



The resolution framework in Europe

what is in place, what is the practice, what needs to be done



INSTITUT BANCAIRE ET FINANCIER INTERNATIONAL
INTERNATIONAL BANKING AND FINANCE INSTITUTE

SEMINAR

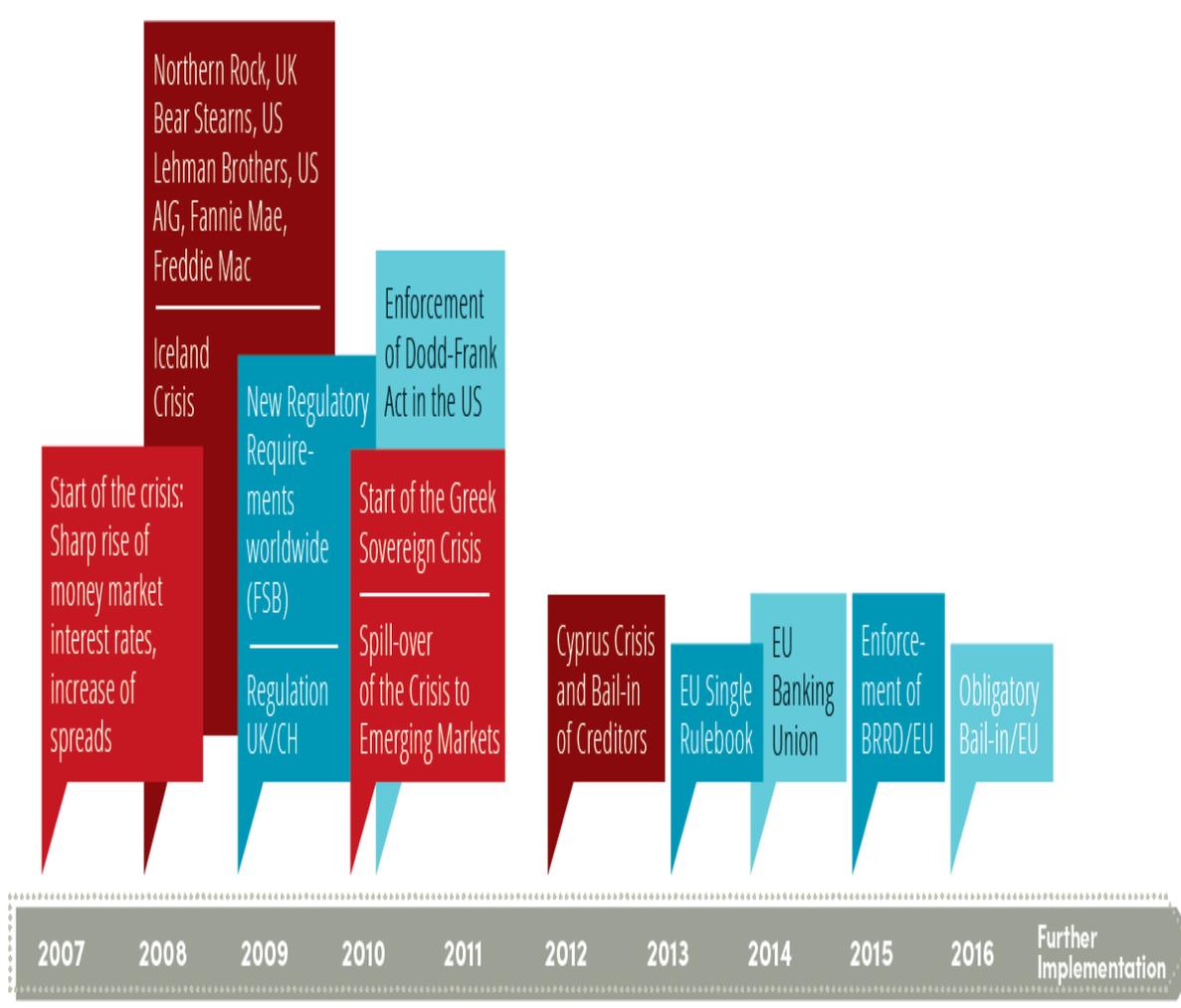
LEGAL EXPERTS AND FINANCIAL CRISES :
PREVENTION, MANAGEMENT, RESOLUTION

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1.1.

