



FONDS DE GARANTIE
DES DÉPÔTS ET
DE RÉOLUTION

*French deposit insurance
and resolution fund*

Bail-in and resolution financing within BRRD

March 2014

CONTENTS

- **BRRD**
- **Bail-in**
- **Resolution financing**
- **Contributions from banks**



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BRRD itself

Contents

- **Title 1: Scope, definitions and authorities**
- **Title 2: Preparation**
 - *Chapter 1: Recovery and resolution planning*
 - *Chapter 2: Resolution planning*
 - *Chapter 3: Intra group financial support*
- **Title 3: Early intervention**
- **Title 4: Resolution**
 - *Chapter 1: Objectives, conditions and general principles*
 - *Chapter 1A: Special management*
 - *Chapter 2: Valuation*
 - *Chapter 3: Resolution tools*
 - *Chapter 4: Write down of capital instruments*
 - *Chapter 5: Resolution powers*
 - *Chapter 6: Safeguards*
 - *Chapter 7: Procedural obligations*
 - *Chapter 8: Right of appeal and exclusion of other actions*
- **Title 5: Cross-border group resolution**
- **Title 6: Relations with third countries**
- **Title 7: Financing arrangements**
- **Title 8: Penalties**
- **Title 9: Powers of execution**



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Resolution instruments in BRRD

Resolution instruments

- **Resolution tools:**
 - ***Sale of business tools***
The Resolution Authority (RA) can force the selling or transfer of shares, assets and liabilities of the failing institution to the market
 - ***Bridge institution tool***
The RA can 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 can 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**
 - ***Government financial stabilisation tool***
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



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The bail-in concept

- **A simple idea**

Granting an administrative authority (the “Resolution Authority” – “RA”)

With the power,

In case a bank looks likely to fail,

To write down or convert capital and debt instruments to:

- Pass expected losses to existing risk holders
- Reduce the liabilities of the bank
- Rebuilding the capital base

- **Close to what a liquidator would do after a failure, but:**

- **Before the failure**
- Quickly and in an orderly manner
- Not by a judicial authority
- With the hope that an actual failure will be avoided, the critical functions and a part of the value of the bank will be preserved

- **Therefore, in respect with the “no creditor worse off than in liquidation” principle (NCWOL)**

- **Open questions**

- When, how and by whom?
- Which liabilities?

