“Estimating the bridge financing needs of the Single Resolution Fund”

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  • Losses and need for intervention change over time
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Function of the Single Resolution Fund

• Provide funding for Single Resolution Board’s resolution actions (investment not covering losses)
• Covering Euro area banks
  • Focus on significant and cross-border banks
• Providing up to 5% (liabilities incl. own funds) after 8% bail-in
• Target size 1% of covered deposits (app. €55 bn) plus three years advance contributions
• Risk based contributions by banks
Functioning of the Single Resolution Fund

• Providing up to 5% (liabilities incl. own funds) after **8% bail-in**

• 8% bail-in of liabilities (= assets), needed later as capital must be 8% of (risk weighted) assets

=> 8% bail-in useful only if

\[
\text{risk weighted assets (RWA) < assets}
\]

• For small banks (RWA≈assets) bail-in needed to cover capital needs, binding limit is 5% of liabilities

• Especially for large banks can bail-in reduce funding need from SRF
Estimation of the funds required (I)

- 72 distinct banking groups received capital support (2007-14)
- 48 banks significant
- App. 45% of Euro area banking assets

Number of aided euro area banks (2007-2014)

Source: De Groen & Gros (2015)
Estimation of the funds required (II)

- No data for 10 less significant banks
- App. 40% of the banks: losses below indicative bail-in
- About a fifth need just bail-in plus SRF (<5% L.)
- Remaining quarter needs more

Distribution of peak cumulative losses of aided banks (2007-2014)

Source: De Groen & Gros (2015)
Estimation of the funds required (III)

Loss absorption tools to cover peak losses (2007-2014)

- 17 banks no need for additional funds to meet min. req. capital
- 14 banks would have needed bail-in (e.g. Dexia, Fortis)
- 13 banks need bail-in plus SRF funds
- For 18 banks bail-in plus SRF insufficient (i.e. €87 bn remaining)

Source: De Groen & Gros (2015)
Estimation of the funds required (IV)

Min. Bail-in contribution across BMs (% of total liab.)

- Statistical significant differences in the min. bail-in contribution across banks
- Bail-in contribution of diversified retail type 2, wholesale and investment much larger than other retail banks (higher RWA/TA)
- Differences between ownership structures less profound, though especially public banks seems to have a slightly higher bail-in capacity

Notes: The potential bail-in contribution is the difference minimum bail-in requirement (8% of total liabilities) and capital requirement (8% of risk-weighted assets)

Source: Ayadi & De Groen (forthcoming)
Estimation of the funds required (V)

Loss absorption tools to cover peak losses of SRF-funded banks (2007-2014)

- SRF-banks 6% of total banking assets
- Primarily small and medium sized banks (assets <€150 bn)
- AIB, Bankia, MPS only exception
- Total contribution €72 bn
- SRF contribution concentrated in Spain, Greece and Ireland (± 95%)

Source: De Groen & Gros (2015)
Estimation of the funds required (VI)

- Loss estimates uncertain: Supervisors ask for capital buffer?
- Cyprus (12%), Greece (8% + comprehensive assessment)
- Higher capital buffers: more bail-in needed (SRF investment safer)

Source: De Groen & Gros (2015)
Bridge financing required (I)

Cumulative contributions to Single Resolution Fund during transition (2016-2023)

- Ex-ante funds 1.0% of covered deposits
- Target size to be reached in 2023 (€55 bn)
- Ex-post contributions 3x max. annual contributions (max. 12.5% of target size per annum)
- During transition funds gradual mutualized and initial transfer of funds collected under BRRD in 2015

Source: De Groen & Gros (2015)
Bridge financing required (II)

Maximum SRF contributions in a single country during transition (2016-2023)

- Funds effectively available substantially less due to national compartments
- E.g. median ex-ante funds available for bank in single country €4.8 bn of €11.7bn collected (ex. transfer) in 2016

