



BRE BANK SA



Centrum Analiz
Społeczno-Ekonomicznych

◀ Procedura restrukturyzacji i uporządkowanej likwidacji banku – doświadczenia światowe, rozwiązania dla UE i dla Polski ▶

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Risk Sharing and Risk Bearing: New Generation
Regulations in Bank Insolvency Resolution
Dzielenie i ponoszenie ryzyka – nowa generacja
regulacji dotycząca uporządkowanej upadłości banku

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Reformed Bank Resolution: Summary Features

Resolution : Protect Depositors and creditors, but also assign losses according to pre-established rules/conditions.

Tools: asset separation, partial asset/liability transfers, bridge banks, debt write downs.

International Experience with Resolution Regimes

- **Germany – BaFin has asset/liability transfer powers, bridge bank creation, & creditor ‘cram downs’.**
- **UK – Wide range of resolution tools and a public ownership option, w/several qualitative triggers. Strong ex post shareholder rights to redress.**
- **Spain – Fund for Orderly Bank Restructuring has resolution powers and can contribute its funds to fill in balance sheet gaps. Central Bank revokes license upon resolution entry.**
- **Canada – Deposit Insurance Fund is the resolution authority. Several tools. “Depositor Preference” rule.**



Guiding Principles

- **Preservation of bank value (repeat), protection of deposits: all critical given economic stability if there is a deposit run.**
- **Because judicial/corporate liquidation at economic insolvency is too late: assets lose value and deposit runs occur. Costly for all!**
- **FSB and EU recommendations propose innovative measures. Several countries have already been practicing some (Canada, Japan, U.S., Malaysia, Spain, UK, Germany, Turkey).**

International Experience with Resolution Regimes

- **US – Deposit Insurer is the resolution authority. Several asset transfer, risk sharing, and gap funding tools using deposit insurance funds.**
- **Malaysia – Resolution authority is the deposit insurer - can halt a bank's operations, seize control, acquire shares w/out shareholder ok.**
- **Japan – Deposit insurer is res. authority: P&A, bridge bank, temp public ownership (if systemic).**
- **Turkey – Dep. ins./authority: Privileged creditor.**

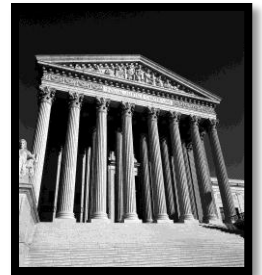
Benefits of the new resolution regime

- **Minimization of public funds and deposit insurance funds through preservation of assets of a failed bank & prompt transfer (w/deposits) to acquiring banks before full insolvency.**
- **Ability to stem financial system contagion or deposit runs by transferring working parts of balance sheet (or entire bank) to another bank.**
- **Resolution authority can be providing 'gap' funding to complete 'deal' provided it is not higher than payout cost to insured depositors.**



Assignment of Losses

- **The transfer/sale of assets with liabilities to a another (sound) bank, constitutes de “facto protection of depositors/creditors.” Thus no need for a cash payout to insured depositors or any unnecessary early closure of a bank.**
- **Creditors are assigned losses according to a hierarchy, *if insufficient assets exist to cover liabilities*. Creditors will not be worse off compared to traditional liquidation. Assets not transferred, are liquidated in order to pay non transferred liabilities/creditors (w/losses).**



Different Hierarchy of Creditor Claims

(a) Cost of services/TA to conduct resolution, (b) insured deposits, (c) secured senior creditors, (d) short term cash/labor contracts, (e) advances or loans of the deposit insurance/resolut. agency.

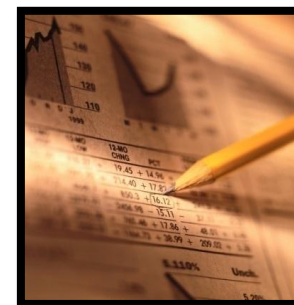
(a) Central Bank loans, (b) Other senior creditors, (c) other retail deposits (stratified by size), (d) unsecured creditors & bondholders, (e) loans from commercial banks

(a) Deposits from public sector, (b) subordinated loans, (c) general tax obligations.

(a) Other claims not included above, (b) shareholders of the institution being resolved.

Determining intervened bank's real capital position – Key step before applying tools

The resolution authority, with the financial supervisor, must assess the value of loans, assets, collateral, to apply correct loss provisions (and risk charges) and fix the real value of capital if any remains, or determine the capital deficit. Technical services may be contracted by the authority to conduct this. (Basel II, Pillar 2 powers)



Elaboration of some resolution tools

- The asset separation tool is meant to exclude non performing assets. These can be managed separately via contracted **asset management** outfits to get residual recoveries on 'bad' assets.
- Simple loan securitizations can facilitate asset transfers to more than one bank. These are “plain vanilla” securitizations. Banks acquire such securities as on-balance sheet items. Other banks or AMC's can manage underlying loans to collect for a fee (i.e., off balance sheet since such loans are collateral for the securities transferred).

Securitizing Loans to Distribute Assets

- Place loan assets of a failing bank into legal “trust” which will issue bonds of senior, mezzanine and subordinated rankings (e.g: A, B, C bonds).
- “A” bonds are most protected, e.g., covered by up to 150% of loan portfolio (“collateral”) to provide yield.
- This allows quick construction of viable transferable assets, with potential for several acquiring banks to participate (e.g.: if a large bank fails).



Resolution tools, continued ...



- The resolution authority may also participate in the financial structures, e.g.: a balance sheet 'gap filling' loan, capital contribution, temporary portfolio purchase, or other measure, to facilitate speedy transfer to other banks, if such contribution remains less than the quantum of insured deposit amounts.
- The bridge bank option should only be used after other resolution options have failed. The bridge bank objective is to temporarily own and manage it until it can be sold to a private investor/bank.
- The bridge bank must meet the financial supervisory agency's prudential and supervisory requirements.

Set-off, Netting, Termination Rights

- Collateralized securities, derivatives, structured transactions cannot be separated in resolution operations and are treated as combined (to avoid counterparty, systemic effects). Claims can be netted but not split.
- Creditors cannot terminate contracts only due to a resolution proceeding having begun.
- The resolution authority can suspend contracts in the interest of preserving asset value. Creditors can only terminate if default occurs. Invoking resolution is not a default.



License Revocation and its Equivalency

- **Besides the triggers to invoke resolution (quantitative/qualitative triggers related to insolvency or imminent failure) and the subsequent realization of losses, the fact is that triggering of resolution can immediately trigger license revocation and thus suspension of shareholder rights. Thus, even when not revoking the license, entering into resolution automatically suspends board, management and shareholder rights since virtually and regulatorily speaking, the bank has failed.**



Systemically Important Financial Institutions

Too big to fail SIFIs – What are the tools?

- Debt write down (can be used for non-SIFIs, but most likely for SIFIs where P&A transfers are too large to be absorbed).
- **Debt write downs: following shareholder write downs, subordinated creditors are written down. Recommended to use capital level/capital deficit as objective trigger for write down. Convertible debt to equity or COCOs (contractually pre-defined) can be an option too but harder to place as bondholders may not accept such a new asset.**
- Resolution and Recovery Plans – are mandatory for SIFIs.
- MoF/FSC can also provide, as part of banking support crisis measures, special lending or capital facilities, for all banks; but particularly apt for SIFIs.
- New approach: use the market to share risks.

