



---

## HIGH LEVEL SEMINAR ON BAIL-IN AND DEPOSIT INSURANCE SYSTEM INTERACTION

# SAFEGUARDS TO LIMIT RISK OF BAIL-IN FOR DISs

**Krzysztof Broda**  
Bank Guarantee Fund, Poland

## From your point of view, what are the main risks associated with the bail-in tool?

### Remarks

Respondents who has chosen „other” specified in supplementary text:

- „Contagion risk”,
- „Liquidity risk: bail in could accelerate problems if it triggers a run”,
- „Increased probability of bank run”.



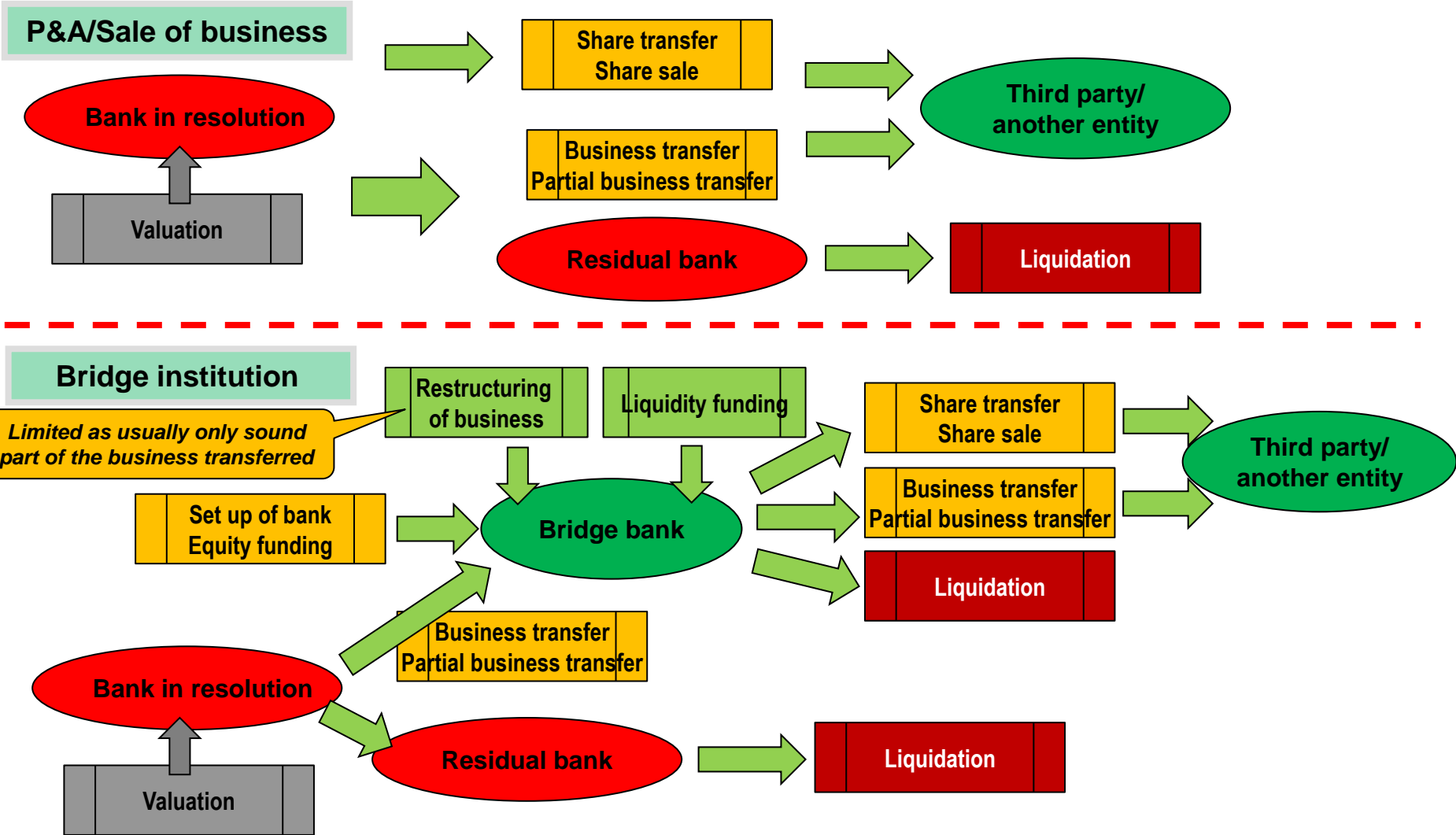
\* n – number of participants who answered the question (at least one option marked)

\*\* percentages calculated in relation to number of participants who answered the question (n)

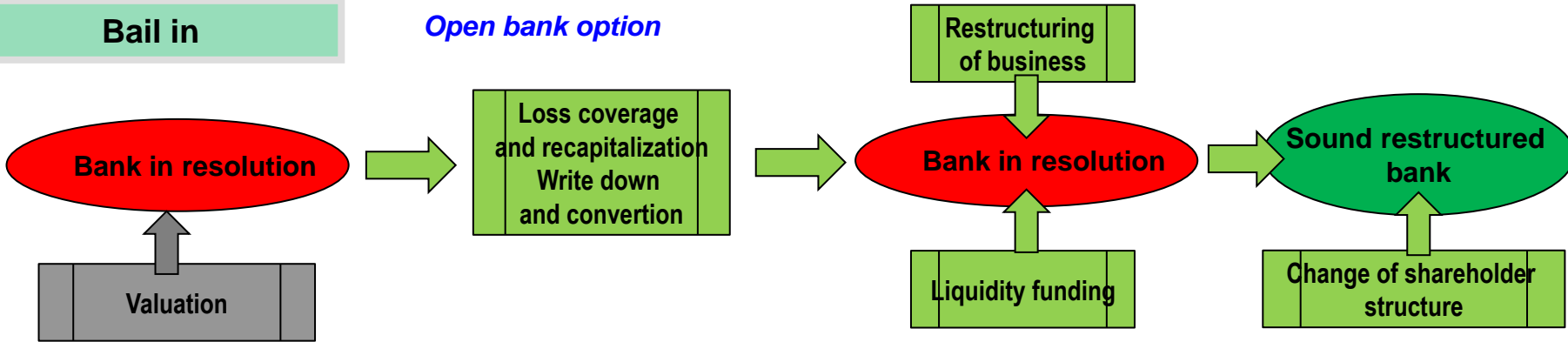
**Does bail in is a new concept?**

**The same as regards write down and similar economic effect as regards debt conversion could give:**

- **Partial transfer of liabilities and liquidation of residual bank (what are differences for closed bank bail in option?)**
- **Voluntary or semi-voluntary restructuring with partial write down and share-for-liabilities conversion – possible both for solvent and insolvent entities - keep business going concern but difficult to apply to the banks because of risk to loose market confidence.**
- **Bankruptcy and similar liquidation procedures – entity insolvent - usually destroy business value and/or stop the business, contagion and financial stability risk in financial sector.**

