity support: State participates in recapitalisation (CET1/AT1/T2)
  
  • Temporary public ownership (MS nominee or MS-owned company)
    - Only if public equity injection was not sufficient
Use of DGS in resolution

*DGS can be used in several capacities:*

a) **Payout**

b) **Finance resolution** (to ensure access to covered deposits):
   - Amount = losses that covered deposits would have borne under bail-in/other resolution tool
   - Liability must not exceed losses that would have been borne under normal insolvency (*NCWOL*)
   - Limit: 50% of target amount

c) **As a means of financing insolvency** (Article 11(6) DGSD)
   - Including transfer assets/liabilities/deposits book
   - To guarantee access to covered deposits
   - Not more than net amount of compensating covered depositors (*least cost principle*)

*Cases under b) and c) = State Aid scrutiny*
Thank you