What is in place Resolution: a response to the crisis



The financial crisis 2007-2009 revealed

- a lack of clarity about how to react to distressed banking sector
- Serious shortcomings in the tools available to deal with failing banks without interrupting the provision of systemically critical functions to customers and the economy in large

Source: Understanding Bank Recovery and Resolution in the EU: a Guidebook to the BRRD (World Bank Group – April 2007)

1.2.

What is in place

Need to end with fiscal interventions to restore financial stability



COSTS OF THE CRISIS (2007–2009)

Nationalization of Banks*	29
Gross restructuring support for countries concerned*	In % of GDP 0,7–7,7
Liquidity support*	%-points 1,1–18,3
Asset purchases and guarantees*	In % of GDP 0,2–13,4
Other measures taken included guarantees for liabilities and bail-in of creditors (Cyprus)	

Source: Understanding Bank Recovery and Resolution in the EU: a Guidebook to the BRRD (World Bank Group – April 2007)

A regulatory response:

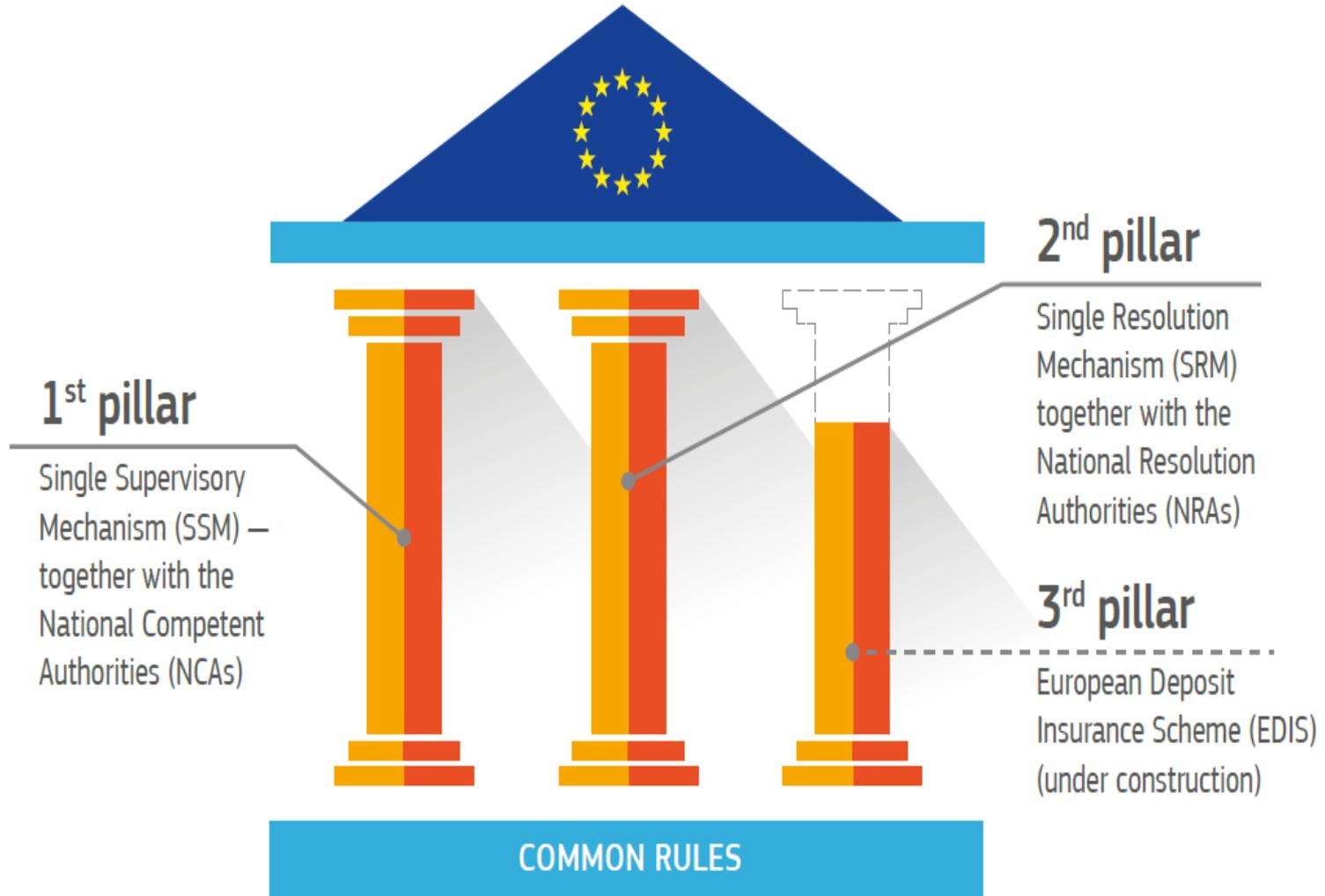
In 2008, the G20 called for strengthened cooperation on crisis prevention, management and resolution to permit an orderly resolution, including of large complex institutions, without public bail-out.