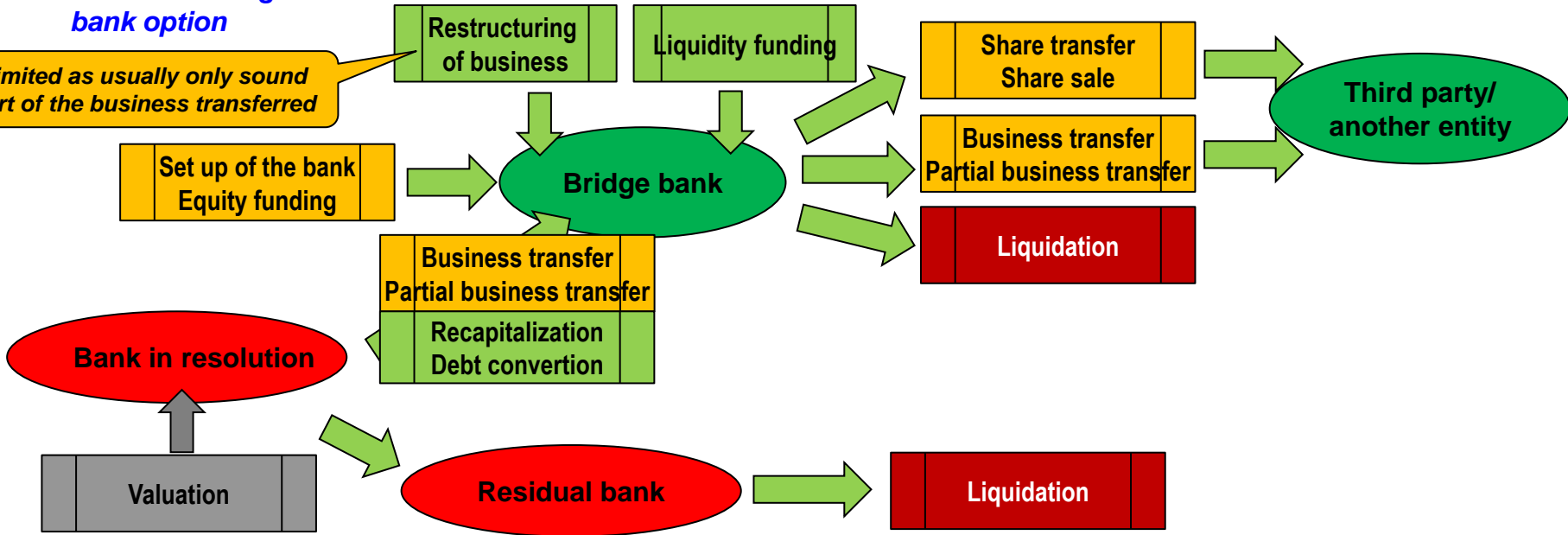


## Bail in



## Closed bank & bridge bank option

*Limited as usually only sound part of the business transferred*

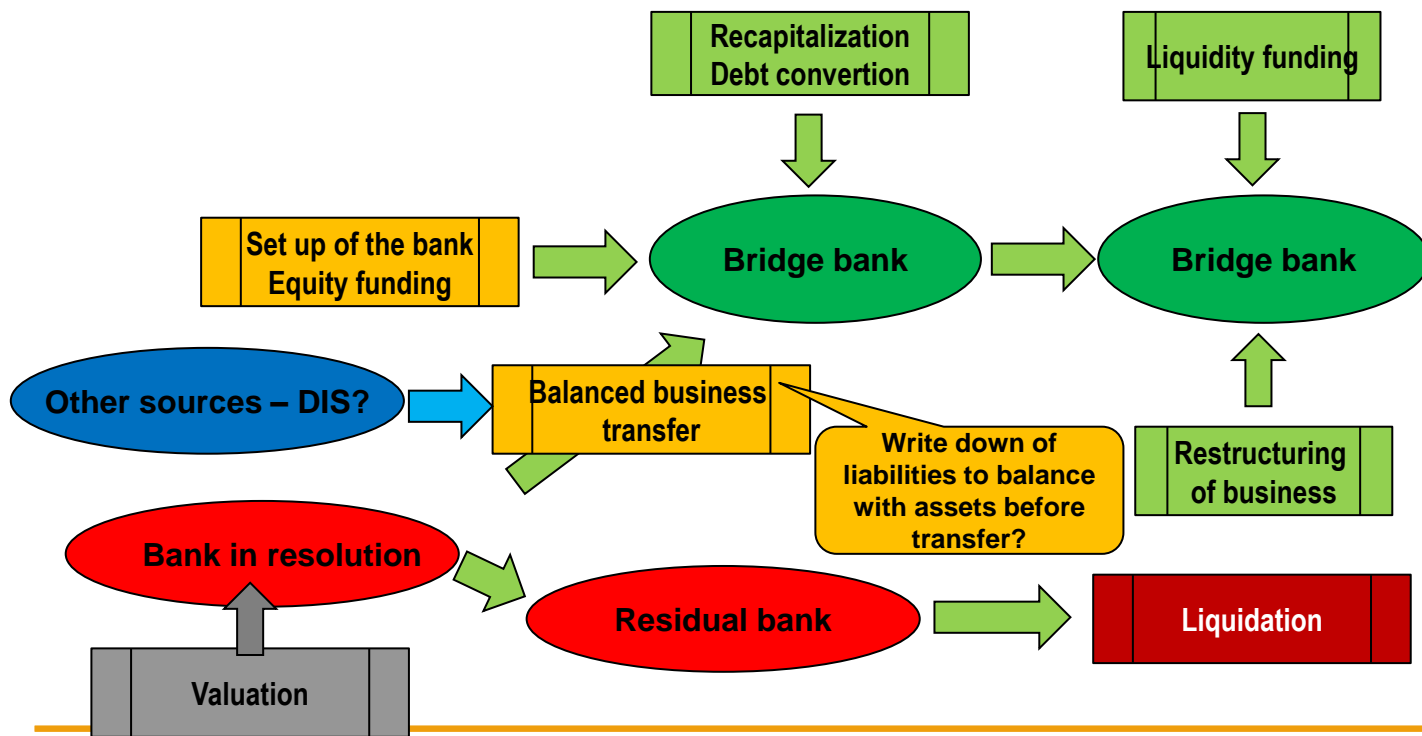


## Bail in in Bank Restructuring and Resolution Directive

Resolution authorities may apply the bail-in tool ... to convert to equity or reduce the principal amount of claims or debt instruments that are transferred:

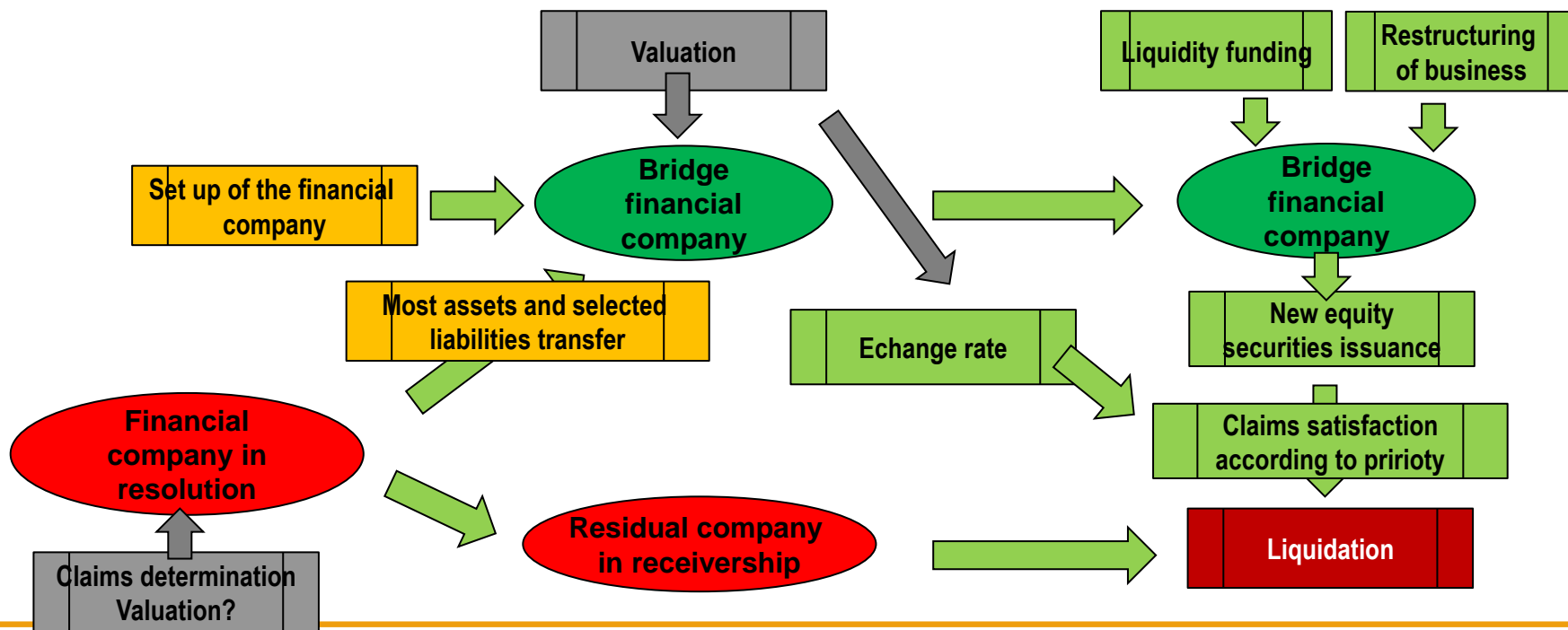
(i) to a bridge institution with a view to providing capital for that bridge institution ... (art. 43 par. 2)

When applying the bridge institution tool, the resolution authority shall ensure that the total value of liabilities transferred to the bridge institution does not exceed the total value of the rights and assets transferred from the institution under resolution or provided by other sources. (art. 40 par. 3)



## Bail in in Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy

*The FDIC would organize a bridge financial company, into which it would transfer assets from the receivership estate, primarily the covered financial company's investments in and loans to subsidiaries. Losses would be apportioned according to the order of statutory priority among the claims of the former equity holders and unsecured creditors, whose equity, subordinated debt and senior unsecured debt would remain in the receivership. Through a securities-for-claims exchange the claims of creditors in the receivership would be satisfied by issuance of securities representing debt and equity of the new holding company or holding companies*



