Implementing Financial Sector Resolution

Report on first meeting

23 June 2015

Among the many responses to the financial crisis, the most novel has been the insistence on creating resolution frameworks for the financial sector. For each bank there must now be detailed recovery and resolution plans readily available, which are prepared by the banks and the resolution authorities, respectively. The set of terms and conditions already envisaged for the banking sector is now on the table for insurance and market infrastructures.

In the coming months, the group of senior representatives from banks and other financial institutions, infrastructures, government and associations as well as academics and other experts will meet regularly for in-depth discussions of the unresolved issues related to the EU’s resolution mechanism. By the end of the year, the group, chaired by Thomas Huertas, will arrive at a series of policy recommendations, focusing on the implications of the resolution and recovery regime for EU banks and its adaptation to insurers and CCPs.

A kick-off meeting of a new Task Force was held at CEPS to explore various issues regarding resolution in the financial sector. In particular the priorities of the task force were discussed, preparation of the Single Resolution Board as well as the implementation of a new recovery and resolution framework for banks at both European and global level were discussed.
Implementing Financial Sector Resolution

Chairman’s opening address
Thomas Huertas (EY & Chair of the Task Force)
- Resolution important part of new financial legislative framework
- Still pending issues regarding implementation of banking resolution and design of the resolution framework of non-banks
- New framework in Europe, but global context should not be ignored

Tour de table
Objectives of participants
- There might still be issues regarding the bank resolution legislation, but implementation is considered the most urgent matter (e.g. execution of resolution planning by the SRB)
- Implementation of TLAC/MREL, especially in cross-border context
- Cross-border resolution (incl. third-country bank resolution)
- Impact of resolution on Too Big to Fail (TBTF) problem
- Real impact of the legislation of the past years (e.g. implementation of new financial legislative framework (incl. BRRD) and macro-economic consequences)
- Working of early intervention in practise
- Investor knowledge about the implications of bail-in (i.e. meaning of subordination)
- Impact on diversity/decentralised banking groups
- Issues regarding developments of non-bank resolution
- Understanding the differences between resolution of banks and (re)insurers
- More balanced view on financial resolution, accounting for specificities of insurance groups and other non-bank institutions
- Resolution of CCPs (e.g. triggers, tools, practicalities, etc.)
- Transparency on corporate structures
- Impact of resolvability requirements and processes on the structure of financial institutions
- Necessities to complete the resolution framework
- Coming up with some suggestions on how the EU should proceed

SRB policy priorities and preparation
Invited speaker
Mauro Grande (Single Resolution Board)

- SRB is a European agency, comparable to the ESAs but contrary to the ESAs the SRB depends not primarily on the European Commission and National Competent Authorities for its funding, but on the contributions from supervised banks instead for their funding
- SRB started earlier this year, with the help of different DGs
- Governance is peculiar with executive board of six members plus European Commission and ECB as observer. The executive board is responsible for interventions, while plenary is responsible for more horizontal issues
- Staff currently being hired (120 by the end of 2015 and 250 when fully in force)
- SRB is directly responsible for resolutions tasks of 150 Euro-area banks that are significant and/or cross-border well as responsible for smooth functioning of system as a whole. Not clear yet whether the list of non-systemic cross-border banks will be disclosed by the SRB or not. Currently defining which banks are cross-border (e.g. branch, single subsidiary, or multiple subsidiaries). The SRB can take over responsibilities from the national resolution authorities (NRAs) at
Implementing Financial Sector Resolution

the request of the NRA or in can impose itself at the moment that the NRA is not following the legislative requirements, it has two tasks:

- Resolution planning (since 2015 responsibility of SRB)
  - G-SIBS [benefitting from crisis management groups of the FSB] are prioritised, others will follow later
  - Resolution manual for all banks, like the supervisory manual of the ECB
  - Strategies for different banks (e.g. SPOE vs MPOE, resolvability, legal risks [subordination statutory vs contractual], MREL vs TLAC)
    - Inside the banking union the SPOE approach should be considered, while outside depends
    - The Single Point of Entry (SPOE) is the view of the US in the case that it is the home-supervisory. Otherwise, it will be in favour of the Multiple Point of Entry approach
  - There is a need for a certain degree of transparency on recovery and resolution to the investment community. But how this will be done is still unclear

