Overview on the BRRD
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Financial Sector Advisory Center (FINSAC) Workshop
FROM EXPERTS TO EXPERTS RECOVERY & RESOLUTION PLANS

How to establish credible and feasible recovery and resolution strategies for individual firms? What to take into account when assessing recovery plans and preparing resolution plans?

23 - 24 April, 2015
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# Overview on the BRRD

<table>
<thead>
<tr>
<th>Section</th>
<th>Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Institutional and regulatory overview</td>
<td>• The European Banking Union&lt;br&gt;• Scope of SSM vs SRM&lt;br&gt;• Decision Making under the SRM&lt;br&gt;• EU Rules pyramid</td>
</tr>
<tr>
<td>2. Some definitions</td>
<td></td>
</tr>
<tr>
<td>3. Resolution Background: financial crisis</td>
<td></td>
</tr>
<tr>
<td>4. BRRD: Scope of application</td>
<td></td>
</tr>
<tr>
<td>5. BRRD Priority of Resolution over Liquidation</td>
<td></td>
</tr>
<tr>
<td>6. BRRD: Overview Phases and Triggers</td>
<td></td>
</tr>
<tr>
<td>7. Preparation for Resolution</td>
<td>a) Recovery plans: single entity and group&lt;br&gt;b) Resolution plans: incl. resolvability ass.: single entity and group&lt;br&gt;c) simplifications and waivers&lt;br&gt;d) Intra group financial support agreements (IGFSA)</td>
</tr>
<tr>
<td>8. Resolution Triggers: Failing, Public interest,</td>
<td></td>
</tr>
<tr>
<td>9. Adoption of the Resolution Scheme: single entity and group</td>
<td></td>
</tr>
<tr>
<td>10. BRRD Resolution tools</td>
<td>a) Overview&lt;br&gt;b) Sale of Business (SoB)&lt;br&gt;c) Bridge Bank (BB)&lt;br&gt;d) Asset Transfer&lt;br&gt;e) Bail-in&lt;br&gt;f) Government stabilization</td>
</tr>
<tr>
<td>11. BRRD minimum Resolution powers for RAs</td>
<td></td>
</tr>
<tr>
<td>12. a) Resolution Priority for „public interest Banks“ under the BRRD</td>
<td>b) Resolution of „non-public interest Banks“: The example of the FDIC P&amp;A process</td>
</tr>
<tr>
<td>13. Resolution financing under the BRRD</td>
<td>a) What for?&lt;br&gt;b) Financing Cascade under the BRRD&lt;br&gt;c) Financing Cascade under the SRM&lt;br&gt;d) Use of DGS under resolution</td>
</tr>
<tr>
<td>14. Entering into force of BRRD/SRM/SSM</td>
<td></td>
</tr>
<tr>
<td>15. Overview National Options &amp; Discretions</td>
<td></td>
</tr>
<tr>
<td>16. Annex: EU versus US resolution system</td>
<td></td>
</tr>
</tbody>
</table>
1) Institutional and regulatory overview

The European Banking Union

ESAs direct decision making & mediation powers

SSM
Single Supervisory Mechanism (ECB direct suvi + NSA)
Euro 18 +

SRM
Single Resolution Mechanism (SRB / NRA execute)
Euro 18 +

EDGS
European Deposit Guarantee Guarantee Mechanism
ALL EU

Single Rulebook – EU 28

CRD/CRR
BRRD / SRR
DDGS

National fiscal policy
National company law / ownership instruments
National insolvency law
1) Institutional and regulatory overview

Institutions under the SSM & SRM

- **Resolution:** SRB
- + all cross border banks

- **Direct Supervision:** ECB Significant banks

**NSA/ NRA**
Non EUR area excl opt. ins

- **NRAs:** nat. banks, save use of SRF
- **NSA:** LSI

~ 120 **significant CIs**
= ~ 85% of total banking assets

Nat. resolution for national banks in “public interest”

**ECB List**

NSA: National Supervisory Authority / NRA: National Resolution Authority
SRB: Single Resolution Board / LSI: Less Significant Institutions
1) Institutional and regulatory overview

**Decision making for Resolution in the SRM**

**3 Conditions**

- **Failing or likely to fail:** ECB or if no action by ECB by SRB itself
- **No alternative private sector measures** including bail-in would prevent failure: SRB or NRA in coop. with ECB
- **Public interest:** SRB + Council veto

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**Diagram:**

- Single Resolution Board (SRB) adopts resolution scheme
  - Commision / Council VETO
  - Enforcement by National Resolution Authorities
  - NO resolution (national liquidation)
  - 24 hrs!

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**Notes:**

- COM State aid decision condition
3 Conditions
• **Failing or likely to fail** (ECB or SRB if no action by ECB)
• **No alternative private sector measures** (SRB or NRA + ECB)
• **Public interest** (SRB)

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**SRB: resolution scheme**
- Executive: Fund < 5 bn (10 bn Li) / Plenary: Fund > 5 bn (10 bn Li)

**Commission**
- **Endorsement**
- **Objection**
- Proposal to Council

**Council**
- Objection
- **No Objection**

- **No resolution** (orderly wind-down)

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**SRB: modified resolution scheme**
- Executive / Plenary

**COM State aid decision condition**

**Enforcement of the resolution scheme by NRA**

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**autonomous assessment by the SRB**
- positiv
- negative

- approve or object a modification of amount of fund
- object due to public interest

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**PL/05/2014**
1) Institutional and regulatory overview

Decision making within the SRM - Two Formats of the SRB

**Executive Session**
4 PM + Chair + NRAs concerned
(observer: ECB, COM)

- If no consensus: simple majority of 4 PM + Chair
- Preparation of all plenary decisions
  - specific resolution action including Fund < 5 bn (10 bn Liquidity)

**Plenary Session**
4 PM + Chair + 18 NRAs
(observer: ECB, COM)

- Simple majority but min 30% of SRF resources
- More influence of NRAs with largest banks
- Simple majority
  - Budget, annual work prog, staff rules etc..
  - SRF investments
- 2/3 majority but min 30% (for 8 y: 50%) of SRF resources
  - SRF funding: ex post contributions, mutualisation, alternative financing

