



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

SAFEGUARDS TO LIMIT RISK OF BAIL-IN FOR DISS

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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", ٠
- "Liquidity risk: bail in ٠ could accelerate problems if it triggers a run",
- "Increased probability ٠ of bank run".

Operational and financial risk: time and accuracy of valuation process			
Operational risk: complex process - numerous cases			
Legal risk: bail-in as a form of expropriation; risk of compensation payment			
Increase of moral hazard of the resolution authorities if DIA funding in bail-in is compulsory			
Liquidity risk - liquidity support required (central bank, resolution or other funds)	_		
Operational risk: identification of excluded liabilities			
Higher cost of funding			
Financing structure: possible shift to excluded liabilities other than secured ones Operational risk: suspension of operations necessary	-		
to carry out the process (to freeze book records)	-		
Asset encumbrance			6
Other		3	
	Δ	2	



* 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-forliabilities 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 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





Risk of failure of resolution







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

٦

Remarks	Lack of control over the process if DIA is not resolution authority	15					68 % ^{**}	
One response "other" excluded from the graph because of the commentary	Duplicated costs in case of resolution failure (financing resolution and pay-box)	-		13			59%	
"no response due to absence of legislation"	Additional challenges in managing the DIA - calculation of contributions, liquidity management etc.	-	10		4	15%		
Only one respondent with answer "other" has	Negative influence on the actual credibility of deposit insurance by limiting funds available for pay-box	_	9		41%			
specified the character of risk:	Negative influence on the perceived credibility of deposit insurance (in case of imprecise communication)		9		41%	6		
"The use of funds, which were originally build up for deposit protection, for	Asset encumbrance	- 5	2	23%				
resolution cases (especially in the "too-big-to-fail-case" of systemic important	Other	3	14%		n=:	22*		
banks!)"		0 2	4 6	5 8	10	12	14	16

* 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)



DIS risks related to bail in application





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





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?

	-							
DIA has the right to seek reimbursement for the estate of the or participate in recoveries from the bank (CP11, EC 7				14			70%	**
DIA authorizes the use	of its funds			14			70%	
DIA is part of a framework within a system safety net that prearly detection and timely intervention and resolution of trou in line with IADI CP 15				13		6	5%	
DIA is fully informed in advance by other safety-net particip banks that are in financial difficulty or are expected to be i difficulty in advance in line with IADI CP 6				13		e	5%	
Participation of DIA funds is restricted to the cost the depo would otherwise have incurred without such intervention o (CP11, EC7(c))				12		60%		
DIA covered by no credito	r worse off		:	11		55%		
The use of DIA funds is audited by an independent au reported back to the deposit insurer (CP5, EC	-		8		40%			
DIA funds can be used only for resolution processes that restructured institutions which are both solvent and viable, of duplication of cost			8		40%			
	Other	3	15%					n =20 *
Remarks – next slide		D 2 er of participant ges calculated i						



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

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".



Safeguards to limit risk of bail for DISs

DIS risk		Safeguards
Failure of bail in resolution	Cost duplication	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 forbearence
		Strong cooperation and communication between safety net participants (local and cross border)
		Efficient resolution planning and resolvability assesement – selection of bail in model
		Strong legal framework
		Sufficient and adequately allocated GLAC and developed funding market



Safeguards to limit risk of bail for DISs

DIS risk		Safeguards
Contagion	Additional cost	Efficient resolution planning and resolvability assesement – selection of bail in model
		Sufficient and adequately allocated GLAC and developed funding market
Break of least cost rule	Efficiency	Extended mandate to conduct the resolution process
Asset encumbrance		Participation in the resolution process
		Transparent and reported use of DIS contribution to resolution
		No creditor worse off rule and least cost solution rule
		Depositors and DIS preference in claims satisfaction ranking
		Strong legal framework
		Sufficient and adequately allocated GLAC and developed funding market



Safeguards to limit risk of bail for DISs

DIS ris	sk	Safeguards
Availability of funds for pay out	Reputation	Ex ante funds Ambitous target level
Confidence in deposit protection		Credible backstop funding
Execution of bail in resolution		Extended mandate to conduct the resolution process
(communication)		Participation in the resolution process
		Efficient public awareness and communication policy
		Sufficient and adequately allocated GLAC and developed funding market





THANK YOU

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