



FONDS DE GARANTIE  
DES DÉPÔTS ET  
DE RÉOLUTION

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*French deposit insurance  
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## **Bail-in and resolution financing within BRRD**

March 2014

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# BRRD *itself*

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# Resolution instruments in BRRD

## Resolution instruments

- **Resolution tools:**
  - ***Sale of business tools***  
The Resolution Authority (RA) can force the selling or transfer of shares, assets and liabilities of the failing institution to the market
  - ***Bridge institution tool***  
The RA can 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 can 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**
  - ***Government financial stabilisation tool***  
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**
  - Independently of or together with a resolution action



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# The bail-in concept

- **A simple idea**

Granting an administrative authority (the “Resolution Authority” – “RA”)

With the power,

In case a bank looks likely to fail,

To write down or convert capital and debt instruments to:

- Pass expected losses to existing risk holders
- Reduce the liabilities of the bank
- Rebuilding the capital base

- **Close to what a liquidator would do after a failure, but:**

- **Before the failure**
- Quickly and in an orderly manner
- Not by a judicial authority
- With the hope that an actual failure will be avoided, the critical functions and a part of the value of the bank will be preserved

- **Therefore, in respect with the “no creditor worse off than in liquidation” principle (NCWOL)**

- **Open questions**

- When, how and by whom?
- Which liabilities?



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# Bail-in as seen in BRRD - 1

Ranking of bail-inable debt/  
Hierarchy of creditors

Bail in

Resolution

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

EU  
specific



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# Bail-in as seen in the BRRD - 2

## PRINCIPLES

- Articles 37 to 50d (25 pages or so) dealing with:
  - The bail-in tool itself
  - Minimum requirements for own funds and eligible liabilities (MREL)
  - Implementation of the bail-in tool
  - Various ancillary provisions (so far including the government stabilization tools - public equity support tool and temporary public ownership tool)
- What for?
  - Recapitalizing an institution so it could be viable again, together with other resolution measures
  - Converting to equity or reducing the liabilities that are transferred to a bridge institution, through the sale of business tool or the asset separation tool (i.e. forcing existing shareholders and debt owners to take their share of the restructuration/ resolution costs)
- Exclusions from the scope
  - Covered deposits (through DGSD) and contributions to DGSs
  - Secured liabilities (including covered bonds)
  - liabilities arising in virtue of the holding of client assets or client money
  - Interbank operations (except within the group), with an original maturity shorter than 7 days
  - Liability towards employees, tax administration, critical commercial creditors etc

# Bail-in as seen in the BRRD - 3

## EXCEPTIONS: PRINCIPLES

- Optional exclusions from the bail-in scope, “in exceptional circumstances” for:
  - 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
- When the RA practices such exclusions, it could increase accordingly the level of write down or conversion of other bail-inable liabilities (while staying compliant with NCWOL principle)
- If the RA does not increase accordingly the losses for other bail-inable creditors, and as long as the contribution to loss absorption and recapitalization of the bail-in is higher than 8% of the total liabilities of the bank (including own funds), then:
  - the resolution fund could make a contribution to restore the net value of the bank to zero or to capitalize up to 5% of total liabilities (including own funds)...
- In “exceptional circumstances”, after the resolution fund has financed the 5% above, and as long as all unsecured non preferred liabilities other than eligible deposits have been written down or converted in full, the RA could seek “alternative financing” (i.e. state resources)



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# Bail-in as seen in the BRRD - 4

## EXCEPTIONS: MODALITIES, PROCESS & EXCEPTIONS' EXCEPTIONS

- To finance this up to 5% contribution, the resolution fund could use:
  - its existing (ex ante resources) – art 94
  - ex post contributions – art 95
  - then, alternative financing means (i.e. borrowed money) – art 96
- The optional exclusions of the bail-in scope should be notified to the European Commission
  - In case financing is sought for from the resolution fund or from alternative financing sources, the Commission has a right to prohibit or amend the exclusions of the bail-in scope, especially if the integrity of the Single Market is put at risk

### Exceptions' exceptions

- If the resolution fund's ex ante resources (article 94) have not been depleted after the financing of the 5% contribution, the remaining ex ante resources of the fund could be the source or a part of the “alternative financing”
- Notwithstanding the 8% limit above, the RA could contribute to the resolution financing as long as
  - the contribution to loss absorption and recapitalization of the bail-in is higher than 20% of the risk weighted assets of the bank
  - and the resolution fund resources are larger than 3% of covered deposits in the country as a whole
  - and the failing institution's assets are below a €900 billion threshold



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# Bail-in as seen in the BRRD - 5

## WILL THERE BE ENOUGH DEBT AVAILABLE FOR BAIL IN?

- **Minimum Requirement for own funds and Eligible Liabilities (“MREL”)**
  - own funds and eligible liabilities as a percentage of own funds and total liabilities
  - determined by the RA for each individual institution
  - should take into account that some bail-inable liabilities could be excluded from the bail in in the end
  - Should take into account the systemicity and interconnectedness with the rest of the financial sector
  - eligible liabilities for the MREL are not the same than for the bail-in scope
- **Scope of MREL compared to the scope of bail in + WDCI**
  - remaining maturity of at least one year
  - deposits with no depositor preference
  - the purchase should not be funded by the institution
  - may include instruments issued under the law of a third country, if the institution demonstrates that the bail in by the RA could be applied
  - may include qualifying contractual bail-in instruments



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# *Bail-in as seen in the BRRD - 6*

## WHAT ELSE FOR THE BAIL-IN IN BRRD?

- Implementation of the bail-in tool
  - Modalities of the assessment of the amounts to be written down or converted
- Treatment of shareholders
- Sequence of write down and conversion (hierarchy of claims)
- Derivatives
- Rate of conversion of debt to equity
- Associated business reorganization plan
- Removal of procedural obstacles to bail-in
- Contractual recognition of bail-in (debt issued outside the European Union)
- Bail-in in cross-border resolutions



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# Bail-in: uncharted territories

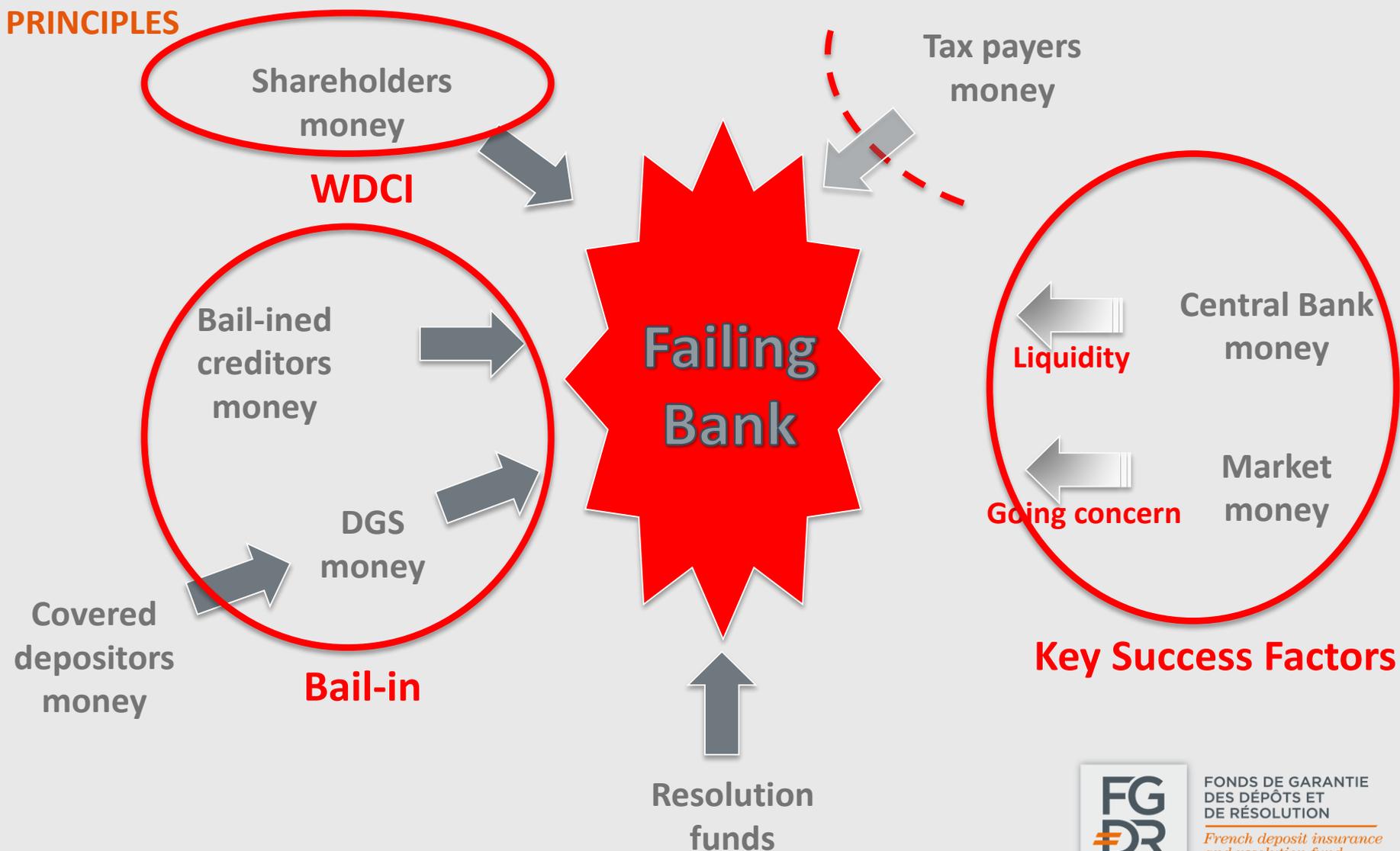
- **Too few and too specific cases for being already comfortable with the implementation of the bail-in instrument**
  - Cyprus crisis (2013): bail-in that encompassed non-covered deposits
  - SNS Real (Netherlands, 2013): bail-in limited to equity and junior debt
  - MB Bank (Italy, 2011): voluntarily bail-in to interbank creditors and the FITD
  - Real Bank (Hungary, 1998-99): equity wiped out, before a recap by NDIF
  - ...
- **Open issues with: operability/ market reaction/ accompanying measures/ liquidity/ parameters...**
  - within a weekend?
  - valuation of the losses/ assets/ liabilities. What if the valuation proves wrong?
  - with a **single point of entry** or a multiple one?
  - for SIFI's or also for smaller banks?
  - Influence of the initial funding structure/ (ex ante) resolution plan/ level of the MREL
  - gone concern or going concern? Open-bank bail-in or closed-bank bail-in? Will the market « buy » a going concern? What will the new shareholders do?
  - including senior debt or not?
  - including non covered deposits or not?
  - how to assess the possible disruption on markets and economy due to the bail-in itself?
  - cross border issues
  - ...



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# Resolution financing - 1

## PRINCIPLES



# Resolution financing - 2

## THE OBVIOUS PART

- Shareholders
  - early intervention – recovery plans (WDCI)
- Bail-inable creditors
  - in resolution
- DGSs, in lieu of covered deposits and up to the net losses they would have to bear in case of liquidation, and up to 50% of their target level, in case of:
  - virtual bail-in on covered deposits
  - use of other resolution tools



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# Resolution financing - 3

## THE LESS OBVIOUS PART

### ▪ Public support

- Contribution to bail-in, but only **after** the “8%”, after the “5%” and **after** all unsecured non preferred liabilities other than eligible deposits have been written down or converted in full

+

- Governmental financial stabilisation tools (public support equity tool/ temporary public ownership tool), after the other resolution tools have been applied up to the maximum practicable extent (**i.e. after the 8%**)

### ▪ Resolution Funds

- Contribution to bail-in, after the “8%”

+

- Guarantees, loans, contributions, purchases for:
  - The failing institution
  - The bridge bank
  - The asset management vehicle
  - The purchaser (in the context of the sale of business tool)
- **Caveat 1:** no transfer of losses to the resolution fund, no recapitalization by the resolution fund
- **Caveat 2:** if the actions above result in a transfer of losses to the resolution fund, then the principles set out for the bail-in instrument should apply (**i.e. after the 8%**)



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# Contributions from banks - 1

- **Many Layers**
  - CRD 4
  - MREL
  - Contributions to DGSs
  - Contributions to national Resolution Funds
  - Contributions to the single European Resolution Fund
  - Systemic taxes and alike
- **How are those contributions...**
  - Calculated?
  - Split within the banking system?
- **Any possible effect on the banking system?**



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# Contributions from banks - 2

<u>Equivalences Français/Anglais</u> MSU = SSM MRU = SRM FRU = SRF	<b>Deposit Guarantee Funds (DGSD)</b> <i>Trilogie concluded</i>	<b>Resolution funds - RFs (BRRD)</b> <i>Trilogie concluded</i>	<b>Single resolution fund (SRM)</b> <i>Trilogie concluded</i>
<b>Total amount</b>			
Reference base	Covered deposits	Covered deposits	Covered deposits
Reference geog. area	Country	Country	SRM zone (= SSM)
Target level	0,8% (0,5% possible)	1%	1%
<b>Individual breakdown</b>			
Base for contribution	Covered deposits	Total liabilities less own funds and covered deposits	Total liabilities less own funds and covered deposits
Reference geog. area	Country	Country	SRM zone (= SSM)

- DGSs are called as a last resort instrument because of the preference granted to covered deposits
- The resolution fund could be called before the DGS if necessary after 8% of the liabilities have been bailed-in
- Banks with large liabilities excluding deposits and own funds contribute the more to the RF/ Single RF
- At the same time, those banks have the largest bail-inable debt, and are therefore less likely to draw on the FR/ Single RF resources

Courtesy of H. Courtehoux - SocGen



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