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FONDS DE GARANTIE
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*French deposit insurance
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Bail-in application: challenges for DISs

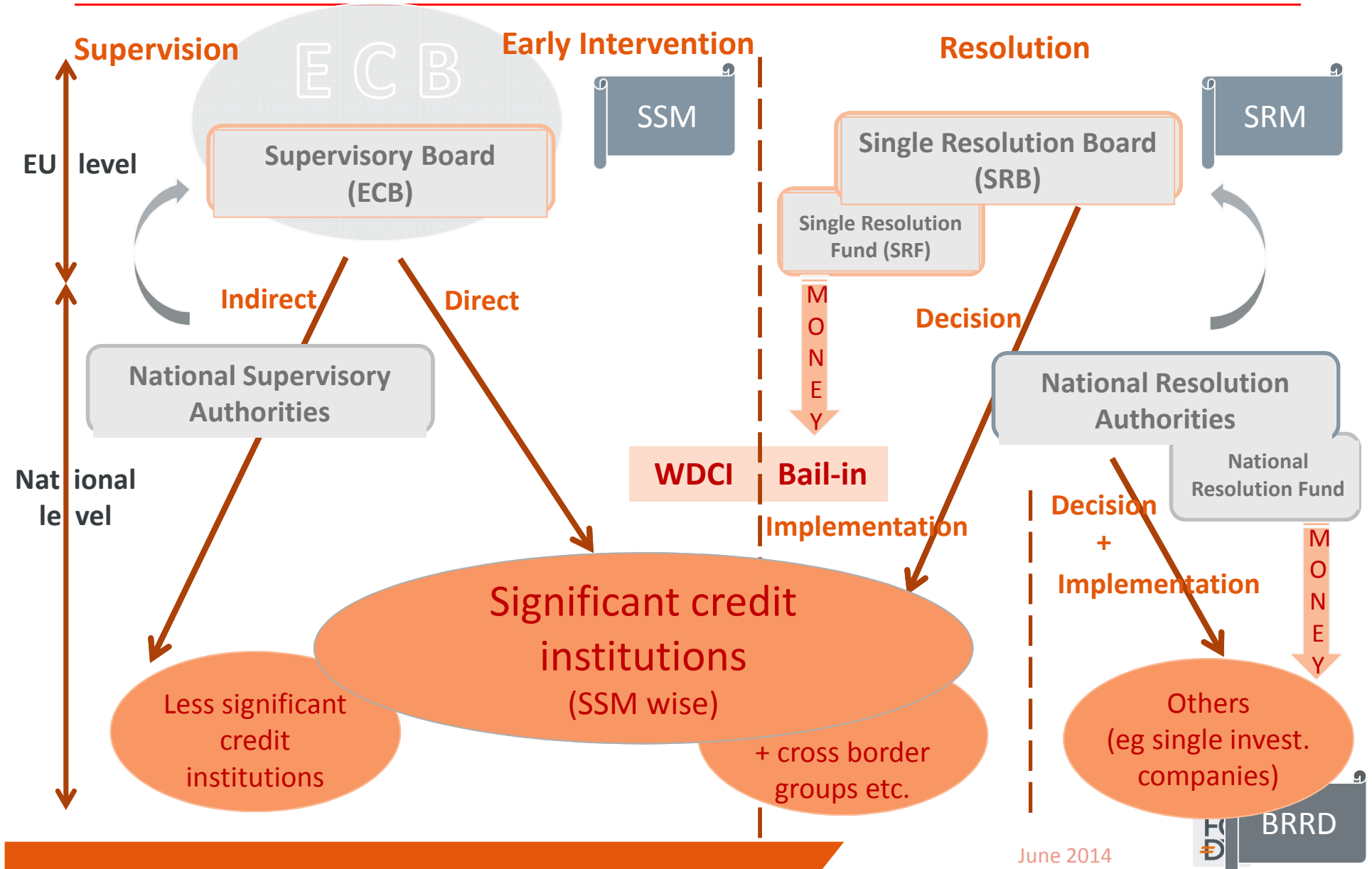
A EU/ Banking Union perspective

June 2014

CONTENT

- **SSM, SRM, BRRD: who does what in banking crises?**
- **Implementing resolution instruments/ bail-in: challenges**

Who does what in the Banking Union?



Role of national EU DISs in resolution

- ▶ **Country specific...**

- ▶ **But:**

- ▶ **Outside SRM scope (eurozone)**

- DISs may have a direct role in resolution, as a resolution authority, on all banking institutions – if so decided by jurisdictions

- In any case, DISs may be involved in the resolution decisions and implementation – matter of national discretion

- ▶ **Within SRM scope (eurozone)**

- Same than above for some institutions (e.g. not for systemic ones): resolution authority or involvement in the process

- Possible role in implementing decisions taken by the Single Resolution Board for systemic institutions (and some others) – matter of national discretion

Resolution instruments in the EU

▶ Resolution tools:

▶ *Sale of business tool*

The Resolution Authority (RA) may force the selling or transfer of shares, assets and liabilities of the failing institution to the market