- specific resolution action use of Fund > 5 bn (10 bn Li) only if triggered by a Member
1) Institutional and regulatory overview

EU Rules pyramide

- **IS**
  - non binding International Standards (IS)
  - FSB 2011/14 Key attributes

- **EU law**
  - 2014: BRRD, SRM Regulation, Int.Gov.Agreement on SRF, ESM
  - 2013: DGS, State aid rules

- **EU guidelines**
  - Commission & Council **secondary legislation** upon EBA draft ITS / RTS (IAs / DAs) *in process*

- **National laws**
  - EBA non binding guidelines *in process*
  - Transposition of BRRD *in process*
  - Nat. Insolvency laws
3) Resolution Background

The financial crisis dilemma

Dilemma

• government recapitalisation or straight liquidation (closing)
• cross border banks are “international in life, but national in death.”

EU crisis figures:
• State Guarantee: 2009: 835 Bn (7,1% GDP) / 2012: 490 Bn (3,8% GDP)
• Public Recap: 2008-2012: 413bn (3,2 % GDP)

Solution Resolution

1. Better Preparation
2. Strengthening early intervention
3. New set of minimum tools and powers
4. Centralization / coordination in order to make EU cross border banks (also) „European in death“

Break sovereign-banking nexus

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PL/5/23/2015 9
3) Resolution Background

Why traditional liquidation does not work for banks of public interest

- Pre-crisis some jurisdictions provided for moratorium and/or pay-out of insured deposits already before formal insolvency or even a P&A or BB

- No tools were available to facilitate survival of bank and/or continue the essential banking functions and/or keep value of the bank as going concern while ensuring that shareholders and creditors would bear loses

- “Need for restructuring within shortest time frame without break of business and impose losses on shareholders and creditors without their approval
3) Some definitions

**What are we talking about?**

*“Conservatorship”* also called (special) “administration”
- Supervisory action to take interim control
- Conservator appointed to “conserve” the assets of a problem bank and either “stabilize” bank or gain time to prepare for “resolution” (sale, liquidation)
- Replacement of management and Board of directors
- Bank open but regularly moratorium
- Suspension of shareholder rights but no override - **No P&A without shareholder agreement under conservatorship**

*“Liquidation”*: the process of winding-down a company and selling its remaining assets in the interest of the creditors. Liquidation is regularly an insolvency and / or bankruptcy procedure.

*“Receivership”*: synonym to liquidation
- In US used when FDIC takes over ie “receives” a failed institutions who's license was withdrawn (by the supervisor) and starts the liquidation process.
3) Some definitions

‘Resolution’ under the BRRD:
• the restructuring of a bank
• by a resolution authority
• through the use of resolution tools
• at a stage before liquidation when a bank is considered failing or likely to fail without immediate closing of the bank while overriding shareholders/creditors
• to ensure the continuity of its critical functions, preservation of financial stability and restoration of the viability of all or part of that institution, while the remaining parts are put into normal insolvency proceedings.
4) BRRD: Scope of application

Scope of application

- All EU credit institutions (CRD) and Large investment Firms (initial capital <730,000EUR)

- EU based parent and intermediate financial holding companies

- Subsidiaries of EU parent credit institutions or investment firm of financial holding company
5) BRRD Resolution - Liquidation

Resolution versus Liquidation

BRRD Resolution

- Under control of RA
- No legal “insolvency action” (ie Settlement Finality, CCPs...)
- **Expropriation**: without shareholders' involvement and creditors' approval

Aim:
- Ensure early + flexible triggers
- Pass losses to owners and existing risk holders without formal liquidation
- Continuity of critical functions
- Maintain financial market stability
- Restore viability of key financial stability parts of the failing institution

Safeguard
- NCWOL

normal insolvency

- Regularly Court proceedings,
- Suspension of activities, including payments
- Effect of formal insolvency management on market prices, gone concern valuation

Aim:
- “simple” Liquidation = sale of assets
- maximizing creditor value
- Payout of insured depositors

New incentive structure: stronger monitoring by shareholders and creditors including of depositors in view of bail-in
6) BRRD: Overview Phases and Triggers

**Institution responsible**

- **Bank (SA)**
  - Recovery
    - Recovery plan measures

- **SA (ECB/NSA)**
  - Recovery
    - Early intervention

- **RA (SRB/NRA)**
  - Resolution
  - Trigger by **SA (+ RA)**

- **NRA / Court**

**Trigger**

- **Financial conditions deteriorate**
  - Financial conditions deteriorate (CRD+CRR), OF+1,5; pillar II, NPLs, ..
  - 4 „failing or likely to fail“ criteria
  - + No private solution + public interest
  - Insolvency threshold(s) as defined under nat. law

**Tool**

- Measures foreseen in recovery plan
  - SA: rec. plan; „temporary administrator“, Article 104 CRD measures,...
  - RA: possibly prepare Resolution; bank to contact potential purchaser; (NRAs) to draft Rschemes

- Measures foreseen in Resolution plan: Sale of Business, Bail-in, Bridge Bank, Asset Separation, + government stabilisation tool

- Sale of assets + depositors pay out

**Note**: WDCC AT1/T2 decided by SA or RA

**National insolvency**

**PL/5/23/2015**
7) Preparation for Resolution

**Overview**

<table>
<thead>
<tr>
<th>„competent authority“</th>
<th>Resolution authority</th>
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<tbody>
<tr>
<td>(national supervisor or ECB,</td>
<td>(SRB oder NRA)</td>
</tr>
<tr>
<td>consolidating supervisor)</td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>• Intra group financial support</td>
<td>• Resolution Plans including</td>
</tr>
<tr>
<td>(IGFS)</td>
<td>„Resolvability assessment“</td>
</tr>
<tr>
<td>• Recovery plans</td>
<td>✓ Revision of any intragroup financing</td>
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<tr>
<td></td>
<td>✓ Limitation of its exposures</td>
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<td></td>
<td>✓ divest specific assets or cease specific</td>
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<td></td>
<td>activities &amp; restrict business lines</td>
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<tr>
<td></td>
<td>✓ changes to legal or operational</td>
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<tr>
<td></td>
<td>structures of the institution or any</td>
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<tr>
<td></td>
<td>group entity</td>
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<tr>
<td></td>
<td>✓ .....</td>
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...
### 7) a) Preparation for Resolution: Recovery plans