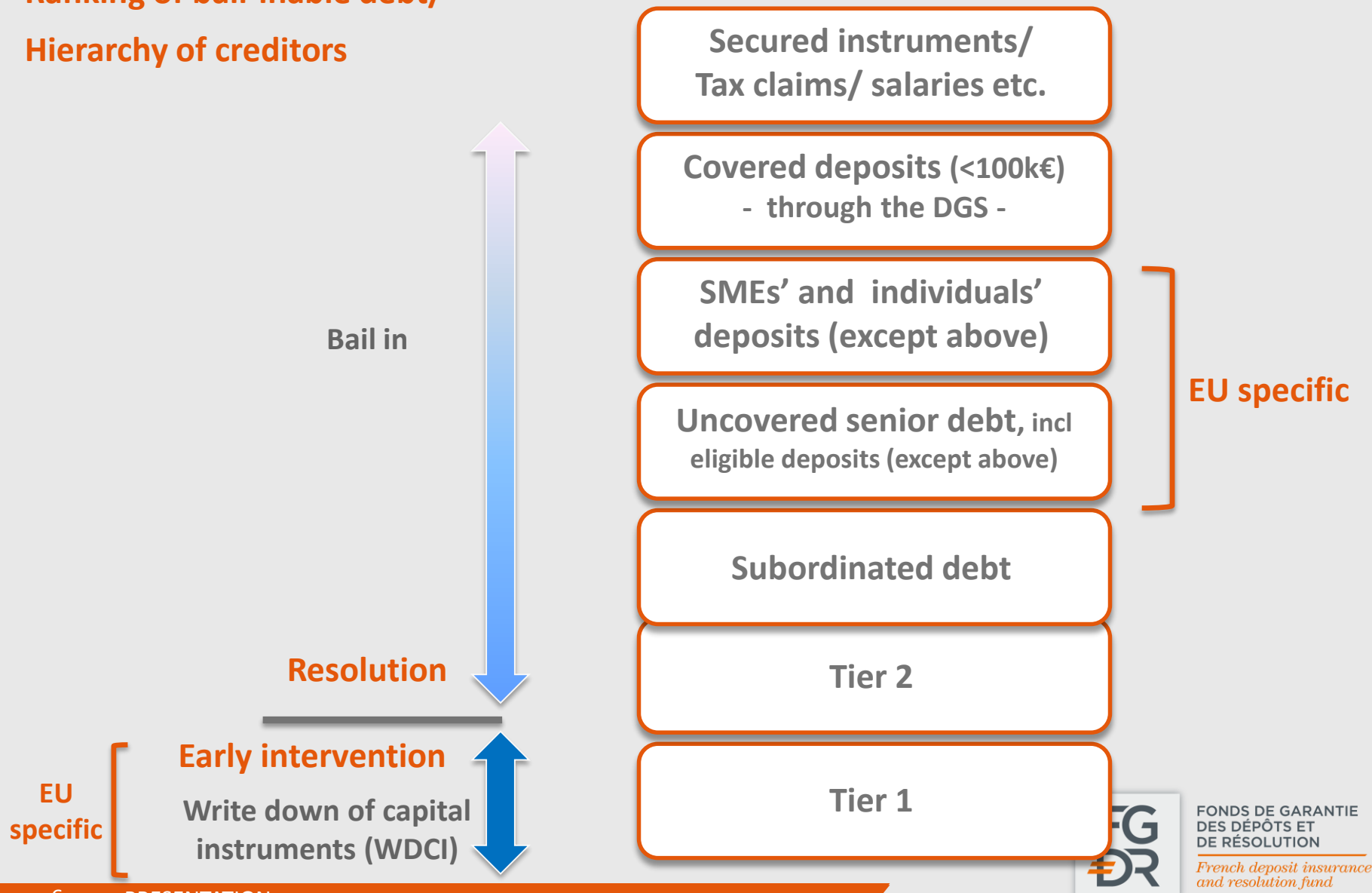


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Bail-in as seen in BRRD - 1

Ranking of bail-inable debt/

Hierarchy of creditors



Bail-in as seen in the BRRD - 2

PRINCIPLES

- Articles 37 to 50d (25 pages or so) dealing with:
 - The bail-in tool itself
 - Minimum requirements for own funds and eligible liabilities (MREL)
 - Implementation of the bail-in tool
 - Various ancillary provisions (so far including the government stabilization tools - public equity support tool and temporary public ownership tool)
- What for?
 - Recapitalizing an institution so it could be viable again, together with other resolution measures
 - Converting to equity or reducing the liabilities that are transferred to a bridge institution, through the sale of business tool or the asset separation tool (i.e. forcing existing shareholders and debt owners to take their share of the restructuration/ resolution costs)
- Exclusions from the scope
 - Covered deposits (through DGSD) and contributions to DGSs
 - Secured liabilities (including covered bonds)
 - liabilities arising in virtue of the holding of client assets or client money
 - Interbank operations (except within the group), with an original maturity shorter than 7 days
 - Liability towards employees, tax administration, critical commercial creditors etc

Bail-in as seen in the BRRD - 3

EXCEPTIONS: PRINCIPLES

- Optional exclusions from the bail-in scope, “in exceptional circumstances” for:
 - 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
- When the RA practices such exclusions, it could increase accordingly the level of write down or conversion of other bail-inable liabilities (while staying compliant with NCWOL principle)
- If the RA does not increase accordingly the losses for other bail-inable creditors, and as long as the contribution to loss absorption and recapitalization of the bail-in is higher than 8% of the total liabilities of the bank (including own funds), then:
 - the resolution fund could make a contribution to restore the net value of the bank to zero or to capitalize up to 5% of total liabilities (including own funds)...
- In “exceptional circumstances”, after the resolution fund has financed the 5% above, and as long as all unsecured non preferred liabilities other than eligible deposits have been written down or converted in full, the RA could seek “alternative financing” (i.e. state resources)



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Bail-in as seen in the BRRD - 4

EXCEPTIONS: MODALITIES, PROCESS & EXCEPTIONS' EXCEPTIONS

- To finance this up to 5% contribution, the resolution fund could use:
 - its existing (ex ante resources) – art 94
 - ex post contributions – art 95
 - then, alternative financing means (i.e. borrowed money) – art 96
- The optional exclusions of the bail-in scope should be notified to the European Commission
 - In case financing is sought for from the resolution fund or from alternative financing sources, the Commission has a right to prohibit or amend the exclusions of the bail-in scope, especially if the integrity of the Single Market is put at risk

Exceptions' exceptions

- If the resolution fund's ex ante resources (article 94) have not been depleted after the financing of the 5% contribution, the remaining ex ante resources of the fund could be the source or a part of the “alternative financing”
- Notwithstanding the 8% limit above, the RA could contribute to the resolution financing as long as
 - the contribution to loss absorption and recapitalization of the bail-in is higher than 20% of the risk weighted assets of the bank
 - and the resolution fund resources are larger than 3% of covered deposits in the country as a whole
 - and the failing institution's assets are below a €900 billion threshold



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Bail-in as seen in the BRRD - 5

WILL THERE BE ENOUGH DEBT AVAILABLE FOR BAIL IN?

