Introduction

Post crisis Bank resolution principles with a focus on the BRRD in the EU

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Workshop on the role of the Judiciary in Bank resolution for Judges
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AGENDA

- Objectives and aims of Bank resolution
- Stages in preparing and dealing with a problem bank
- Conditions for resolution
- Resolution tools
  - Bail-in
- Legal principles and safeguards
- Annex
  - Bail-in cascade
  - DGS – Resolution Fund
  - Bail-in versus Bailout
  - Bank resolution as part of the EU Banking Union
  - BRRD proposed amendments
Why “simple liquidation” may not work for banks

- Stop of all transactions and obligations
- Sale of assets under gone concern value; main objective is maximizing creditor value; does not take into account financial stability, contagion risks, etc.
- Often starts too late
- **TBTF:** Some banks simply are too complex, too interconnected
- Pre-crisis some jurisdictions provided for moratorium sometimes even including transfer of insured deposits already before formal insolvency (under “restructuring phase”). But no tools were available to facilitate survival of bank and keep its systemic functions and its going concern value.
- Also traditional FDIC P&A needs e.g. consent of problem Banks Board for Bidder Due Diligence
- Need for restructuring within shortest timeframe without consent of owners and creditors while continuing critical functions and avoid contagion

**Solution** «special resolution regimes»
BRRD: The new system for resolving Banks in the EU

The EU Bank Recovery and Resolution Directive (BRRD)

- Entered into force 1 January 2015 / obligatory statutory bail-in 1 January 2016
- Based on the FSB Key Attributes (2011)

Key objectives

- Maintain financial stability by ensuring continuity of critical functions
- Ensure losses are borne by bank shareholders and creditors, not by taxpayers

Key elements

- Better planning via Recovery and Resolution Plans and enhance Early intervention measures
- Banks contribute to resolution financing arrangements to support the costs of restructuring
- Strong powers and tools for resolution authorities, overriding rights of owners and investors, to take fast action at an early stage (“Likely to fail”). Allocate losses on owners and creditors also outside liquidation (without closing the bank) via Bail-in
- Better cross border cooperation
Overview Phases & Triggers of bank recovery & resolution

Business as usual ➔ Deteriorating fi. condition ➔ Early intervention ➔ Resolution

Bank

Supervisor

Res. authority

Preventive measure to ensure resolution: resolution plans, remove impediments to resolvability, LAC (MREL)

Ongoing supervision, reporting, stress testing, recovery plans, ...

Deteriorating financial conditions, NPLs, PII, OF+1,5%, ...

Implement recovery plan, Restructuring plan, raise own funds, negotiation on restructuring debt with creditors, Require divestment of activities, changes to the business strategy, legal or operational structures; Moratorium...

Replace members of the management, appoint temporary administrator

Implement measures set out in the recovery plan

Contact potential purchasers to prepare for resolution

Apply resolution powers; and/or Liquidation

Liquidation (sale of assets, DGS payout)

PONV

WDCC

FOLT
Resolution: legal conditions (article)

Conditions for resolution

1. The institution is failing or likely to fail (FOLTF)
2. No private alternative
3. Public interest

An institution is FOLTF when...

1. Breach prudential requirements
2. Assets less than liabilities
3. Unable to pay its debts
4. Extraordinary public financial support (*)

*Unless precautionary Recapitalization to SOLVENT Bank
BRRD minimum resolution toolkit

**Tools**

- **Bridge Bank** (public) - Only in conjunction
- **Asset Separation** (public)
- **Sale of Business**
- **Bail-in**
- **WDCC**

**Powers**

- Payment moratorium
- Mngmt. Replacement

* Without consent of shareholders and creditors

No creditor worse off than in liquidation

Government financial stabilisation tools
Bail-in: concept and aim

write down of equity and/or unsecured creditor claims and/or conversion of unsecured claims into equity in order to absorb the losses and recapitalize the firm (or its successor)

- Bail-in is a financial restructury tool triggered when a bank reaches to point of “failing” upon STATUTORY power

- Allows to recapitalize a bank ”from within” (over a weekend) via
  - full/partial cancellation of debt (”haircut”)
  - conversion of debt to equity (”debt-equity swap”)