**Recovery plans** (Article 5-9 BRRD) (EBA draft RTS July 2014)

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Summary</td>
<td>• key elements including a summary of overall recovery capacity</td>
</tr>
<tr>
<td>Governance</td>
<td>• Development and approval of plan, conditions and procedures to implement recovery options, consistency with general risk management framework, ...</td>
</tr>
<tr>
<td>Strategic Analysis</td>
<td>• key steps to maintain core business lines and critical functions in a situation of financial stress; business &amp; risk strategy of entity/ies covered, intra group exposures, legal interconnectedness, impact &amp; feasibility assessment of recovery option, ....</td>
</tr>
<tr>
<td>Comm. &amp; Disclosure</td>
<td>• Internal, external communication, including analysis when what is disclosed</td>
</tr>
<tr>
<td>Preparatory measures</td>
<td>• Analyses of measures that facilitate the implementation of the plan</td>
</tr>
</tbody>
</table>
7) a) Preparation for Resolution: Recovery plans

Assessment of Recovery Plan – Single entity
that is not part of the group subject to consolidated supervision

- Financial institution
  - Competent (= supervisory) Authority
    - CA sig.branch
      - RA
      - may examine impact on resolvability and make recommendation to CA
    - FI chance to state opinion
  - Require specific changes
    - Revised plan
      - Pos. assessment
        - Still deficiencies of if FI does no submit revised plan
          - Direct FI to make specific changes to the (revised)plan
            - FI required to identify changes to its business
              - Reduce risk profile
              - Recapitalisation measures
              - Changes to (funding) strategy
              - Changes to governance structure (+ Art 104 CRD)
            - Direct FI to take “measures”
              - Pos. assessment
7) a) Preparation for Resolution: Recovery plans

Assessment of Group Recovery Plan (Article 8)

1) Review of group recovery plan:
   - If NO consensus: own decision of cons. CA
   - Any CA may refer to EBA: binding mediation
     - Cons. CA shall take decision in accordance with EBA
     - If no EBA decision: “decision of cons. CA shall apply”

2) Need of recovery plan for individual entity

3) Application of “measures” at subsidiary level
   - If NO consensus: each sub CA takes own decision
   - Any CA may refer to EBA: binding mediation
     - Each CA shall take decision in accordance with EBA
     - If no EBA decision: decision of individual subsidiary CA shall apply
7b) Preparation for Resolution: Resolution plans

Content of Resolution plan
(Art 5-9 BRRD/ Art 19 SRM) (EBA draft RTS July 2014)

<table>
<thead>
<tr>
<th>Summary</th>
<th>• Summary of plan incl. description of the institution or group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resolution Strategy</td>
<td>• Resolution actions incl. to which part of entity, core business lines and critical functions to be maintained/separated, respective timeframes and decision making, for groups: coop.&amp;coord. arrangements</td>
</tr>
<tr>
<td>Operational continuity</td>
<td>of access to critical functions, shared systems and operations,, external and internal interdependencies,, access to payment systems, portability of client positions, ...</td>
</tr>
<tr>
<td>Information description</td>
<td>• Availability of info, mapping of critical functions &amp; core business lines to legal entities incl. possible separation due to resolution tools, sharing of info between authorities, ....</td>
</tr>
<tr>
<td>Financing</td>
<td>• Financing, funding and Liquidity for implementation of resolution strategies, potential sources und funding incl. conditions of use, identify collaterals, use of CB facilities,... Group: sharing of funding</td>
</tr>
<tr>
<td>Communication</td>
<td>• With stakeholders, management, owners ,staff,... customers, media, public,... counterparties, FMIs,... other bodies (court) in case any approval required,...</td>
</tr>
<tr>
<td>Resolvability</td>
<td>• If resolvable, impediments , MREL incl. location of eligible liabilities</td>
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</tbody>
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7b) Preparation for Resolution: Resolution plans

Resolvability Assessment

Resolution Plan: Resolvability Assessment first

Credible and feasible Liquidation

In line with public interest - Esp. if small and non systemic (*6000 Banks /*3000 IF)

Resolution Plan limited to Resolvability Assessment esp. use of DGS

Credible and feasible Implementation of Resolution strategies

Systemic large institutions (* 420 Banks /*110 IF)

“Full” Resolution plan; Resolvability assessment as regards: structure and operations, financial resources, information, cb issues, legal issues: resolution

Cost of Resolution planning: per firm: *34,000 EUR + 11,000 EU annual for all EU: up to 114 million for ongoing annual cost / up to 85 for large institutions only
7b) Preparation for Resolution: Resolution plans

Resolution Plan – Single entity
that is not part of the group subject to consolidated supervision (Article 10,11)

NOTE:
First Resolvability Assessment as part of the Resolution Plan. Detailed description of resolvability assessment is included in the (group) resolution plan.
A Bank is considered resolvable if either liquidation is feasible and in public interest or if adequate Resolution strategy is set up.
Requirement to draw up resolution plan is suspended until substantive impediments to resolvability have been solved.
7b) Preparation for Resolution: Resolution plans

Resolution Plan – resolvability assessment single entity *that is not part of the group subject to consolidated supervision* (Article 15,17)

- **Resolution Authority**
  - Notify
  - [CA](#)
  - [Sig.Branches RAs](#)

- **Financial institution proposes measures to resolve impediments**

- **RA assess after consultation with CA (+ Macroprudential authority)**

- **Still deficiencies: RA requires FI to take alternative measures** *(either directly or through CA)*