▶ *Bridge institution tool*

The RA may force the selling or transfer of shares, assets and liabilities of the failing institution to a public entity designed for that purpose

▶ *Asset separation tool*

The RA may force the selling or transfer of shares, assets and liabilities of the failing institution to a public or partially public asset management vehicle designed for that purpose

▶ *Bail-in tool*

The RA may write down or convert capital and debt instruments so as to pass expected losses to existing risk holders, reduce the liabilities of the bank, rebuild the capital base

▶ *Government financial stabilisation tool (BRRD only)*

When applying other resolution tools to the maximum extent practicable is not sufficient to maintain financial stability or protect public interest, the State member could, as a last resort, offer public equity support or take under temporary public ownership

▶ **Write-down and conversion of capital instruments (WDCI)**

- ▶ Independently of or together with a resolution action

The bail-in tool in the EU

Ranking of bail-inable debt/
Hierarchy of creditors

Bail in

Resolution

EU
specific

Early intervention

Write down of capital
instruments (WDCI)

Secured instruments/
Tax claims/ salaries etc.

Covered deposits (<100k€)
- through the DGS -

SMEs' and individuals'
deposits (except above)

Uncovered senior debt, incl
eligible deposits (except above)

Subordinated debt

Tier 2

Tier 1

EU specific

The bail-in tool in the EU

▶ Definition

The resolution authority may write down or convert capital and debt instruments so as to pass expected losses to existing risk holders, reduce the liabilities of the bank, rebuild the capital base

▶ Constraints

- ▶ The resolution authority should go up the hierarchy of shareholders/ creditors
- ▶ Possible exclusions of the bail-in scope “in exceptional circumstances”:
 - ▶ liabilities not bail-inable in a reasonable time
 - ▶ liabilities needed for the continuity of critical functions and key operations
 - ▶ avoiding widespread contagion, especially for natural persons, SMEs or the functioning of financial markets
 - ▶ avoiding a destruction of value for other creditors higher than otherwise

▶ Open issue

- ▶ What could be the impact on the market?