### BRRD

**Time constrain challenge – at least provisional valuation shall be done before use of any resolution tool**

**Recapitalization in short term**

**If valuation provisional additional correction of scope of bail in might be required (?)**

### SPE (FDIC)

**More time for valuation**

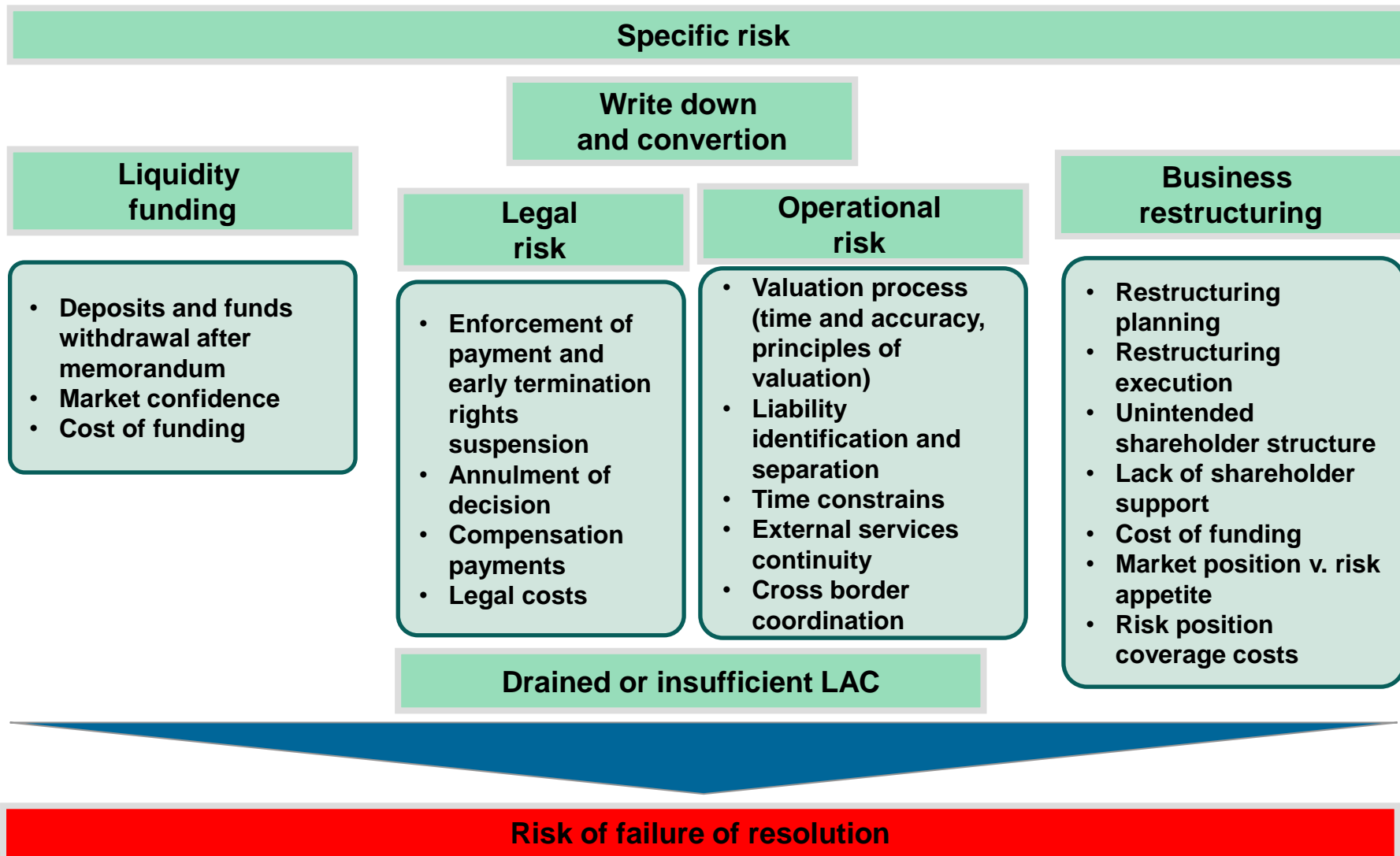
**Before securities-for-claims exchange bridge liquidity funding likely required**