- **FI submits plan how to comply with alternative measures**

- **Pos. assessment**

- **Pos. assessment**

- **4 month**

- **1 month**

- **Revise Intra Group Financing Agreements / Draw up service agreements**
- **Limit exposures**
- **Information requirements**
- **Divest assets**
- **Limit/cease activities**
- **Restrict/prevent business lines or sale of products**
- **Changes to legal/operational structure**
- **Set up a (separate) financial holding in MA or a union parent Financial holding**
- **Satisfy MREL and own funds**

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7b) Preparation for Resolution: Resolution plans

**Group Resolution Plan** (Article 12, 13)

- Union parent submits information concerning parent itself + group entities
- **SubRAs**
- **Group level RA**
  - Joint decision on drawing up and maintaining resolution plan
  - If no joint decision
    - **own decision** by group level RA on group resolution plan
    - Any RA may refer to EBA binding mediation
      - Group level RA shall take decision in accordance with EBA
      - If no EBA decision: “decision of group RA shall apply”
    - own decisions by SubRAs for entity resolution plan
      - Any RA may refer to EBA binding mediation
        - RA_sub shall take decision in accordance with EBA
        - If no EBA decision: “decision of RA_sub shall apply”

- **EBA**
- **SubRA + SigBranches Ras + RA fi Holding**
- **College** (Cons. Suvi + SubCA)
- **SigBranches RAs**
  - CA including Sig. BranchCA
  - RAs of 3rd countries upon group RA “discretion”

Those RA that do not disagree may reach a “joint decision” covering only the entities under their jurisdictions.

NO EBA mediation if any RA concerned “assess that the subject matter under disagreement may impinge on its fiscal responsibilities”!
7b) Preparation for Resolution: Resolution plans

**Group Resolution Plan – Group resolvability assessment** (Article 16-18)

Group Resolution Authority + SubRAs assess within the College the resolvability of the group under the same procedure as for resolution plans

If substantive impediments are detected

- **Group level RA**
- **Report** to the Union parent Undertaking, SubRA (forward to it to Sub), SigBranchesRA proposing measures to remove impediments

Union parent may proposes “alternative measures” to remedy impediments

- **Joint decision** on identifying material impediments and the application of “alternative measures” for all institutions of the group

If no consensus:

- **own decision by group level RA** on “alternative measures” to be taken at group level
  - Must be applied by all other RA concerned
  - Any RA may refer to EBA: binding mediation but only as regards legal structure and Fi Holding
  - Group level RA *shall* take decision in accordance with EBA
  - If no EBA decision: “decision of group RA shall apply”

- **own decisions by SubRA** on “alternative measures” to be taken at individual level by subsidiaries
  - Any RA may refer to EBA: binding mediation but only as regards legal structure and Fi Holding
  - RA_sub *shall* take decision in accordance with EBA
  - If no EBA decision: “decision of RA_sub shall apply”
7c) Preparation for Resolution: simplifications and waivers

**RRPs Simplifications and Waivers**

- **Simplifications on details of Recovery and Resolution Plans**
  Depending on nature of business, shareholder structure, legal form, interconnectedness,...possible effects of normal insolvency proceedings,...

- **Waiver**
  **For R&R planning**
  - institutions affiliated to central body under CRR (*Rabobank*)
  **For Recovery planning only**
  - Members of Institutional Protection Scheme (IPS)

- **No waiver** for ECB institutions or if significant shares in another Member State
7d) Preparation for Resolution: IGFSA

**Intra group financial support (GFSA)** (Art 16-22)

- Groups *may* adopt agreement, ex ante to provide financial support (loan, a guarantee or assets to use as collateral,..)

- MS have to provide for „rules“ eg
  - If entity providing support will continue to comply with the capital ratios, liquidity requirements, large exposures requirements
  - support not to undermine resolvability of the providing entity
  - ....

- **Up / Downstream:** allocation of support/loss absorbing capacity depending of where risk is taken, buffers held... **SPE/MPE**

- **Prohibition or Restriction of IGFS by consolidating supervisor consensus with NSA subsidiary (sbranch)** (EBA mediation)

- May be part of recovery plan
7d) Preparation for Resolution: IGFSA

Review of Intra group financial agreement (GFSA) (Art 19f)

Application for authorisation Union parent submits

Consolidating Suvi

Joint decision to grant authorisation or prohibit IGFSA
If no joint decision

Transmission of authorised IGFA to relevant RAs

all CAs of subsidiaries part of IGFA

4 month

own decision by consolidating SuVi + reasoning incl. reservations of other NSA
- Any CA may refer to EBA binding mediation
- Group level RA shall take decision in accordance with EBA decision
- If no EBA decision: decision of consolidating Suvi applies

Approval of authorised IGFSA by shareholders of every group entity

Note: separate approval process to actually grant support!
7d) Preparation for Resolution: IGFSA

Approval to provide support under an authorised IGFSA (Art 25)

Entity who wants to provide support

CA

Consolidating Suvi and CA of entity receiving support if not CA anyway,

Agrees or no reaction support may be provided

Prohibit or restrict

Notification of the decision to agree, restrict, prohibit by CA to

Cons. Suvi if not CA anyway, CA of entity receiving support

Information by Cons Suvi on CA decision to agree, prohibit or restrict

May request EBA assistance to coordinate if it has objections to the decision of CA to prohibit or restrict. But CA legally decides alone to prohibit or not.