⇒ high-level principles for cross-border cooperation on crisis management

⇒ key Attributes of Effective Resolution Regimes for Financial Institutions

1.3.

What is in place The European response: Three Pillars



1.4.

What is in place Resolution: objectives

Mission: to ensure an orderly resolution of failing banks with minimum impact on the real economy and public finances of the participating Member States and beyond

- Participating Member State (euro area)
- Non-participating Member State (non-euro area)



1

- Establish **uniform rules and procedures for the resolution of entities**
- Establish a **credible and feasible resolution regime**
- **Remove obstacles** to resolution in order to make the banking system in Europe safer
- **Ensure unified decision-making process** for resolution within the Banking Union to foster market confidence
- **Minimise the cost of resolution and avoid destruction of value** unless necessary to achieve the resolution objectives
- **Provide key benefits** for taxpayers, banks, deposit-holders and contribute to financial and economic stability in the entire EU



1.5.

What is in place Resolution: a set of tools



Different **tools** are used to **safeguard public interests**, including the continuity of the bank's critical functions and financial stability, at minimal cost to taxpayers.



1.6. What is in place

FOLTF (failing Or Likely to Fail) and PIA (Public Interest Assessment)

As a principle, the Resolution authority should be a separate body from the Supervisory authority, but **continuity between supervision and resolution is essential**



Single Supervisory Mechanism (ECB + NCAs)



PRE-CONDITIONS TO RESOLUTION





2.1.

What is the practice Risk of bail-out reduced

The **risk of bail-out has been reduced** with the implementation of TBTF reforms, perceived as credible by the market and credit rating agencies

- The credibility of the bail-in mechanism is translated into **greater market discipline**, as evidenced by investors' pricing of bank debt, bail-in risk. The required return on TLAC-eligible debt instruments is higher than the senior unsecured debt, which is also deemed risky
- The **probability of public intervention**, reflected in the rating of SIBs' credit risk is also **seen as low** by credit rating agencies in jurisdictions where resolution regimes (including the bail-in mechanism), are considered credible