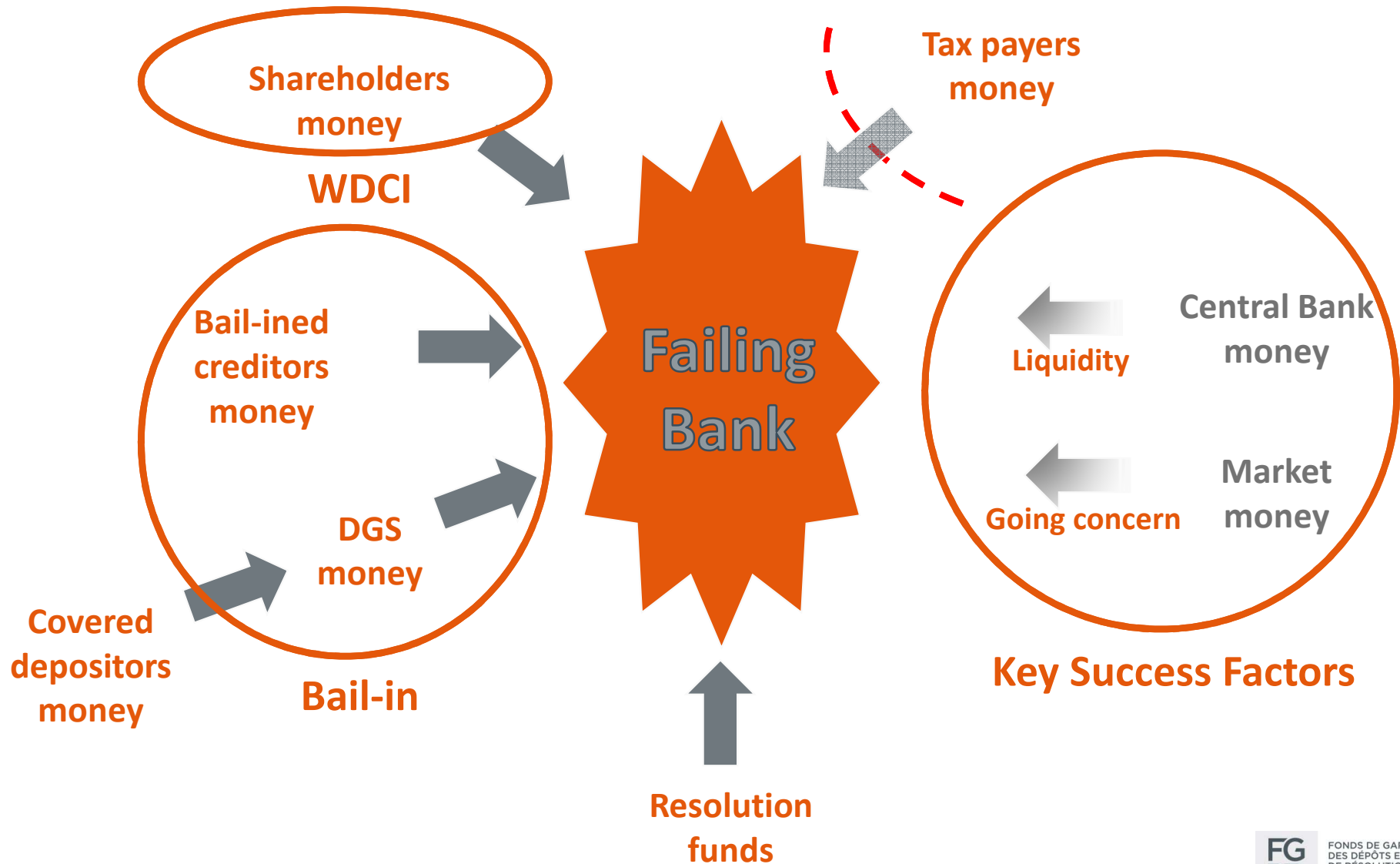
Implementation challenges

Uncharted territories

- ▶ **Bail-in and WDCI implementation in Europe:** too few and too specific cases for being comfortable with those instruments at this stage
 - ▶ Cyprus crisis (2013): bail-in that encompassed non-covered deposits
 - ▶ SNS Reaal (Netherlands, 2013): bail-in limited to equity and junior debt (=WDCI?)
 - ▶ MB Bank (Italy, 2011): voluntarily bail-in to interbank creditors and the FITD
 - ▶ Real Bank (Hungary, 1998-99): equity wiped out, before a recap by NDIF
- ▶ **Core implementation challenges**
 - ▶ Scope: what use should be made of the possible exclusions to bail-in scope?
 - ▶ WDCI or bail-in? Will we dare bailing-in senior debts? non covered deposits? operational debt?
 - ▶ Possible disruption on markets and economy due to the bail-in itself/ contagion effects
 - ▶ Parameters of write-down and conversion, also depending on the initial funding structure and MREL
 - ▶ How will new shareholders behave (after conversion of their claims)? Will they vote with their feet or will they stay?
- ▶ **Concern for DISs involved in the resolution process/ Also possible impact on payboxes**



Implementation challenges



Implementation challenges

Uncharted territories

▶ Which institutions?

- ▶ SIFIs or also smaller banks?
- ▶ Legal / constitutional issues given the extraordinary powers given to an administrative authority before any failure and without any judicial decision – litigation risk ahead
- ▶ Moral hazard risk still to be mitigated: failures should still be the preferred option in some cases
- ▶ Market uncertainty – doctrine of use to be clarified without reinforcing moral hazard

▶ The valuation issue



- ▶ Need for a quick and appropriate valuation of assets/ liabilities/ losses so as to ground adequate and “definite” decisions



- ▶ Risk of not going far enough (markets), risk of going too far (markets)
- ▶ Valuation depends also on market reactions – iterative process rather than a once-and-for-all job
- ▶ BRRD post valuation and NCWOL bring some comfort; but might be better working on better fortune clauses

Implementation challenges

Uncharted territories

▶ **Timing, the essence**

- ▶ Is the over-a-weekend resolution a credible target or a myth?
- ▶ Is the decision-making process clear enough, especially for cross border crises?

▶ **Efficiency of the new framework**

- ▶ Reluctance over bail-out, but will bail-in work as well?
- ▶ New instruments, complex situations, hastily drafted regulation, governance challenges: “proof of concept” needed

Paybox

▶ **Cross border implementation**

- ▶ Most difficult piece of legislation/ implementation
- ▶ Within the EU, with non EU jurisdictions as well
- ▶ Will national interests/ approaches re-emerge on day D?

▶ **The level playing field issue**

- ▶ Gone concern or going concern?
- ▶ i.e.: what will be the impact for the banking sector in terms of 1/ competition or remaining competition; 2/ financial contribution?
- ▶ Adequate balance to be found when time comes

Paybox

Implementation challenges

Uncharted territories

▶ Liquidity as a key success factor



- ▶ Solvency issues have to be solved, but liquidity comes first – no liquidity, no solution
- ▶ Do new pieces of EU regulation address liquidity issues enough?
- ▶ Also depends on the situation: open bank bail-in versus closed bank bail-in
- ▶ Resolution funds may guarantee the failing bank's assets and liabilities - to be further explored

▶ Market reaction



- ▶ Credibility of the reorganisation/ resolution plan – accompanying measures, business perspectives
- ▶ At the end of the day, will the market « buy » a going concern?

▶ Single/ multiple point of entry issue (“SPE/ MPE question”)

- ▶ US have opted for a SPE approach on financial holdings
- ▶ EU legislation and regulation leave the question open
- ▶ For “significant resolutions, will it be:
 - ▶ a matter of national discretion under SB and SRB guidance?
 - ▶ or in the hands of new European authorities?
- ▶ Need for pragmatism, probably

Implementation challenges

Uncharted territories

Some conclusions

- ▶ **Need for appropriate bank resources on recovery and resolution plans**
- ▶ **Need for advanced and thoroughful preparation by (all) authorities**
 - Including DISs/ RAs, DISs involved in the resolution process and payboxes
 - Simulation/ Crisis scenarios absolutely needed
- ▶ **Need for pragmatism in implementation phases**
 - DISs can bring their crisis management experience
- ▶ **Probably just a starting point...**



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