Information transmitted to

CA

Consolidating Suvi and CA of entity receiving support if not CA anyway,

EBA

Resolution College

Other members of Suvi college

Resolution College

Other members of Suvi college

5 days

If group recovery plan refers to IGFSA -> Request of Ca to Cons. Suvi to reassess recovery plan!
8) Resolution Triggers

The Failing or likely to fail criteria

- **infringe requirements for continuing authorization** (including own funds limits)
- **Insolvent**: liabilities greater than assets
- **Illiquid**: unable to pay its debts or other liabilities as they fall due
- **extraordinary public financial support is required except “Precautionary public recapitalisation“** to solvent credit institutions in accordance with the Union State aid framework
  - aims to remedy a serious disturbance in the economy of a Member State and preserve financial stability, and
  - takes any of the following forms: i) a State guarantee to back liquidity facilities provided by central banks according to the central banks’ conditions ii) a State guarantee of newly issued liabilities iii) support measures necessary to address capital shortfall arising from stress-tests, AQR

No hard trigger as the US “Prompt corrective Action” (6% own funds/3 % CET/3% leverage)
8) Resolution Trigger

No Private sector & public interest

• No other (private sector) solution
  – that will result in the firm no longer failing or likely to fail
  – Taking into account WDCC at the Point of non viability

• Public interest
  – if winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent (Article 32) i.e. if normal insolvency proceedings might jeopardies financial stability, interrupt the provision of critical functions, and affect the protection of depositors (Rc 45, 46, 49)
8) Resolution Trigger: Exception to the Rule

Precautionary public recapitalisation (Art 32)

**Principle**
- Institution is considered failing if extraordinary public financial support is required (Art 32 (d))

**Exception**
- State guarantee to back Liquidity provided by CBs
- State guarantee of newly issued liabilities
- Injection of own funds purchase of capital instruments at market prices in view of stress tests AQR results to solvent institutions only

**State aid:** Yes BUT only involvement of junior debt holders demand (not full bail-in)
9. Resolution scheme

Group Resolution scheme decision: Resolution of group SUBSIDIARY (Art 91)

- **Decision of respective RA that a subsidiary of a group meets conditions for resolution**
  - Notification incl. resolution/insolvency action it considers appropriate
  - Resolution College
  - Cons. Suvi (if RA not within same authority as Suvi)

- **Group level RA**
  - Resolution action would NOT make it likely that other Group Member meets resolution conditions or if no assessment
  - RA takes Resolution actions etc

- **Resolution action would make it likely that other Group Member meets resolution conditions**
  - Group level RA proposes GROUP Resolution scheme
  - subRAs covered by group Resolution scheme

**Joint decision on group resolution scheme**
May request EBA assistance to coordinate but NO mediation.
If no joint decision – for reasons of fi stability, + detailed reasoning, each RA takes its own action -> cooperation in College

Those RA that do not disagree may reach a “joint decision” covering only the entities under their jurisdictions.

RAs to take into account (group) resolution plan(s) but may take actions not provide for in plan (art 91 (6))
9. Resolution scheme

**Group Resolution scheme decision: Resolution of group SUBSIDIARY** (Art 91)

- **Decision of group RA that parent meets conditions for resolution**
  - Notification incl. resolution/insolvency action it considers appropriate
  - Other members of Resolution College
  - Cons. Suvi (if RA not within same authority as Suvi)

- **Action does NOT include group resolution scheme** *
  - Group RA takes resolution actions or insolvency measures
    - Consultation
    - College

- **Action does include group resolution scheme**
  - Group level RA proposes GROUP Resolution scheme
  - subRAs covered by group Resolution scheme

**Joint decision on group resolution scheme**
- May request EBA assistance to coordinate but NO mediation.
- If no joint decision – for reasons of fi stability, + detailed reasoning, each RA takes its own action -> cooperation in College

Those RA that do not disagree may reach a “joint decision” covering only the entities under their jurisdictions

*If resolution actions at parent level are sufficient and provide an optimum outcome no group scheme is needed*
9. Resolution scheme

Judicial appeal and approval

- **Ex ante judicial approval of crisis management measures**
  allowed (but not more than 24 hrs) (Art 85 / Rc 92 BRRD)

- **Judicial appeal against RA decisions**
  
  BUT
  
  immediate enforceability of RAdecisions
  no automatic suspension

- **National courts should use the complex economic assessments of the facts carried out by the RA**!
10) a) Resolution tools: overview

**BRRD minimum resolution toolkit**

- **Bridge Bank**
- **Sale of Business**
- **WDCC**
- **Payment moratorium**
- **Mngmt. Replacement**
- **Independent Valuation** (art 36)

- **Bail-in**
- **Asset Separation**
- **Government financial stabilisation tool** (BRRD only)

**Tools**

**No creditor worse off than in liquidation**

**Only in conjunction**
10) a) BRRD Resolution tools: overview

Use of resolution tools & Liquidation under Resolution

Resolution authority

Resolution

SoB and/or BB and/or Bail-in

+ possibly AMV

Also if no action by RA normal insolvency might start

normal insolvency

full liquidation

Possibly part liquidation

Possibly Restore old bank + restructuring
10) a) BRRD Resolution tools: overview

**Overview of the 3 “Transfer tools”**

<table>
<thead>
<tr>
<th>Sale of Business (Art 38-39/ 24 SRM)</th>
<th>Bridge institution (Art 40 -41 BRRD / Art 25 SRM)</th>
<th>Asset separation (Art 42 BRRD / Art 26 SRM)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer of shares, assets, rights or liabilities to a purchaser “on commercial terms” all or part of a business</td>
<td>Transfer of shares, assets, rights or liabilities to a new legal entity „good bank“</td>
<td>Transfer of assets, rights, liabilities from FI under Res. or a Bridge Bank to AMV</td>
</tr>
<tr>
<td></td>
<td>- (partly) public ownership</td>
<td>- (partly) public ownership</td>
</tr>
<tr>
<td></td>
<td>- Controlled by RA</td>
<td>- Controlled by RA</td>
</tr>
<tr>
<td></td>
<td>- 2 years max operation: view to sell, merge, winding down....</td>
<td>- eventual sale or orderly wind down</td>
</tr>
</tbody>
</table>

**Without consent** of shareholders, requirements of company law etc.
10) b) BRRD Resolution tools: SoB

**Sale of Business** Art 38-39 BRRD / 24 SRM

- **Transfer of (certain) liabilities** ie insured deposits + marketable assets to a purchaser “on commercial terms”
  - regularly in combination with bail-in including possible pay out of transferred deposits by DGS

- **Advantages**
  - regularly most quick and efficient solution: no shareholder consent etc..
  - Assets values maintained and kept in private sector on going concern (ie book value)
  - Minimizing bank run and contagion risk
  - Possibility to keep certain assets ,.. to bank under Resolution (or also AMV)-> liquidation or theoretically also to restore it (bail in)