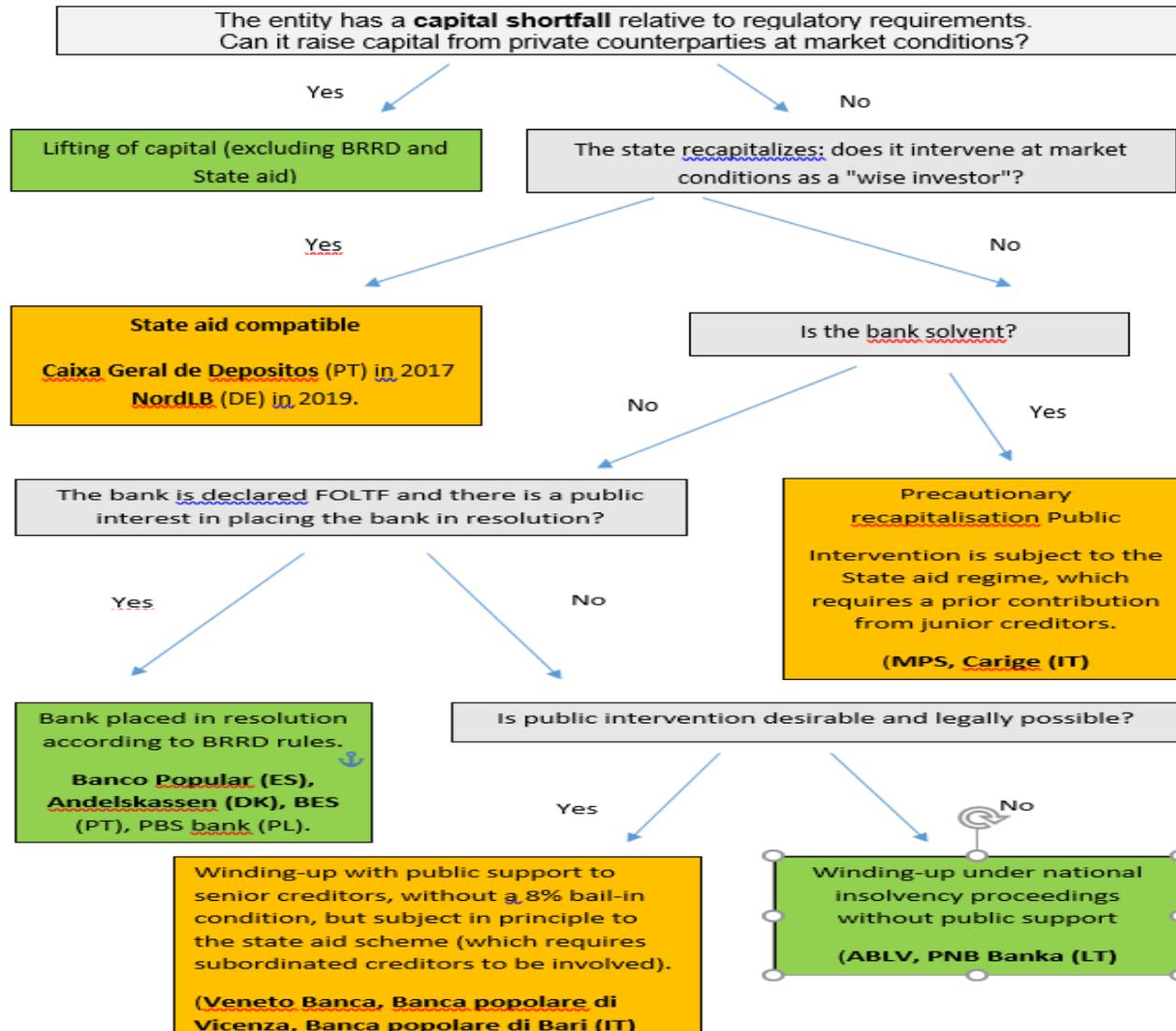
2.2.

What is the practice Limited use of bail-in

As resolution regimes have so far not been tested (with the exception of a few cases), the authorities' **propensity to bail-in and the effectiveness of this mechanism remain to be determined:**

- Public support for banks in distress, especially smaller ones, continues, possibly reflecting recent and still incomplete implementation of resolution reforms in some jurisdictions. Such support could also be provided to facilitate the restructuring and liquidation of banks after loss absorption by shareholders and junior creditors.
- Some persistent shortcomings such as lack of information on TLAC debt holders may constitute obstacles to the operationalization / effectiveness of the bail-in

2.3. What is the practice Crisis management practices under BRRD / DGSD





2.4.

What is the practice

Practice different compared to what expected (1/2)

Public recapitalizations were used to avoid the resolution of failing institutions.