- Applies to both old and new issues of debt instruments (in the EU)

- Reduction of moral hazard via ex-ante Loss Absorbing Capacity (MREL/TLAC)

- Allows for “open bank resolution”
  - Continue business as going concern: bank remains open on the next business day – keep franchise value (”Business reorganisation plan“)
  - customers have access to their accounts and other services whilst an appropriate long-term solution for the bank identified

Obligatory in EU as of 2016
Bail-in: How it works: bank internal recapitalization

Legal principles and Safeguards

Resolution action / Bail-in is applied without shareholders' and creditors' approval and therefore classed as interference with the right of ownership. In terms of Human Rights, expropriations are allowed only if justified on the ground of public interest and if compensation is granted.

- Resolution has to be justified by the public interest in maintaining financial stability (Article 32 BRRD) and the right to compensation is satisfied by the principle of "no creditor worse off than in insolvency" (Article 75 BRRD).
- Importance of valuation and "economic assessment" which shall also be used by the Court as a basis (Article 85 BRRD).
- Deposit Guarantee Scheme (DGS) contribute to resolution for an amount not exceeding the amount it would have paid in a liquidation scenario (Article 101).
- No stay of resolution decisions but compensation of damages (Article 85).
- Possible Ex-ante judicial approval within 24 hours (Article 85).
Annex: Bail-in Cascade: eligible liabilities

WDCC (already before Resolution-PONV)

Bail-in (Resolution only)

TIER 1 (CET / AT1)

TIER 2

SUBORDINATED DEBT
(junior creditors)

OTHER ELIGIBLE LIABILITIES
(sen debt incl. rest of uncovered deposits)

Uncovered deposits
Natural + SMEs > 100,000

DGS contribution „in lieu“
of insured depositors

NEW class of non preferred senior debt (Com proposal)

EU State aid

SAME

Insolvency Ranking
(Art 108)

ECB: 3rd layer of unsecured deposits

EXCLUDED: Secured debt (covered bonds), ring fenced liabilities, short term liabilities (7 days) to other banks, salaries, tax,...

+ ad-hoc exclusions
## Annex: Bail-in versus bail-out

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<th>Bail-in</th>
<th>Bail-out</th>
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<td>+ incentive to more prudent behavior</td>
<td>- Moral hazard, excessive risk taking</td>
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<tr>
<td>+ Losses on investors (who made investment choice and received revenue/interest )</td>
<td>- Socialization of losses (versus profit for few)</td>
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<td>- Relatively high losses for a few</td>
<td>+ Relatively small loses for all</td>
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<td>- Governance issues (fit and proper)</td>
<td>- State ownership</td>
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<td>- Procyclicality and contagion</td>
<td>- Increase in fiscal costs / debt</td>
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<td>- Stronger effects on specific business models; purely deposit funded banks forced to hold MREL; MREL non RWA based: punishes low risk (different: TLAC)</td>
<td>- Longterm negative welfare effects</td>
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<td>- State ownership or at least state support versus free market</td>
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<td>- (Only) effective if idiosyncratic bank failure</td>
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Annex: The Single Resolution Mechanism as part of the EU Banking Union

SSM
Single Supervisory Mechanism (ECB direct suvi of big banks + NSA)
Euro 19 +

SRM
Single Resolution Mechanism (SRB central resolution of big banks / NRA execute)
Euro 19 +

EDGS
European Deposit Guarantee Mechanism
ALL EU

CRD/CRR
BRRD / SRR
DDGS

National fiscal policy
National company law / ownership instruments
National insolvency law

ESAs direct decision making & mediation powers
ANNEX: BRRD proposed amendments

Proposed amendments

- Introduction of TLAC for EU GSIFIs
- Concept of resolution entity:
  - **External MREL**: applicable to resolution entities
  - **Internal MREL**: applicable to subsidiaries which are not resolution entities; allows to upstream their losses to resolution entities without the need to place such subsidiaries in resolution
- Subordination/Creditor hierarchy
- Moratorium
- Intermediate EU parent for 3rd country subsidiaries
Thank you!

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For FinSAC’s recent publication “Guidebook to the BRRD” and accompanying bank resolution case studies see: