



FONDS DE GARANTIE  
DES DÉPÔTS ET  
DE RÉOLUTION

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*French deposit insurance  
and resolution fund*

## **Banking resolutions in the new EU environment: implementation challenges**

May 2014

# CONTENT

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- **Implementing resolution instruments: what to do, which challenges?**

# Implementation: EU instruments in resolution

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## ▶ Resolution tools:

### ▶ ~~*Sale of business tool (= P&A)*~~

~~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

- ▶ Independently of or together with a resolution action

# Getting prepared for the bridge institution tool

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## ▶ Definition

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

## ▶ Constraints

Wholly or partially owned by one or more public entities (including the resolution authority and the resolution fund) and controlled by the resolution authority

## ▶ Target/ Needs (illustrative preliminary list)

- ▶ Having an entity/ shell ready and pre-agreed (or a detailed process predefined so as to create it quickly)
- ▶ Having pre-identified key people and core teams to manage the entity when time comes
- ▶ Having identified and built key processes, reporting requirements, risk controls, governance arrangements etc.
- ▶ Having worked out financing requirements: capital instruments, but also liquidity

# Getting prepared for the asset separation tool

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## ▶ Definition

The resolution authority 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 (**= defeasance**)

## ▶ Constraints

Wholly or partially owned by one or more public entities (including the resolution authority and the resolution fund) and controlled by the resolution authority

## ▶ Target/ Needs (illustrative preliminary list)

- ▶ Working out on a target structure (JV or publicly owned vehicle?), having it ready or a detailed process to create it
- ▶ Working out on the desired performance fee structure
- ▶ Having a ready-to-launch request for proposal to select professional managers in the concerned assets able to provide management services to the defeasance structure (and even to take a share in the JV)
- ▶ Having pre-identified key people/ professionals (depending on the assets etc)

# Getting prepared for the bail-in tool

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

# Getting prepared for the bail-in tool

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## ▶ 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

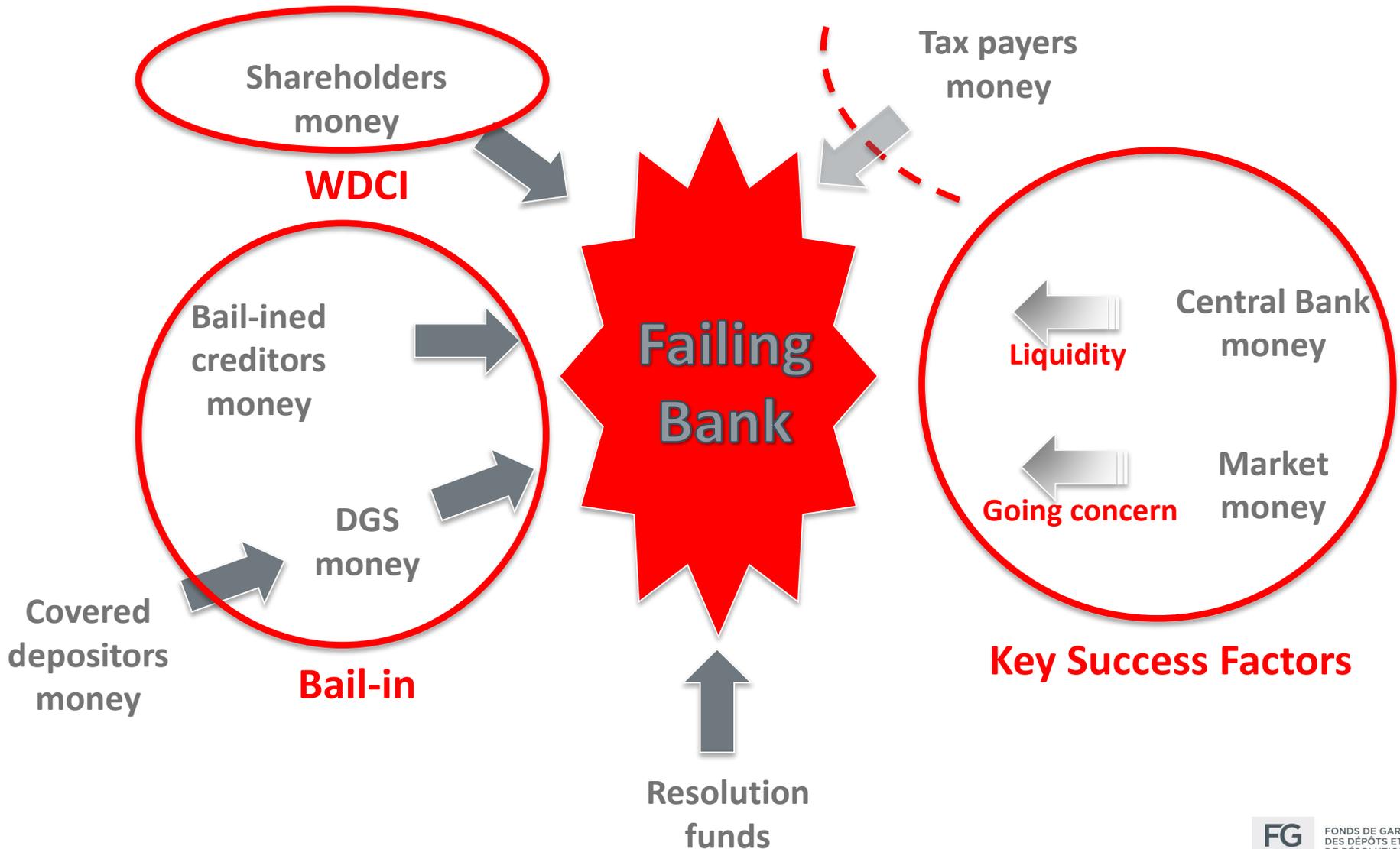
## ▶ Constraints

- ▶ 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?

# Key success factors in resolution



# Implementation challenges

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## 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 strengthening 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

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## Uncharted territories

- ▶ **Timing, the essence (decision-making process)**
  - ▶ 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
- ▶ **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

# Implementation challenges

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## Uncharted territories

- ▶ **Bail-in and WDCI implementation:** 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 Real (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
- ▶ **Bail-in and WDCI implementation: challenges**
  - ▶ Scope: what use should be made of the possible exclusions?
  - ▶ WDCI or bail-in? Will we dare bailing-in senior debts? non covered deposits?
  - ▶ 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?

# Implementation challenges

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## 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

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## Uncharted territories

### Some conclusions

- ▶ Need for appropriate bank resources on recovery and resolution plans
- ▶ Need for advanced and thoroughful preparation by (all) authorities
- ▶ Need for pragmatism in implementation phases
- ▶ Probably just a starting point...



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