**Required scope of bail in precisely identified**

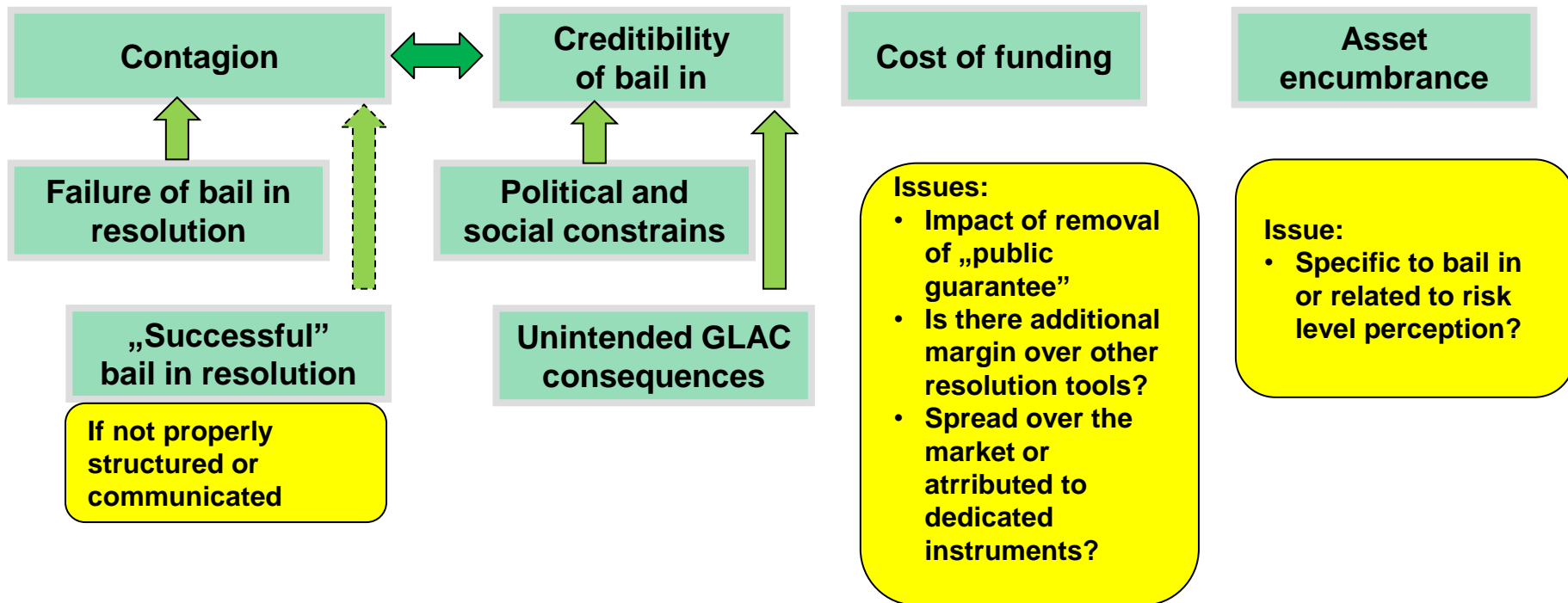
**Two valuation required?**

**In spite of different legal regimes level of legal risk could be different**





## Implicit risk



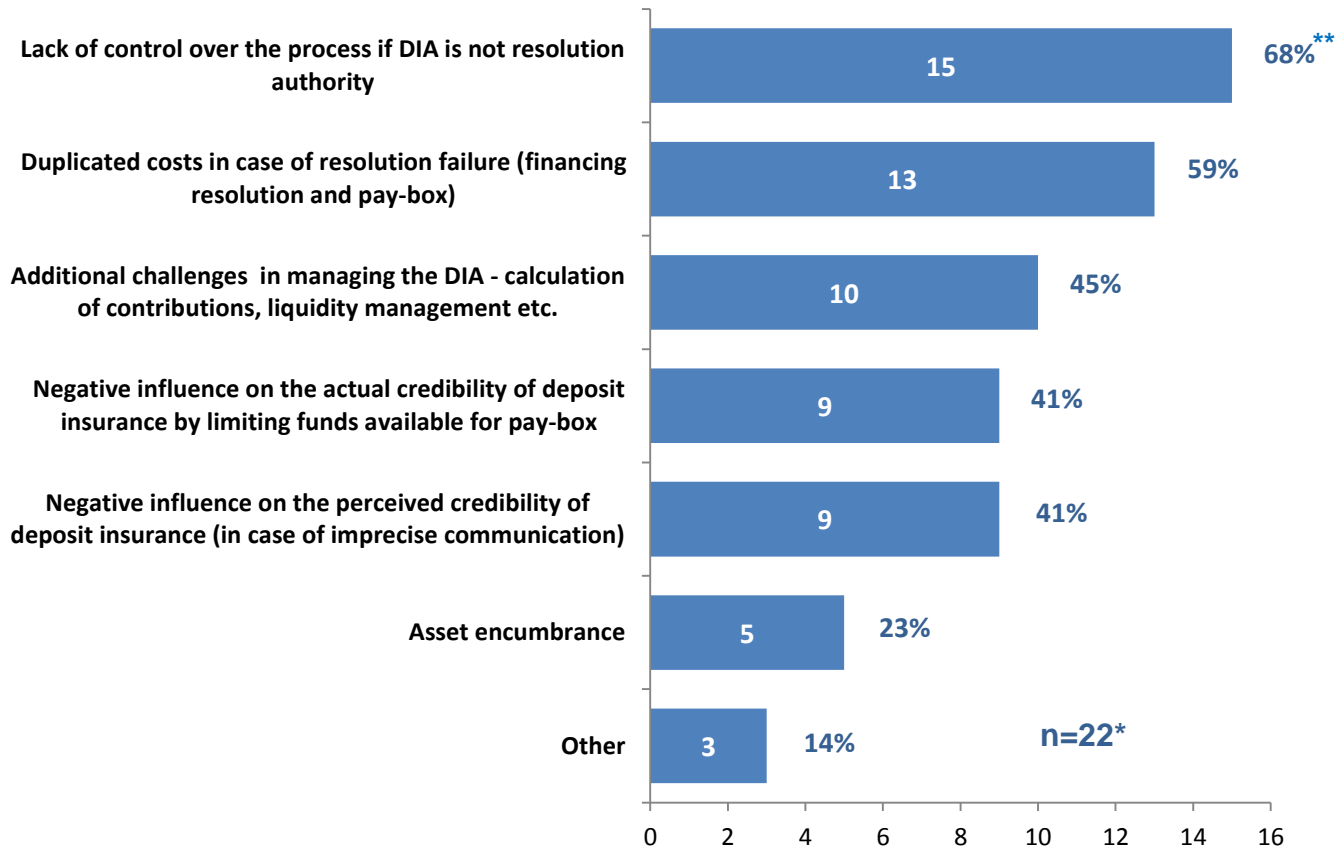
## What risks relating to the participation of DIA