Source: De Groen & Gros (2015)
# Bridge financing required (III)

## Potential alternative funds available for resolution during transition (EUR billion, 2016-2023)

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</tr>
</thead>
<tbody>
<tr>
<td>Temporary transfer</td>
<td>2.4-3.5</td>
<td>2.5-3.6</td>
<td>2.8-4.0</td>
<td>2.8-4.0</td>
<td>2.5-3.6</td>
<td>2.0-2.8</td>
<td>1.1-1.6</td>
<td>0</td>
</tr>
<tr>
<td>Borrowing from third parties</td>
<td>21</td>
<td>21</td>
<td>21</td>
<td>21</td>
<td>21</td>
<td>21</td>
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<td>21</td>
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<tr>
<td>Sales of shares</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
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<tr>
<td>Borrowing from other resolution schemes</td>
<td>3.6</td>
<td>5.4</td>
<td>7.2</td>
<td>9.0</td>
<td>10.8</td>
<td>12.6</td>
<td>14.4</td>
<td>16.2</td>
</tr>
<tr>
<td>Deposit Guarantee Schemes</td>
<td>0.0-3.3(12)</td>
<td>0.0-4.4(17)</td>
<td>0.0-5.6(22)</td>
<td>0.0-6.8(27)</td>
<td>0.0-8.3(32)</td>
<td>0.0-10.0(36)</td>
<td>0.0-11.6(40)</td>
<td>0.0-13.3(44)</td>
</tr>
<tr>
<td>Total</td>
<td>39</td>
<td>46</td>
<td>53</td>
<td>60</td>
<td>67</td>
<td>73</td>
<td>77</td>
<td>81</td>
</tr>
</tbody>
</table>

Source: De Groen & Gros (2015)

- SRF-funds can be complemented with alternative funds
- Internally through borrowing during transition phase
- Borrowing from third parties difficult
- Resolution funds and deposit guarantee schemes gradually increase funds during transition
- ESM direct recapitalization instrument with €60bn facility cannot be used for SRF
- If all funds available in most circumstances already sufficient to withstand shock during transition
Bridge financing required (IV)

Potential alternative funds available for resolution during transition (EUR billion, 2016-2023)

<table>
<thead>
<tr>
<th>Required funds</th>
<th>Shortfall on SRF funds</th>
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<tbody>
<tr>
<td>Failure of a single bank (i.e. Bankia)</td>
<td>8.6-15.7</td>
</tr>
<tr>
<td>Failure of a small group of banks (i.e. 2012)</td>
<td>2.3-13.3</td>
</tr>
<tr>
<td>Failure of a large number of failing banks (i.e. 2009 plus 2010)</td>
<td>48.5-71.1</td>
</tr>
</tbody>
</table>

Source: De Groen & Gros (2015)

- SRF large enough to deal with most bank failures, only first year alternative funds required
- Continuation current trend would only with large cap buffers req. alternative funds
- Systemic banking crisis would ask for add. funds during most years up to app. €45 bn (standard and 12% capital)
Conclusions

• SRF would have required app. € 58 to € 101 bn between 2007 and 2014 (7 years, not point in time)
  • Less than a third capital support actually used (€ 335 bn)
• The fully-loaded SRF (€ 76 bn) would most probably have withstood the crisis
• First two transition years peculiar (but near term danger low? QE, etc.)
• Alternative funds might required during severe banking crisis during early transition
• Bridge financing up to € 45 bn
Policy remarks (I)

• Bridge financing facility of only for extreme case (max. € 60 bn)
• Conditional on BRRD ensures sufficient bail-in
• Contagion contained (who holds bail-in instruments?)
Policy remarks (II): further work needed?

• Improve methodology to estimate losses
• Ensure liquidity facility (funding for non bank)
• Need for monitoring (i.e. bail-in contribution, resolution risk, holding of bail in capital, sovereign exposure deposit insurance)
Reference:

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