- **Minimum Requirement for own funds and Eligible Liabilities (“MREL”)**
 - own funds and eligible liabilities as a percentage of own funds and total liabilities
 - determined by the RA for each individual institution
 - should take into account that some bail-inable liabilities could be excluded from the bail in in the end
 - Should take into account the systemicity and interconnectedness with the rest of the financial sector
 - eligible liabilities for the MREL are not the same than for the bail-in scope
- **Scope of MREL compared to the scope of bail in + WDCI**
 - remaining maturity of at least one year
 - deposits with no depositor preference
 - the purchase should not be funded by the institution
 - may include instruments issued under the law of a third country, if the institution demonstrates that the bail in by the RA could be applied
 - may include qualifying contractual bail-in instruments



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DE RÉOLUTION
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Bail-in as seen in the BRRD - 6

WHAT ELSE FOR THE BAIL-IN IN BRRD?

- Implementation of the bail-in tool
 - Modalities of the assessment of the amounts to be written down or converted
- Treatment of shareholders
- Sequence of write down and conversion (hierarchy of claims)
- Derivatives
- Rate of conversion of debt to equity
- Associated business reorganization plan
- Removal of procedural obstacles to bail-in
- Contractual recognition of bail-in (debt issued outside the European Union)
- Bail-in in cross-border resolutions



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Bail-in: uncharted territories

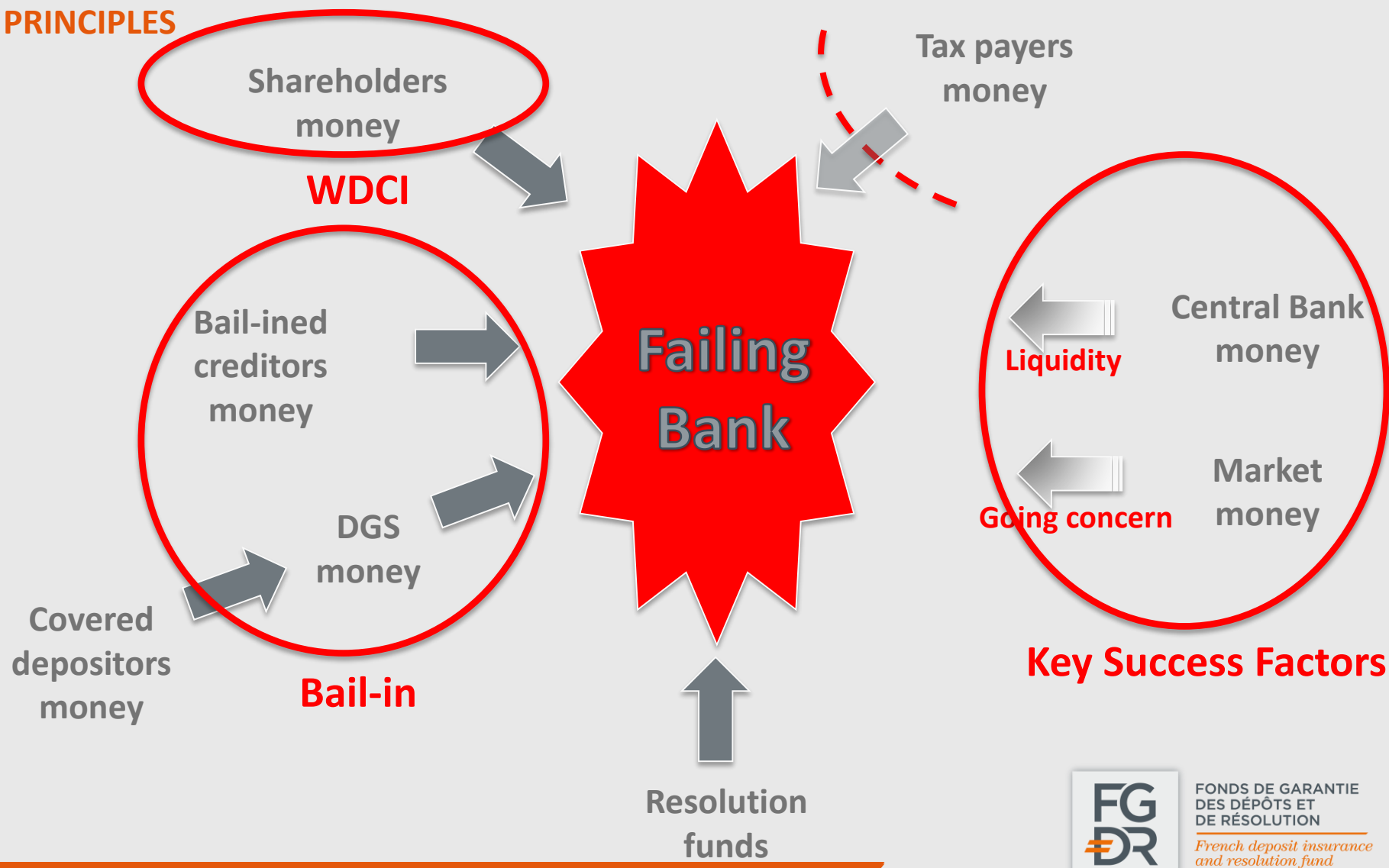
- **Too few and too specific cases for being already comfortable with the implementation of the bail-in instrument**
 - Cyprus crisis (2013): bail-in that encompassed non-covered deposits
 - SNS Real (Netherlands, 2013): bail-in limited to equity and junior debt
 - MB Bank (Italy, 2011): voluntarily bail-in to interbank creditors and the FITD
 - Real Bank (Hungary, 1998-99): equity wiped out, before a recap by NDIF
 - ...
- **Open issues with: operability/ market reaction/ accompanying measures/ liquidity/ parameters...**
 - within a weekend?
 - valuation of the losses/ assets/ liabilities. What if the valuation proves wrong?
 - with a **single point of entry** or a multiple one?
 - for SIFI's or also for smaller banks?
 - Influence of the initial funding structure/ (ex ante) resolution plan/ level of the MREL
 - gone concern or going concern? Open-bank bail-in or closed-bank bail-in? Will the market « buy » a going concern? What will the new shareholders do?
 - including senior debt or not?
 - including non covered deposits or not?
 - how to assess the possible disruption on markets and economy due to the bail-in itself?
 - cross border issues
 - ...