funds in financing resolution, including bail-in, do you recognize?

### Remarks

One response „other” excluded from the graph because of the commentary „no response due to absence of legislation”

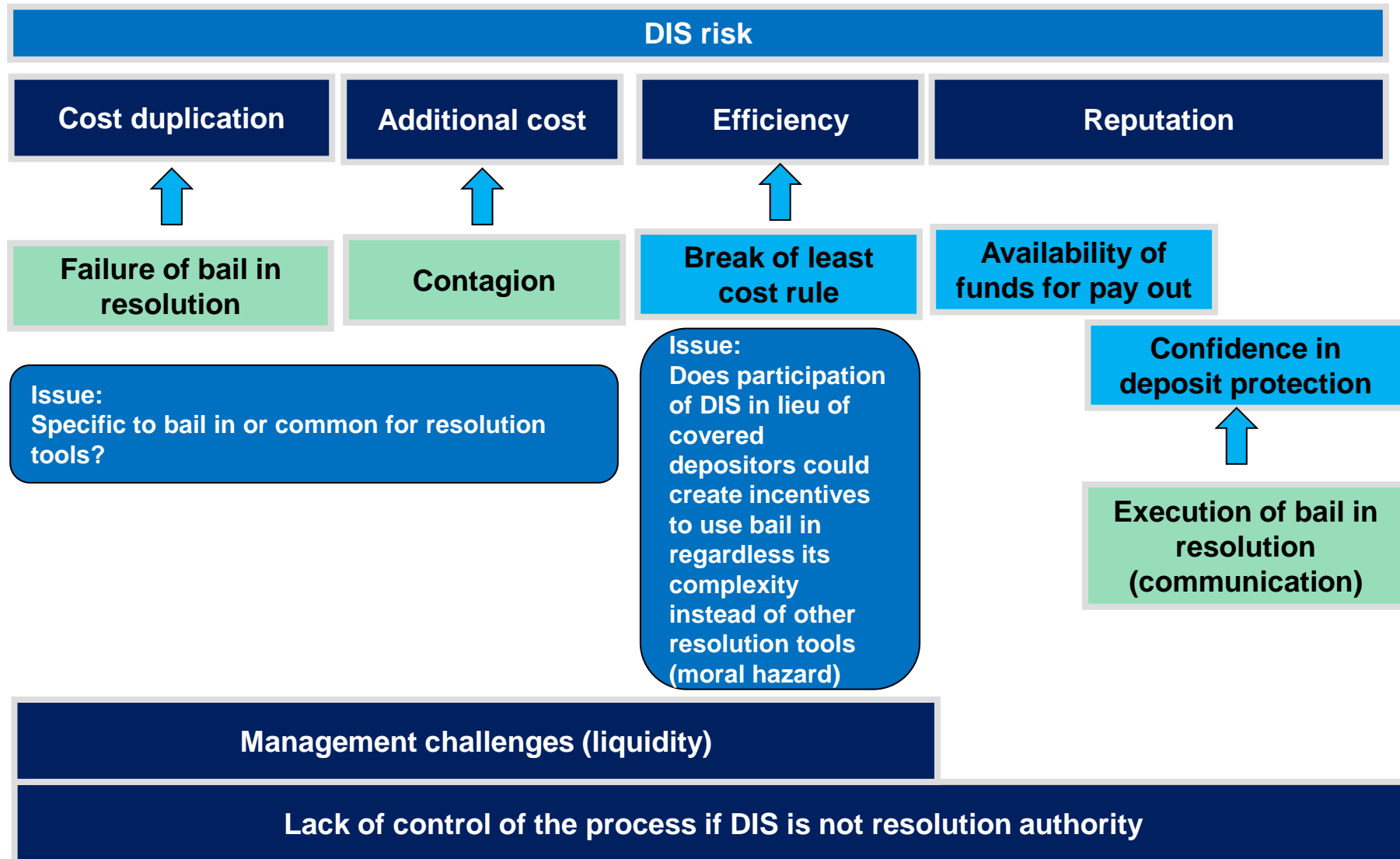
Only one respondent with answer „other” has specified the character of risk:

*„The use of funds, which were originally build up for deposit protection, for resolution cases (especially in the "too-big-to-fail-case" of systemic important banks!)”*



\* n – number of participants who answered the question (at least one option marked)

\*\* percentages calculated in relation to number of participants who answered the question (n)

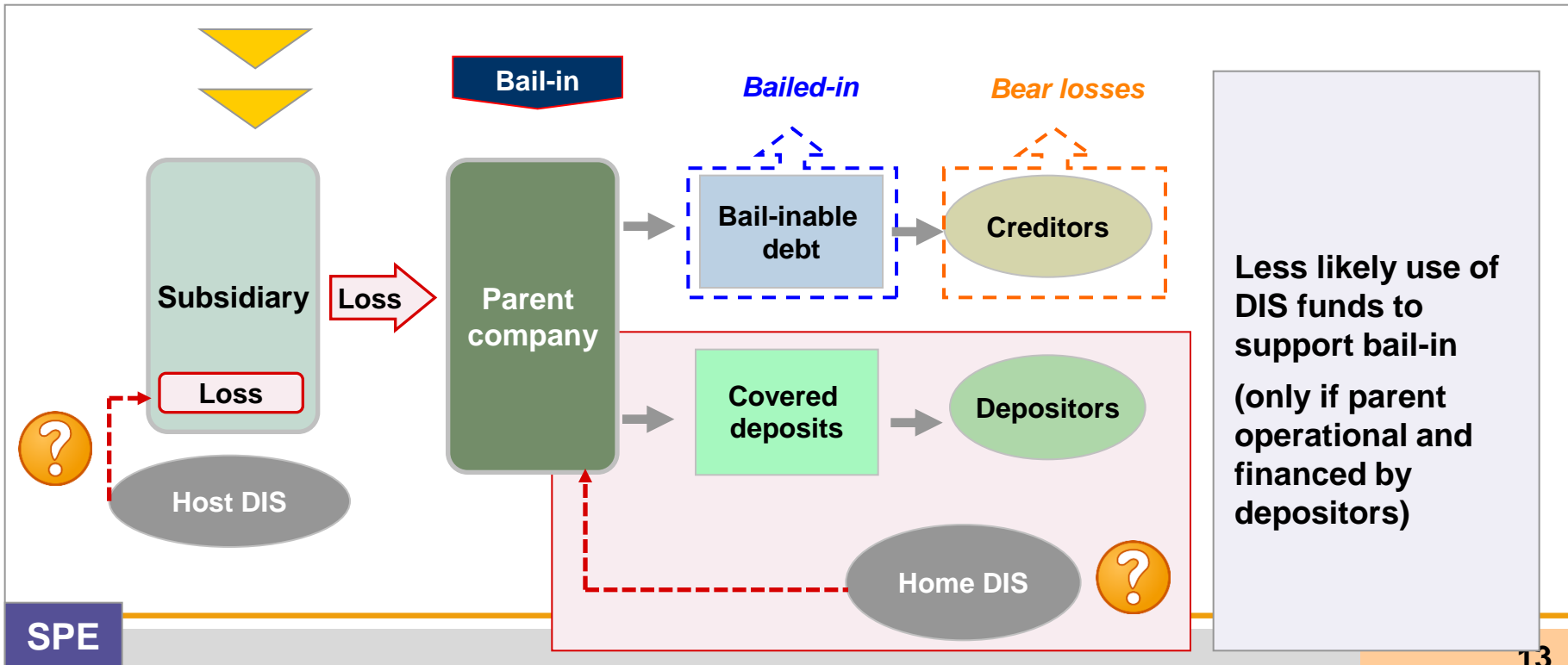


## Pre-assumption

covered deposits  
excluded from the scope  
of bail-in

### Resolution strategy impinges on the role of DIS and influence DIS exposure to risk

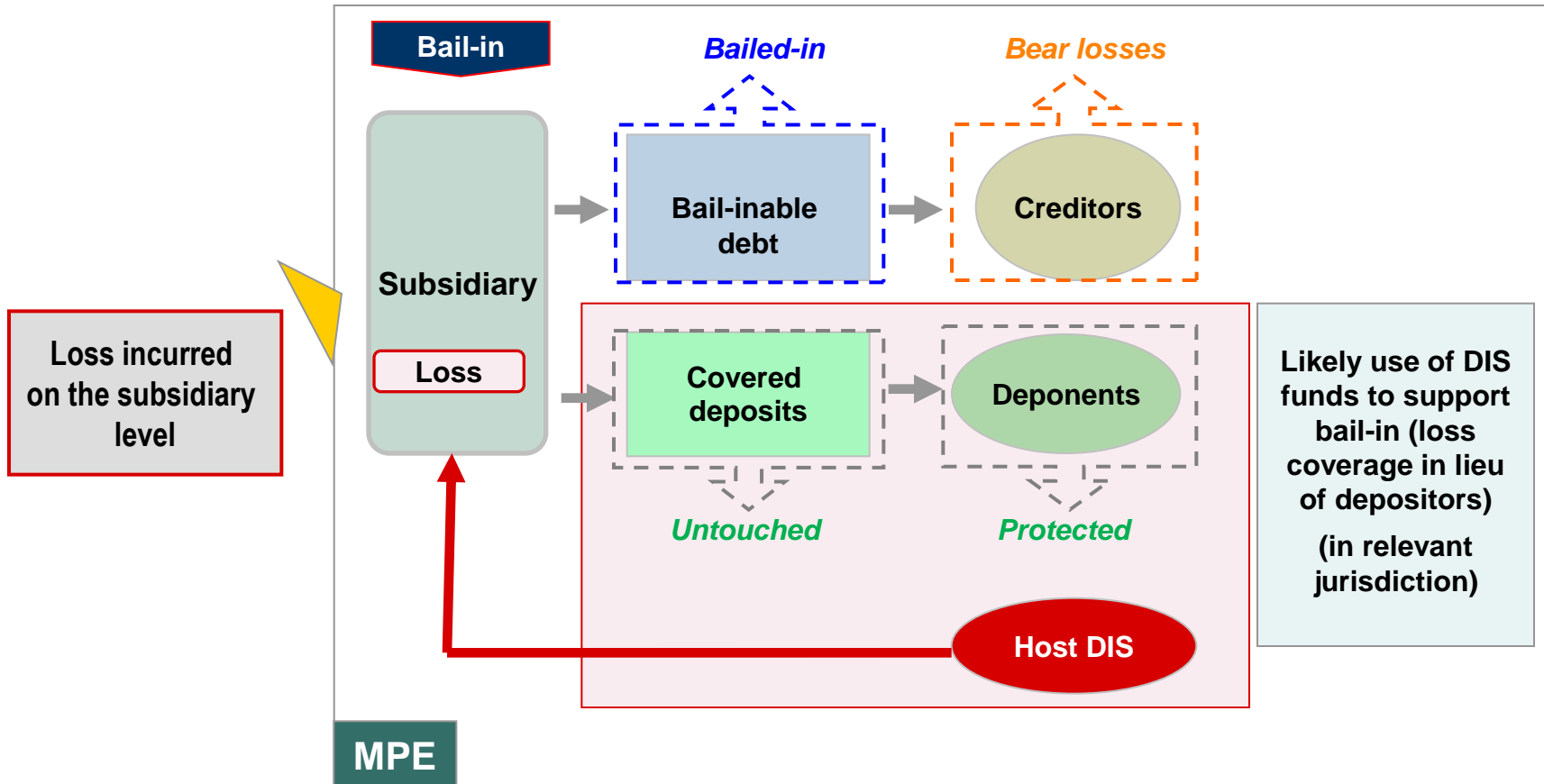
Loss incurred  
At the subsidiary  
level