- **Challenges:**
  - Swift decision (over a weekend), marketing: selection of acquiring bank whom to contact, professional secrecy
10) c) BRRD Resolution tools: Bridge institution

**Bridge institution** (Art 40 - 41 BRRD / Art 25 SRM)

- Temporary (partly) public owned new legal entity („good“ bank) under control of resolution authority
- Resolution authority or resolution fund may also be (part) owner

**Advantages**
- Keeps (part of the) institution going concern, provision of critical functions
- Possibility to keep certain assets „... to bank under Resolution (or also AMV) -> liquidation or (theoretically) also to restore it (Bail-in)
- Gives time (to find 3\(^{rd}\) party acquirer)
- as a rule less risky than nationalisation of recapitalisation with own funds
- possibility to partially and temporarily wave authorisation requirements (CRD)

**Challenges**
- temporary construction (max 2 years + extension)
- difficulties to unwind: exit strategy and marketing of assets
10) d) BRRD Resolution tools

**Asset separation tool** (Art 42 BRRD / Art 26 SRM)

- Transfer of assets, rights, liabilities from FI under resolution or a Bridge Bank to AMV under (partly) public ownership controlled by RA
- Resolution authority or resolution fund may also be (part) owner
- Only fall back: if liquidation of assets would have adverse effect on financial markets

- Advantages
  - Transferor *may* be kept alive and recapitalised (Bail-in)
  - Time: maximize value through eventual sale or orderly wind down

- Challenges
  - Fair transfer prices, Valuation
  - Time
  - Temporary construction
10) e) BRRD Resolution tools: Bail-in

**Bail-in purpose** (Art 43-55 BRRD)

1) Recapitalisation of bank under resolution
to comply with authorisation & **restore financial soundness**
& **long term viability** -> „**Business reorganisation plan“ to stabilise a firm“

2) Conversion of debt into equity or reduction of principal amount of claims/debt instruments (haircut) that are transferred
   – **to a bridge institution**
   – under sale of business or asset separation tool

Obligatory only as of 2016
10) e) BRRD Resolution tools: Bail-in

**Bail-in Cascade**

*Based on a slide of FGDR*

**WDCC (already before Resolution-PONV)**

**Bail-in (Resolution only)**

**Secured instruments**

- Short term interbank liabilities, and clearing claims - Maturity 7 days
- + Tax, salaries, ...

- Tier 1
- Tier 2
- Subordinated liabilities (junior creditors)
- Other eligible liabilities (uncovered sen debt incl. rest of uncovered deposits)
- Uncovered deposits
- Natural + SMEs > 100.000
- DGS „in lieu“ max 50% target

State aid
10) e) BRRD Resolution tools : Bail-in

Possible exclusion of creditors from bail-in

Under certain circumstances:

- Bail-in of that liability not possible in ‘reasonable time’
- Exclusion is strictly necessary and proportionate to achieve continuity of critical functions and core business lines
- Exclusion is strictly necessary and proportionate to avoid widespread contagion (...)
- The application of the bail-in tool would cause a destruction in value such that the losses borne by other creditors would be higher than if those liabilities would be excluded

Compensation

- Increase level of WDCC for other liabilities

OR

- Contribution by the RF
  - max 5% total liabilities and
  - minimum bail-in of 8% liabilities (as of 2016)
  - OR minimum 20% risk weighted assets bailed in + RF resources high enough (3% covered deposits) and assets of failing institution <900bn EUR
10)e) BRRD Resolution tools Bail-in

**MREL Minimum Requirement of Eligible Liabilities** (Art 45 BRRD / Art 12 SRM)

- To ensure enough bail-in-able instruments
- Percentage of own funds or of shares, contingent capital or other type of unsecured liabilities determined by the RA for each individual institution
- Allocation of loss absorbing capacity in dependence of where risk taken - **Top down approach within group SPE/MPE** -> but robust MREL for all entities
- Separate assessment of MREL for subsidiaries

Still a lot of open issues and possible neg. effects....
10)f) BRRD Resolution tools: Government stabilization

2 Government stabilization tools within resolution (Art 56-58 BRRD)

RA may seek alternative public funding (Art 37 (10) via extraordinary public financial support

1. Temporary public equity support – MS participates in recapitalization (Art 57 BRRD)
2. Temporary public ownership (TPO, Art 58 BRRD)

Condition

• very extraordinary situation of systemic crisis
• Last resort, normal Resolution tool not sufficient to avoid significant adverse effect of fi system
• min 8% of total liabilities loss absorption and recapitalization by shareholders, etc

Transfer to the private sector as soon as commercial and financial circumstances allow.
11) BRRD Resolution powers for RAs

**Powers of Resolution Authorities under BRRD**

- appoint a special manager with all the powers of shareholders and management body (art. 35)
- general powers under art. 63 (control, transfer shares etc, conversion, cancel debt instruments,...
- ancillary powers under art 64
- require provision of services or facilities to enable a recipient to operate effectively the business transferred to it (art 65)
- Powers in respect of assets, rights and liabilities located in third countries (art. 67)
- exclusion of certain contractual terms (art. 68)
- suspension of certain obligations (art. 69)
- restriction of enforcement of security interests (art. 70)
- temporary suspension of termination rights (art. 71)
11) BRRD Resolution powers for RAs

**Special manager** (art 35)

Appointment of Special Manager
- Replaces management of entity under resolution
- Takes over shareholder powers
- Under control of RA
- To implement resolution action (cap. increase, reorganization etc..)
- max. 1 year
- Insolvency management may constitute special management
12) a) BRRD Resolution Priority for „public interest Banks“

**Priority of Resolution over Liquidation**

**Principle**

- A failing institution should be liquidated under normal insolvency proceedings (Art 4, 15, Rc 45,..)
- Resolvability assessment first!