- Resolution action (from 2016 responsibility of SRB)
  - Collaboration with NRAs
    - The NRAs are responsible for the national execution
    - Currently confronted with differences in speed of developments (e.g. implementation of BRRD)
    - Thinking about how to structure the organisation of the organisation for resolution teams (e.g. like Joint Supervisory Teams but maybe for several banks etc.)
  - Communication with ECB
    - The SRB requires supervisory data to do its job, negotiating cooperation agreement with ECB to share the information (e.g. to get recovery plan). This to prevent that the burden on banks becomes unnecessary burdensome
    - The SRB is already entering the stage at the moment that the ECB starts executing the recovery planning. This is a delicate phase at which many things for the remainder of the resolution process are determined (e.g. time for resolution)
  - Cross-border cooperation
    - SRB becomes counterpart for host authority
    - Need for resolution colleges for banks with one leg in the EU
  - Role of externals
    - Valuation of the bank and legal implications
  - Resolution fund
    - Currently exploring the possibilities for bridge financing in case the funds from the Single Resolution Fund is insufficient
    - DG Comp should only come into play at the moment that the SRF is used. The judgement of DG Comp and the SRB on whether the intervention is necessary for financial stability and the amount of funds used minimal

➤ Recovery planning is the responsibility of the prudential supervisor (ECB needs to approve plans submitted by banks)
Implementing Financial Sector Resolution

- Issue of liquidity provisioning for ex-post bank. This entity should be a solvent, which does have access to the monetary funds. Depending on the availability of collateral (e.g. marginal lending vs ELA)
- SRB confronted with legal risks (e.g. BRRD preference for deposits, while pari passu in some national legislation), different approaches towards implementation, but increasing coordination among each other
- The implementation of the common back-stop is important to make the SRF more credible. Need to make sure that the back-stop is there also during the transition

Implementing a new recovery and resolution framework for the financial sector, a policy makers’ perspective
Invited speakers
Danuta Hübner (European Parliament)
Anna Jarosz-Friis (DG COMP - European Commission)
Georges Zavvos (Legal Service - European Commission)
Mark Adams (European Banking Authority)

- Accountability very important, imposed on independent supervisors through monitoring and public hearings
- Implementation is up to the member states and the European Commission. 6 or 7 MS have already adopted the directive so far, the remaining countries should follow around the summer. The EP, however, cannot do much to enforce consistency
- Possibility for non-EA countries to join the Banking Union. Increasingly separation between EA and non-EA countries (BU, but also five presidents’ proposal). Based on five presidents proposal the ESM might provide a credit line to the SRF
- DG Comp still relevant, since State aid is still possible within the context of the resolution funds. Although it is financed by the banks, it is considered State aid. To ensure harmonisation across member states DG Comp has gotten the authority
- When intervention is pure bail-in there won’t be a role for DG Comp, while in case of any support from resolution funds there is a need for an approval from DG Comp
- Recent example in Greece of bank (i.e. Panellinia) being bailed-in based on requirements similar to resolution requirements, which now forms a de facto requirement for DG Comp. The decision on Panellinia contains view on interaction between BRRD and State aid
- BRRD only implemented next year, but MREL requirement is already largely applicable in the ongoing year (bail-in of at least 8% demanded)
- The losses of the share- and debt holders depend on the losses that are measured by third-parties
- Legal issues regarding the BRRD should be well framed
- For the SRM there is no specific legal base like was the case of the SSM. This is especially important taking into account the far reaching powers that the agency has received
Legal certainty of paramount importance to prevent legal twists after the resolution decisions. It is important that the room for discretion within the SRB is limited.

Commission has a dual role. Hence it is the controller of State aid as well as of the power used by the SRB. Commission has possibility to interfere before decision is taken (24hrs).

Also role for Council when the funds from the resolution fund used exceed the threshold of EUR 5 billion.

EBA produces rules and guidelines under BRRD, of which most have already been delivered or will be delivered in the upcoming weeks.

EBA will write report for the review on the complementary of MREL with the international legislation.

It is important that the implementation of MREL (all credit institutions) won’t be causing problems for countries that apply TLAC (G-SIBS).

Provide guidelines/regulations for structure of resolution planning (e.g. decisions on resolvability, bail-in tools, etc.) and functioning of resolution colleges (e.g. too large to make it workable?)

Will work on transparency for investors to allow them to estimate loss given default.

Large overlap between representatives in the plenary of the SRB and the college of the EBA.

EBA has discussed the MREL proposal, which will be finalised and published in the upcoming weeks (no creditor worse off vs national insolvency regimes). If no-creditor is a problem, a solution needs to be found, e.g. higher MREL requirement (definitions of MREL differ across countries ES: tier 3; DE senior debt securities).

A bail-in can only be done once, if you make a mistake there is no second chance.

It is still unclear who is going the massive amount of MREL instruments (subordinated debt) that will be issued in the upcoming period.

The market expectation is that the bail-in will apply to equity more than to debt.

Impact on the banking sector

Invited speaker

Dhruv Roy (Standard & Poor’s Rating Services) [PRESENTATION]

The ratings aim to provide a view on the probability of default not to the loss-given default.

The bank ratings are based on a stand-alone rating on the banking risk, which is topped-up with a few notches depending on its systemic relevance and the strength of the central government.