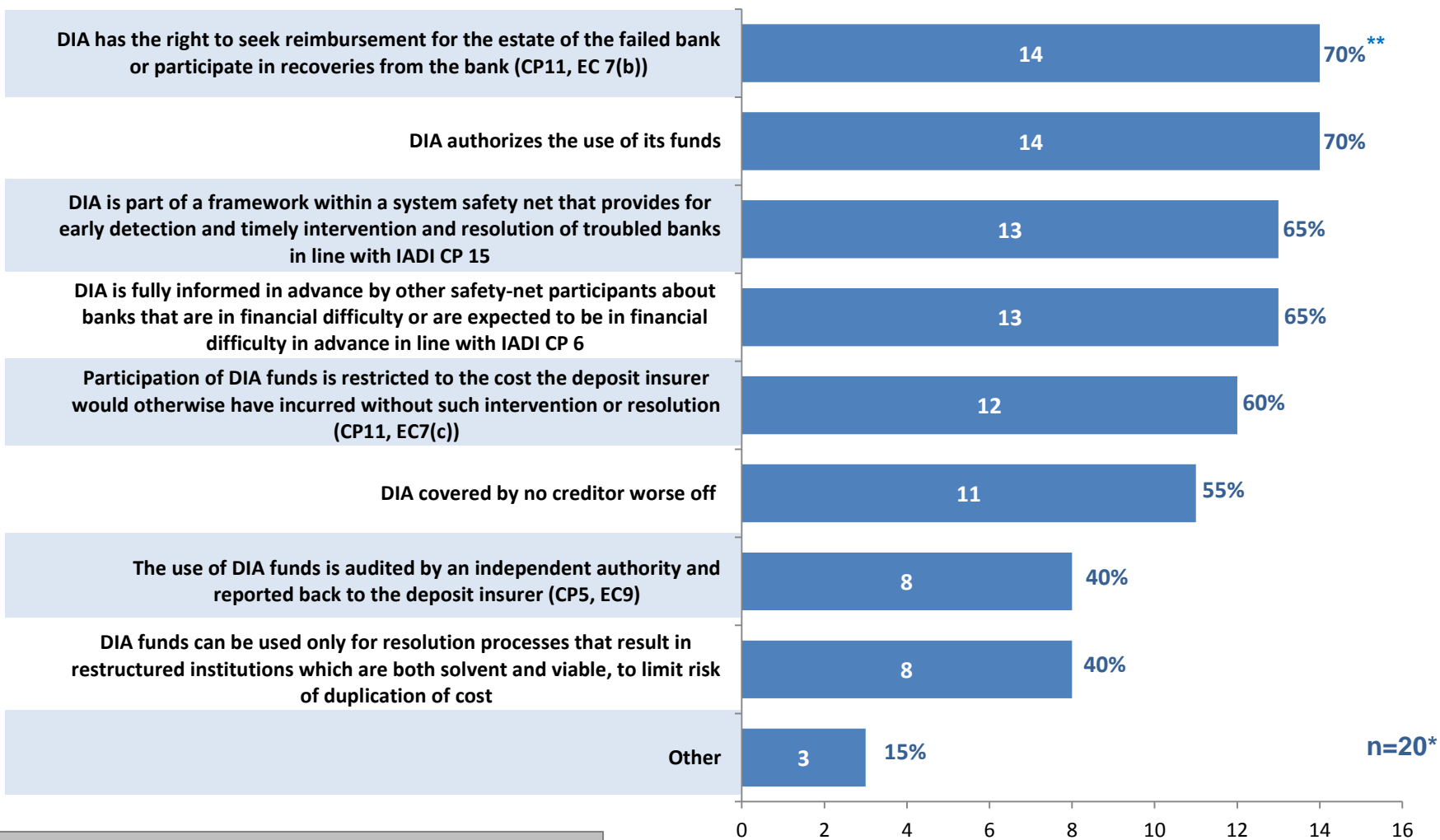
## Pre-assumption

covered deposits  
excluded from the scope  
of bail-in

### DIS would be exposed to risk more likely in MPE strategy



## If contribution of DIA is compulsory what are the safeguards to protect DIA's interests?



Remarks – next slide

\* n – number of participants who answered the question (at least one option marked)

\*\* percentages calculated in relation to number of participants who answered the question (n)

If contribution of DIA is compulsory what are the safeguards to protect DIA's interests?

Remarks

Respondents who has chosen „other” specified in supplementary text:

- *„Strictly separates systems and funds! No "link" between resolution and deposit protection!”*,
- *„Covered deposits are benefitting from depositor preference”*,
- *„Ultimately, there needs to be alignment between responsibility for conducting resolution and funding of resolution. The resolution authority needs to be accountable for funding the cost of resolution”*.



## DIS risk

Failure of bail in resolution

Cost duplication

## Safeguards

Extended mandate to conduct the resolution process

Participation in the resolution process

Enhanced financial safety net – DIS participation

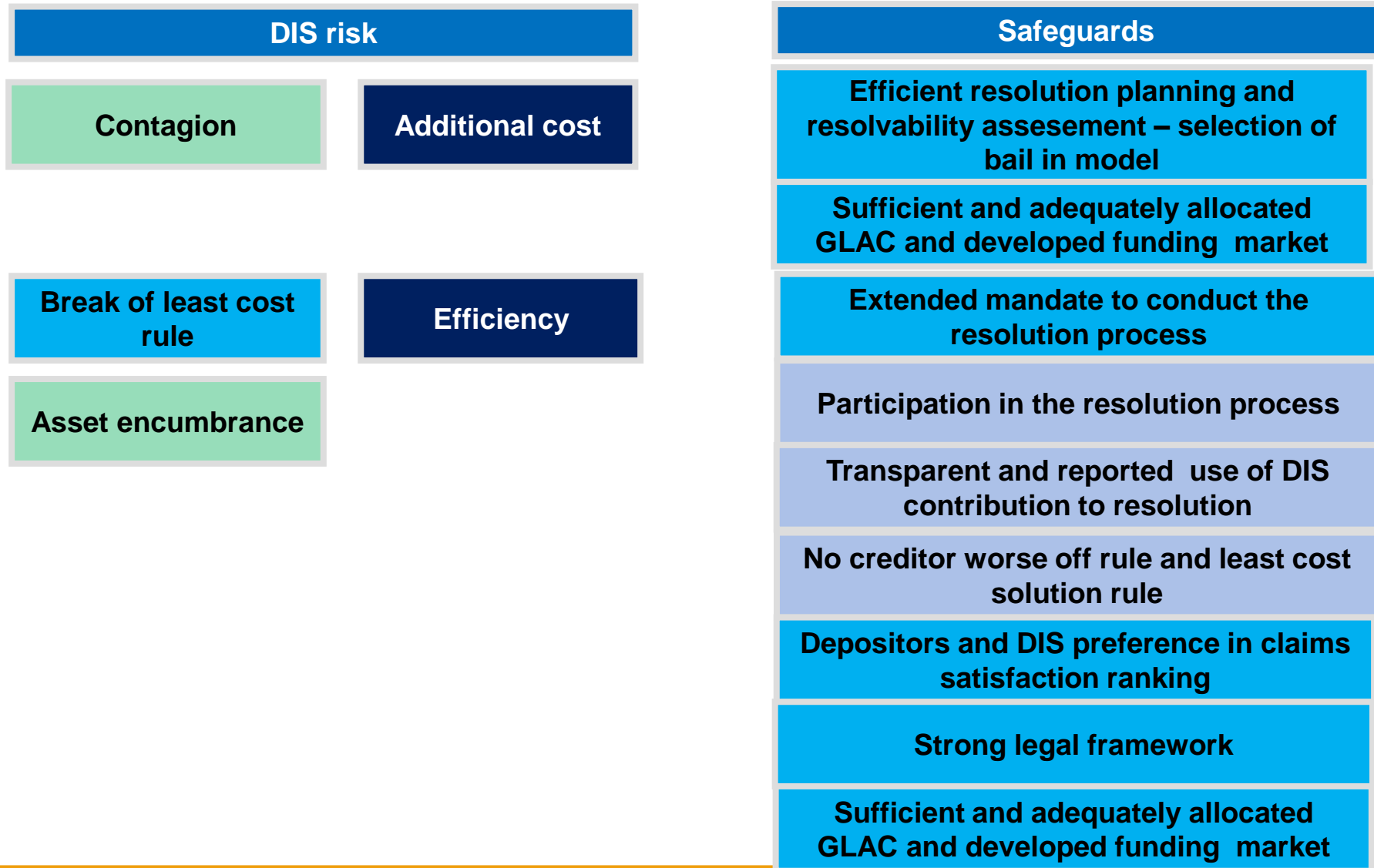
Split of responsibilities among financial safety net participants to avoid forbearance

Strong cooperation and communication between safety net participants (local and cross border)

Efficient resolution planning and resolvability assessment – selection of bail in model

Strong legal framework

Sufficient and adequately allocated GLAC and developed funding market



## DIS risk

Availability of funds for pay out

Confidence in deposit protection

Execution of bail in resolution (communication)

Reputation

## Safeguards

Ex ante funds  
Ambitious target level

Credible backstop funding

Extended mandate to conduct the resolution process

Participation in the resolution process

Efficient public awareness and communication policy

Sufficient and adequately allocated GLAC and developed funding market

*THANK YOU*

*[www.bfg.pl](http://www.bfg.pl)*