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Resolving banks in Europe

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Agenda

The new EU rules on crisis management are among the most significant responses to the financial crisis: banks' failure must be credible (no TBTF) and feasible with no threat to financial stability and with minimum involvement of taxpayers money

Some issues are still open:

1. Resolution funding

2. Framework for "non resolution" banks

1. Available funding in resolution

There are virtually **three sources of funding** that can be used in resolution:

1. Bail-in → already available, but banks are building up their MREL;
2. Single Resolution Fund → not fully built-up before 2024; limited firepower; strict access conditions;
3. Public backstop to the SRF → still missing.

Still halfway across, at least until adequate MREL levels will not be reached

1. Available funding in resolution

- Since the entry into force of the BRRD **different strategies** were adopted:
    1. Four mid-size banks (Italy - 2015) → resolution involving the write-down of shareholders and subordinated creditors + intervention of the national resolution fund;
    2. Banco Popular (Spain - 2017) → resolution involving a sale to a private purchaser and write-down of shareholders and subordinated creditors;
    3. Two Venetian banks (Italy - 2017) → no public interest for resolution, liquidation involving a sale to a private purchaser and write-down of shareholders and subordinated creditors + State liquidation aid
    4. ABLV (Latvia and Luxembourg – 2018) → no public interest for resolution

  [Source: SRB, *Annual Reports* (2016; 2017); World Bank, *Bank resolution and “bail-in” in the EU: selected case studies pre and post BRRD* (2017)]
- **One main common feature:** no bail-in was applied to senior creditors

No MREL → no bail-in → no fully-fledged resolution

1. Available funding in resolution

How fast can the process be?

- According to the EBA analysis of a sample of 112 EU banks, under the current MREL framework, the funding needs – calculated according to a consolidated approach – range **from EUR 131.5 to EUR 1031.5 billion**, depending on assumptions on calibration and subordination. [Source: EBA, Quantitative update of MREL Report (2017)]
- Shortfalls may increase in a hard-Brexit scenario due to sudden disqualification of UK-law instruments.
- 70% of Significant Institutions are not listed, 60% have never issued AT1 instruments and 25% have not issued subordinated debt (T2). [Restoy, *Bail-in in the new bank resolution framework: is there an issue with the middle class*? (2018)]

1. Available funding in resolution

Building up MREL is essential to make resolution feasible and credible. This requires:

- to increase transparency in the pecking order, by layering the banks' liabilities (including through subordination and/or depositors preference) (*limit legal risk*)
- to discourage both MREL cross-holdings and retail investments: institutional investors as the main MREL subscribers (*limit contagion risk*);
- to provide for a long and smooth MREL phasing-in regime to address potentially high shortfalls, also in light of limited market absorbing capacity, and reduce the increase in funding costs and the impact on lending (*limit macro-prudential risk*).

2. Framework for “non resolution” banks

“Resolution is for the few, not the many: insolvency remains the primary route for failing banks”

[E. König, *Why we need an EU liquidation regime for banks* (2018)]

- Many banks (even SI) are likely not able to tap capital markets to issue MREL-eligible instruments.
- Insolvency is *de facto* the only available strategy for these banks. Segmentation between: large banks -> resolution **VS**. other banks -> national insolvency.

However, while resolution ensures that crises can be managed in a way that preserves at least part of the firm value and reduces creditors’ losses, the same does not always hold true for insolvency.

2. Framework for “non resolution” banks

What’s insolvency?

- Piecemeal liquidation? … but value-destroying and requires large DGS payout.
- Orderly liquidation (failing banks still exiting the market, but some of their assets and liabilities transferred to other banks)?
- Logically to be preferred, … but little room in Europe. It would require to:

1. identify adequate funding
2. reinforce the possibility of DGS alternative interventions
3. re-think the consequences of the DGS’ super-priority and how to assess the least cost criterion

2. Framework for “non resolution” banks

- The issue is gaining attention among legal and economic scholars, regulators, standard setters and resolution authorities. The FSB Key Attributes and the IMF 2018 FSAP fore the Euro Area Policies call for an ad hoc procedure to orderly liquidate failing banks by minimizing value destruction

- No straightforward solution; different trade-offs: minimizing costs, minimizing disruption from failures, minimizing operational and financial risk, minimizing liquidity needs, minimizing moral hazard and encouraging market discipline

2. Framework for “non resolution” banks

An option to explore could build on the US experience, where the FDIC has an ample set of powers to resolve non-systemic banks (including through use of the Deposit Insurance Fund to finance P&A transactions) with the aim of maximizing recovery and minimizing costs for the FDIC.

THANK YOU