The BRRD is a game-changer, making it very unlikely that banks will receive government support. This justifies erasing the government top-up. However, S&P is still making up its mind what the exact implications will be. The specificities of the legislation are still not completely clear (e.g. BRRD implementation). The reductions in government top-up can be compensated through strengthening loss absorbing capacity.

For less senior issuances the ratings had already been based on the stand-alone ratings for a longer period.

When the TLAC becomes applicable at subsidiary-level, it implies that the bank becomes less flexible in employing its TLAC capacity.
Implementing Financial Sector Resolution

- The ring-fencing initiatives will have similar implications. This might justify differences in ratings for different parts of the bank holding companies. Ring-fencing will impact resolvability, at least in theory, because the banks has already pre-sorted for a resolution.
- To accommodate that the BRRD is not applicable to the insurance entities, the Additional Loss-Absorbing Capacity (ALAC) threshold has been lowered for banks with insurance subsidiaries.
- The current differences between the market perception of risk and the credit rating is primarily explained by the QE, which has reduced the yields on debt securities below the fundamental levels.

Resolution in its international dimension

Invited speakers

Maria Nieto (Bank of Spain) [PRESENTATION] [personal views]
Franklin Allen (Imperial College London)

- The FSB is undertaking the initiative for resolution at global level, which is inspired by the EU approach.
- The main objective of the FSB policies is to address the too-bit-to-fail problem and reduce the moral hazard in banks and non-bank systemic financial institutions (e.g. identification G-SIFIs, loss absorption requirements, resolution planning standards, and supervision).
- The main challenge based on the FSB report is to come-up with an appropriate loss absorbing capital requirement (TLAC definition and quantity) as well as to make cross-border resolution actions enforceable (i.e. comprehensive group-wide resolution strategies).
- Member States may refuse to recognise or enforce third country resolution proceedings under specific circumstances (e.g. financial stability, unequal treatment domestic creditors, negative fiscal impact, and contrary to public policy).
- NRA can resolve branches of third country banks at the moment that the bank no longer meets its conditions.
- The resolution of international banking groups with presence outside the euro area will be arranged either through resolution colleges and non-binding EBA cooperation agreements (i.e. non-EU).
- The main challenge for the SRB is to be consistent over time and across countries. The political interference should be as minimal as possible.
- The bail-in tool is mend for stand-alone issue, not for systemic crisis.
- Resolving small banks works well in most cases, while resolving big banks seems to be difficult. Hence, the big banks have such a high penetration that a bankruptcy will influence market prices. The losses at the peak of the crisis are further often overstated, generating a premium for investors that are able to wait.
- Bail-ins are very difficult. There was a good reason why governments were hesitant for bail-ins. Markets will be distressed and roll-over of financing will be difficult. Moreover, there is still a contagion risk (banks holding debt paper of each-other).
- Bank failures are correlated. Multiple institutions under pressure fail at the same moment, the problems become systemic and the system might no longer able to run the necessary procedures and the resolution funds incl. backstop won’t be sufficient.
State-aid has, in general, not been that costly for governments, in most cases they even gained some money. In case there are losses that is often due to impatience of governments. By using the mark-to-market the losses are exaggerated. Taking a more long-term view might reduce the losses.

To build credibility of the SRB it would be ideal when first a few banks will fail and then a systemic institution on its own. The real solution, however, would be to have an EA/EU single rule-maker and federal/central government with deep-pockets.

You need to be very careful in moving from mark-to-market to historical valuation. But some times of severe crises demand it.

**Terms of reference of the Task Force**

Drafting of the report with recommendations to policy makers (focusing on Europe as well as other areas and both banking and non-banking [e.g. insurance and market infrastructures])

Themes already outlined in the issues paper

Next meeting in November will focus on (re)insurance and critical infrastructure

Will send note for volunteers for sub-groups. The sub-groups should be developing the recommendations for the different areas. This to be able to make a significant contribution with thoughtful recommendations

A draft outline of the report will be circulated before the second meeting.

**Task Force documentation**

The information about the Task Force, including the Task Force Guidelines, programmes, presentations, meeting reports and background documentation is shared through this Dropbox-folder\(^1\). The documents can be retrieved using the download tool on the right hand side at the top of the Dropbox-website. Additional documentation of interest for the Task Force can be sent to vilde.renman@ceps.eu.

**Second Task Force Meeting**

The second task force meeting will be held on Friday 25 September 2015 in Frankfurt. The programme for this meeting are sent in due course to all TF participants.

---

\(^1\) Link to Dropbox-folder "CEPS TF on Implementing Financial Sector Resolution":
https://www.dropbox.com/sh/tzuszd4qtt7i0om/AACdBS3gBjRXRvmToWkFtLXa?dl=0