**Priority of resolution over liquidation in case of**

- **Public interest** if winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent (Article 32) i.e. if normal insolvency proceedings might jeopardize financial stability, interrupt the provision of critical functions, and affect the protection of depositors (Rc 45, 46, 49)
- Normal insolvency proceedings are excluded if resolution is started (Rc 44, Art 86)
- Bail-in and WDCC in accordance with the priority of claims under normal insolvency proceedings (as a rule)
- NCWOL: No creditor worse of then under liquidation safeguard (Art 73)
- Also AST only to be used if the liquidation of those assets under normal insolvency proceedings could have an adverse effect on one or more financial markets. (Art 42)

What about liquidation processed for “non-public interest banks” !?

- National process under BRRD. Alternatives to outright insolvency liquidation such as preparation for a forced transfer of assets/liabilities to 3rd parities or BB was already recommended as “best practice” before the crisis on the example of FDIC (Binder, 2014)
12) b) Resolution of „non-public interest Banks“

FDIC “traditional” P&A resolution process

- **Initiation of resolution**
  - Supervisor inform FDIC when a bank will be closed ie is about to fail
  - Prompt corrective action letter is sent by the chartering authority to the failing institution advising that it is critically undercapitalized and/or insolvent.

- **Information package**
  - **Asset valuation** incl. estimation of **hypothetical liquidation value** for comparison with cost of deposit payoff (**least cost solution**)
  - Determination of **possible resolution structures**
  - **Preparation for closing** including on-site.

- **Bid submission**
  - **Information meeting** with potential bidders
  - **Bidder due diligence** (on-site) bid submission. FDIC request permission for the failing institutions Board(1)
  - **Bid Comparison** by FDIC + comparison with estimated liquid. cost -> **least cost**.
  - The FDIC as receiver may offer loss sharing under a P&A: FDIC agrees to take ie 80% of FUTURE losses on assets that have been designated as “shared loss assets”
  - FDIC Board approves resolution transaction – legal contract with acquirer

**Closing of the bank**

- **Chartering authority closes Bank and appoints FDIC as RECEIVER** -> FDIC transfers all assets to acquirer (over the weekend)

  In case not all assets transferred via P&A, FDIC continues after closing with receivership = **collecting any assets and satisfying claims (Liquidation)**. In case FDIC provided **loss sharing for the P&A** it monitors the “assistance payments”
13) a) Resolution financing: what for?

Resolution financing: what for?

- Mere Fallback
- Cover costs of resolution
  - Guarantee assets or liabilities or give loans to the entity under resolution (incl subsidiaries), BB or AMV
  - Purchase assets of entity under Resolution Make contributions to BB or AMV
  - Contribute in lieu of creditors excluded from bail-in (8% requirement/5% limit)
- Ex post payment of difference between bail-in and theoretical contribution under insolvency
- Lending to and from other Resolution Funds

| NCWO |

no direct use to absorb losses or direct recapitalization
If indirect contribution of losses than 8%/5% requirement
13) Resolution financing

National financing arrangements (Art 100)

- Target level: 1% covered deposits (31 December 2024)
  - Ex ante: annually per FI based on liabilities (- own funds) less covered deposits adjusted in proportion to risk profile.
  - Extraordinary ex post; max 3 times annual ex-ante amount (possible deferral)
  - max 30% collateralized payment commitments allowed

- Fund use decided by RA
- Same administrative structure as DGS possible
- Financing outside fund possible exceptional circumstances (ie interim phase till SRF 2016!)
13) b) BRRD resolution financing Cascade

Cascade of EU financing arrangements under BRRD (Art 99)

- **Bail-in**
- **NRF (Ex-ante + ex post)**
  - Cover costs of resolution (but no direct loss absorption/recapitalisation); Contribute in lieu of excluded creditors (min Bail-in >8%, max 5% liabilities), pay difference to NCWO „test“
  - only if 5% reached by Fund and if all unsecured, non-preferred liabilities other than insured deposits have been fully written down or converted.
- **Alternative ad hoc financing**
- **Borrowing between RFs**
- **Mutualisation of NRFs**

- State Aid rules
  - Le borrowing or public in case of systemic crisis

---

Principles for group resolution financing as part of the group resolution plan
13)c) Resolution financing under the SRM

The Single Resolution Fund

- **Target level: 1% covered deposits** (31 December 2024) ~ 55 Mrd EUR
  - *Ex ante*: annually per FI based on liabilities (- own funds) less covered deposits in relation to aggregated amount of all SRM institutions + adjusted in proportion to risk profile.
  - Extraordinary ex post; max 3 times annual ex-ante amount (possible deferral)

- max. 30% collateralized payment commitments allowed

- Transfer by MS to the SRF (June 2016)

- Transition period: 2016-1024 „*compartmentalisation*“

- New counting from BRRD to SRM
  - 90% of the SRF would come from the eurozone’s large banks, which account for 85% of all banking assets
  - „countries with highly-concentrated banking systems would end up paying as much as 4.5 times as they would under existing EU rules for national schemes“
13)c) Resolution financing under the SRM

**SRF**: transition period - “national compartments”

- X % of national compartment(s)
- X % all compartments
- Rest of national compartment(s)
- Extraordinary contributions by credit institution of national MS
- Alternative financing through the SRF
- Temporary transfer between compartments (borrowing)

<table>
<thead>
<tr>
<th>Year</th>
<th>Step 1: concerned compartments</th>
<th>Step 2: mutualisation of all compartments</th>
<th>Step 3: back to concerned compartments</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>100%</td>
<td>40%</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>60%</td>
<td>60%</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>40%</td>
<td>66.7%</td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td>33.3%</td>
<td>73.4%</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>26.6%</td>
<td>80.1%</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>19.9%</td>
<td>86.8%</td>
<td></td>
</tr>
<tr>
<td>2022</td>
<td>13.2%</td>
<td>93.5%</td>
<td></td>
</tr>
<tr>
<td>2023</td>
<td>6.5%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>2024</td>
<td>0%</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

*Source: BBVA Research based on the Intergovernmental Agreement.*
13)c) Resolution financing under the SRM

**Cascade of Resolution financing under SRM**

- **Private Bail-in**
  - SRF (Ex-ante 55 Bn EUR + ex post)
  - Alternative ad hoc financing
  - National public Funding
  - ESM - DRI (60 bn EUR)

**If not enough?**

- >8% total liabilities, max 5% liabilities for bail-in excluded creditors

- 5% reached; all unsecured, non-preferred liabilities other than insured deposits fully written down or converted.