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Resolution financing - 1

PRINCIPLES



Resolution financing - 2

THE OBVIOUS PART

- Shareholders
 - early intervention – recovery plans (WDCI)
- Bail-inable creditors
 - in resolution
- DGSs, in lieu of covered deposits and up to the net losses they would have to bear in case of liquidation, and up to 50% of their target level, in case of:
 - virtual bail-in on covered deposits
 - use of other resolution tools



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Resolution financing - 3

THE LESS OBVIOUS PART

- **Public support**

- Contribution to bail-in, but only **after** the “8%”, after the “5%” and **after** all unsecured non preferred liabilities other than eligible deposits have been written down or converted in full

+

- Governmental financial stabilisation tools (public support equity tool/ temporary public ownership tool), after the other resolution tools have been applied up to the maximum practicable extent (**i.e. after the 8%**)

- **Resolution Funds**

- Contribution to bail-in, after the “8%”

+

- Guarantees, loans, contributions, purchases for:
 - The failing institution
 - The bridge bank
 - The asset management vehicle
 - The purchaser (in the context of the sale of business tool)
- **Caveat 1:** no transfer of losses to the resolution fund, no recapitalization by the resolution fund
- **Caveat 2:** if the actions above result in a transfer of losses to the resolution fund, then the principles set out for the bail-in instrument should apply (**i.e. after the 8%**)



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Contributions from banks - 1

- **Many Layers**
 - CRD 4
 - MREL
 - Contributions to DGSs
 - Contributions to national Resolution Funds
 - Contributions to the single European Resolution Fund
 - Systemic taxes and alike
- **How are those contributions...**
 - Calculated?
 - Split within the banking system?
- **Any possible effect on the banking system?**



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Contributions from banks - 2

Equivalences Français/Anglais

MSU = SSM

MRU = SRM

FRU = SRF

Deposit Guarantee Funds (DGSD)

Trilogue concluded

Resolution funds - RFs (BRRD)

Trilogue concluded

Single resolution fund (SRM)

Trilogue concluded

Total amount

Reference base

Covered deposits

Covered deposits

Covered deposits

Reference geog. area

Country

Country

SRM zone (= SSM)

Target level

0,8% (0,5% possible)

1%

1%

Individual breakdown

Base for contribution

Covered deposits

Total liabilities less own funds and covered deposits

Total liabilities less own funds and covered deposits

Reference geog. area

Country

Country

SRM zone (= SSM)

- DGSs are called as a last resort instrument because of the preference granted to covered deposits
- The resolution fund could be called before the DGS if necessary after 8% of the liabilities have been bailed-in
- Banks with large liabilities excluding deposits and own funds contribute the more to the RF/ Single RF
- At the same time, those banks have the largest bail-inable debt, and are therefore less likely to draw on the FR/ Single RF resources

Courtesy of H. Courtehoux - SocGen



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