1. The BRRD authorizes exceptional and supervised recourse to preventive recapitalizations in order to prevent resolution proceedings from being opened.
2. Recurrence of public recapitalizations in the Banking Union challenges the existing legal framework.
 - an alternative to the implementation of the resolution tools under the BRRD, in particular to bail-in involving all creditors.
 - the frequency of such preventive recapitalizations does not correspond to their purpose, namely to constitute an exceptional tool for specific cases of failure
 - these recent disasters raises a level playing field for banks established in the jurisdictions which wish to use of resolution tools as a preferred scenario for crisis management



2.4.

What is the practice

Practices different compared to what expected (2/2)

The repeated use by certain deposit guarantee schemes of preventive or alternative measures under the DGSD also raises questions.

1. The DGSD authorizes the deposit guarantee schemes to take preventive or alternative measures, i.e. to mobilize their resources other than for the compensation of depositors
2. The relationship between preventive action by DGSs and the European State aid framework remains uncertain and should be clarified.
3. The practice of alternative intervention is supported by the narrow interpretation of the concept of public interest by the SRB



3.1. What needs to be done

Effective solutions for all categories of banks (1/2)

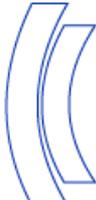
1. The framework currently appears to contain **incentives towards using tools outside of resolution**, driven mainly by the different conditions to access funding within and outside of resolution and by a restrictive approach to the public interest assessment
2. There are currently differences across Member States in the **availability and actual use of tools in insolvency**. In some jurisdictions, insolvency proceedings provide tools similar to those available in resolution creating discrepancies, even among jurisdictions participating to the banking union
3. The legal **certainty and predictability of the current** framework is sub-optimal, particularly in a cross-border context



3.1.

What needs to be done Effective solutions for all categories of banks (2/2)

4. Several impair the objective to **foster further market integration**, among other things, the lack of agility in the management of resources at central level for cross-border banking groups and the misalignment between liability (i.e. who bears the costs of bank failures) and supervisory control (i.e. who is in charge of preventing and handling of such failures) in the safety nets of the Banking Union.
5. **Discrepancies in depositor protection** across Member States in terms of the scope of protection and payout processes are observed and may undermine the confidence in the financial safety nets



3.2. What needs to be done

Harmonized administrative liquidation regime as a solution?

Aligning the framework with practice through the establishment of a harmonized administrative liquidation regime in Europe to facilitate the management of claims by banks which are said to be "too small to be resolved but too big to be wound up".

An administrative liquidation would consist in a public intervention to the creditors to deal with claims of deposit-financed small and medium-sized banks (while bail-in would place the burden on their creditors, including uncovered depositors).

There a risk to duplicate the existing resolution framework, which already provides for business transfer tools, while diminishing the relevant requirements for these banks in accordance with a proportionality principle (MREL requirement, contributions to resolution funds, etc.), with a significant risk of distortion for large systemic banks

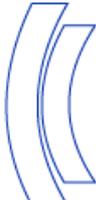


3.3.

What needs to be done

French views: principle of equal treatment of creditors (1/2)

- A clarification of the conditions for recourse to preventive recapitalizations established by the BRRD
- Alignment of the Commission's State aid guidelines for the banking sector with the shareholders and creditors share burden set out in the BRRD, to ensure that shareholders and creditors of the same seniority are treated in the same way in a public recapitalization as in a public body resolution
- The classification of the preventive and alternative measures by DGSs as State aid, with particular regard to the provisions of DGS2



3.3.

What needs to be done

French views: principle of equal treatment of creditors (2/2)

- Opposition to a new harmonized regime for administrative liquidation, which would create a significant risk of distortion for large banks
- Support for the development of resolution tools already existing in the BRRD other than bail-in (in particular business transfer tools), even though the existing framework (MREL requirements, conditions of access to mutualized funds) is to be adapted to the specificities of small and medium-sized banks financed by deposits on the margin
- Advocacy for a broader interpretation of the notion of public interest by the SRB to limit national crisis management cases that effectively involve public intervention