- I5% reached; all unsecured, non-preferred liabilities other than insured deposits fully written down or converted.

- Only for “systemically relevant institutions”, National MS finances at risk, min. cap injection by nat. MS to reach the 4,5% CET1 or 20% (10%) of ESM contribution

- Restructuring plan: ESM, ECB EU-COM

**Request of MS (in future also SRF ?)**

**Only as of 2016 + transition till 2024**
Use of DGS under resolution

DGS versus BRRD Resolution Fund

<table>
<thead>
<tr>
<th>DGS</th>
<th>NRF/ SRF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Target level 2024 (+4): 0.8% covered deposits</strong></td>
<td><strong>Target level 2024 (+4): 1% covered deposits</strong></td>
</tr>
<tr>
<td><em>may: 0.5% for high concentration sectors</em> (− Resolution anyway!)</td>
<td><a href="#">Total liabilities in future?</a></td>
</tr>
<tr>
<td><strong>Individual base: covered deposits (fix + risk weighted part)</strong></td>
<td><strong>Individual base: liabilities less own funds less covered deposits (fix + risk weighted)</strong></td>
</tr>
<tr>
<td><strong>Extra ex post up to 0.5% per year</strong></td>
<td><strong>Extra ex post</strong> Possible deferral</td>
</tr>
<tr>
<td>• Direct pay out in insolvency</td>
<td>To finance resolution tools (min 8% Bail-in max. 5% of banks total liabilities)</td>
</tr>
<tr>
<td>• finance alternative measures OUTSIDE resolution (art 11 DGS)</td>
<td>Same administrative structure as DGS possible but not same funding</td>
</tr>
<tr>
<td>• <strong>support resolution to the extent of losses that would have occurred under insolvency</strong> (max. 50% Target level)</td>
<td></td>
</tr>
</tbody>
</table>
14) BRRD/SRM/SSM: Entering into force

<table>
<thead>
<tr>
<th>SSM (ECB powers)</th>
<th>BRRD</th>
<th>SRM</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 November 2014 (ex ante already preparation)</td>
<td>Nat. application: 01 Jan 2015</td>
<td>Applicable: 01 Jan 2016</td>
</tr>
<tr>
<td></td>
<td>May Except: <strong>bail in</strong> until 2016</td>
<td><strong>Except</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Information, cooperation of SRB (esp for Resolution Plans): 01 Jan. 2015</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Set up of SRB etc…: 19 August 2014</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Preparation of secondary legislation</td>
</tr>
<tr>
<td></td>
<td><strong>Target level NRF: 2024</strong></td>
<td><strong>Target level of SRF: 2024</strong> (8 year mutualisation nat. compartments)</td>
</tr>
</tbody>
</table>

**Note**: **bail in** until 2016 refers to the temporary application of bailout procedures until 2016.
15) Overview of national options / discretions

- **Art 3:** Designation of RA (CBs, MoFs, SAs..) Requirement: public administrative
- **Art 3:** Limitation of the liability of RA, SA: of a Temporary administrator (Art 29), of a bridge institution (Art 40), of AMV (Art 42)
- **Art 4:** Simplified obligation and waiver for RRP\(\text{s}\) incl. frequency of up/dates
  Additional info in Recovery plans, records of financial contracts
- **Art 32:** determination of resolution trigger in addition to SA also by RA
- **Art 37 (9):** additional resolution tools and powers
- **Art 60:** determination Capital Write Down may be SA or RA
- **Art 44:** Exclusion of liabilities from bail in
- **Art 45:** Additional criteria for MREL
- **Art 56-58:** Government financial stabilization: equity tool and temporary public ownership
- **Art 84:** Confidentiality - Authorization of information exchange
- **Art 85:** Ex-ante judicial approval of crisis prevention or management
- **Art 89:** Waiver of Resolution College
- **Art 97:** entering into bilateral agreements with 3\(^{rd}\) countries until Commission acts
- **Art 100:** same administrative function of RF and DGS
- **Art 102:** Higher Target levels for RF / 109: for DGS use higher than 50%
- **Art 106:** Inclusion of Ministry or government in decision on lending between RFs
### 16) Annex

**EU versus US resolution system “for SIFIS”**

<table>
<thead>
<tr>
<th>US (Dodd-Frank Act Title II)</th>
<th>EU Resolution (BRRD / SRR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Only SIFIS (Bank Holding + non-bank FI)</td>
<td>In principle all banks and also large investment firms but “public interest test”</td>
</tr>
<tr>
<td>Failing or likely to fail + public interest/ financial stability + no private alternative</td>
<td></td>
</tr>
<tr>
<td>Concrete remediation trigger*</td>
<td>Decision by Supervisory Authority (+ RA)</td>
</tr>
<tr>
<td>recovery planning just started...</td>
<td>Bank ownership, SA approval</td>
</tr>
<tr>
<td>SPE</td>
<td>No preference</td>
</tr>
<tr>
<td>Similar Bail-in Hierarchy*</td>
<td></td>
</tr>
<tr>
<td>Resolution financing: ex post by banks</td>
<td>Resolution financing: ex ante + post by banks</td>
</tr>
<tr>
<td>Orderly Liquidation fund(OLF): Liquidity support</td>
<td>SRF: liquidity and capital support (loans guarantees, asset purchases incl. losses from bail-in excluded instruments</td>
</tr>
<tr>
<td>No public support foreseen</td>
<td>Public financial stabilization tools; direct Recap via ESM</td>
</tr>
</tbody>
</table>

* In US: 6% Risk based capital, 3% Leverage / in EU: Failing or likely to fail

*Less discretion of usage and exemptions in US / EU: MREL