



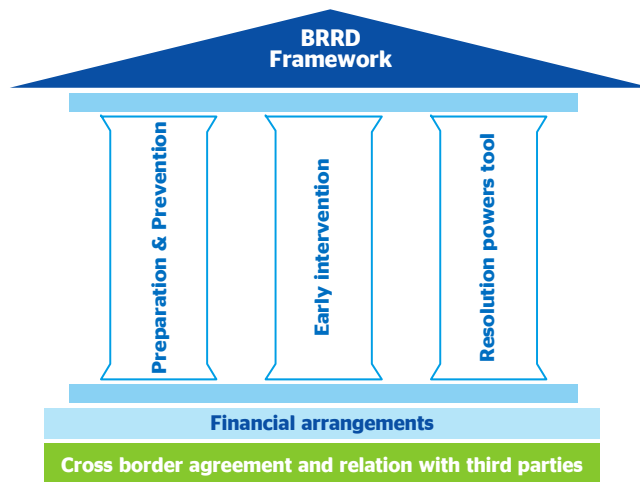
# Chapter B: The EU Bank Recovery & Resolution Directive

## 1. Introduction

On 15 April 2014 the Parliament approved the Bank Recovery and Resolution Directive (BRRD), after several months of negotiations between the Commission, the European Council and the European Parliament. The enforcement of BRRD is scheduled for 1 January 2015, and the bail-in regime will be introduced from 2016.

The goal of the Directive is to achieve a common framework of rules and powers that guide all 28 EU countries' intervention in banking crises. National resolution authorities are given some flexibility to resolve distressed institutions through a quick procedure which minimises financial and economic disruption.

Figure 4  
**BRRD's Pillars**



Source: BBVA Research

The BRRD is based on three main pillars, reflecting the different stages of the recovery and resolution planning and execution:

1. **Preparation & prevention:** banks must draw up recovery plans while resolution authorities must prepare resolution plans that ensure the continuity of critical functions.
2. **Early intervention:** the supervisor may activate the early intervention process if a bank does not meet regulatory capital requirements or is likely to breach them. The institution must restore its financial situation by implementing recovery measures, and/or adopting key reforms or restructuring its debt with creditors, among others.
3. **Resolution powers and tools:** the resolution phase is activated only if the two previous stages fail. Authorities would take control of the institution and activate any of the following resolution tools: i) sale of business, ii) bridge bank, iii) asset separation and iv) debt conversion or write down (bail-in, the main novelty).

This Chapter is divided into nine sections: (1) scope and resolution authorities, (2) preparation and prevention, (3) intra-group financial support, (4) early intervention, (5) resolution objectives, trigger conditions and general principles, (6) resolution tools and powers, (7) resolution fund, (8) cross border issues, and (9) next steps.



Finally, it is important to keep in mind that EBA will develop draft regulatory technical standards to specify a minimum set of triggers for the use of the measures provided below.

## 2. Scope and resolution authorities

### Which institution will be subject under the BRRD?

The Directive states that **all credit institutions and investment firms** established in the European Union should come within the scope of the regime. It also includes:

- EU financial institutions if they are subsidiaries of a credit institution
- EU financial holding companies
- Parent financial holding companies in a Member State
- Branches of institutions that are established outside the Union

In addition, when establishing and applying the requirements under this Directive, resolution authorities and competent authorities shall take account of the following topics related to each institution: the nature of its business, its shareholding structure, its legal form, its risk profile, size and legal status, its interconnectedness to other institutions or to the financial system in general, its interconnectedness to other institutions or to the financial system in general, the scope and the complexity of its activities and its membership of an institutional protection scheme (IPS).

### Who will be the Resolution Authority?

**Member' States will designate public authorities to act as resolution authorities.** Although a prescriptive list of the types of authorities is not provided, in practice, resolution powers will be granted to existing competent authorities, central banks or ministries. In the case of the eurozone (EU -18), the BRRD will be transposed by the Single Resolution Mechanism (SRM), and the resolution authority will be the Single Resolution Authority (see next Chapter for further details). The BRRD provides the technical tools for the SRM to develop resolution powers in the near future in the eurozone.

In order to avoid conflicts of interest between the supervisory and resolution functions, there must be clear and operational independence between the resolution and supervisory or other activities of the relevant authority, although the cooperation must be guaranteed.

The European Banking Authority (EBA) is given an important role in the supervision of the proposed framework and the development and coordination of cross-border recovery and resolution plans. The EBA will mediate in disagreements between relevant national authorities in the context of group recovery and resolution planning.

## 3. Preparation and prevention

The preparation and prevention stage sets the **preparatory steps and plans that are required to minimise the risks** of potential problems. In this sense, the BRRD requires institutions and resolution authorities to develop recovery and resolution plans respectively.

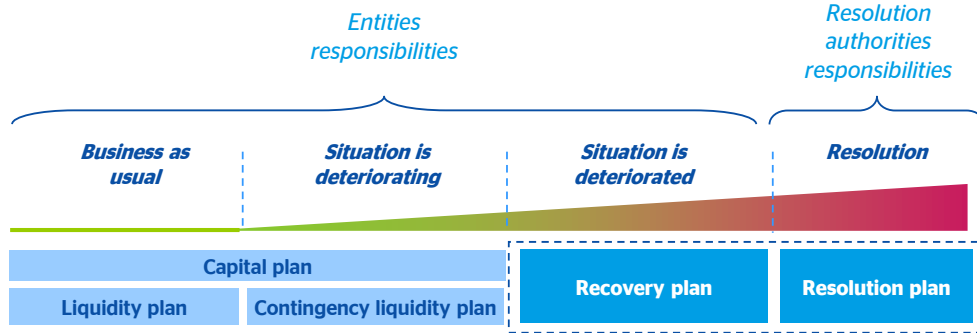
The **recovery plan complements the existing policies** and risk management framework with respect to capital and liquidity by including and analysing a menu of management actions under recovery situations. In this sense, it is understood that recovery becomes an extreme case, as it believes that management actions would be carried out prior to any such adverse situation, in order to cope with progressive deterioration of capital and liquidity.



Figure 4 shows the integration of the recovery plan in the corporate governance framework and in the overall risk management framework.

Figure 5

Integration of the recovery plan and resolution plans with other management policies



Source: BBVA Research

### Recovery plan

Institutions have to prepare and regularly update recovery plans. The requirement to prepare a recovery plan should, however, be applied proportionately, reflecting the systemic importance of the institution.

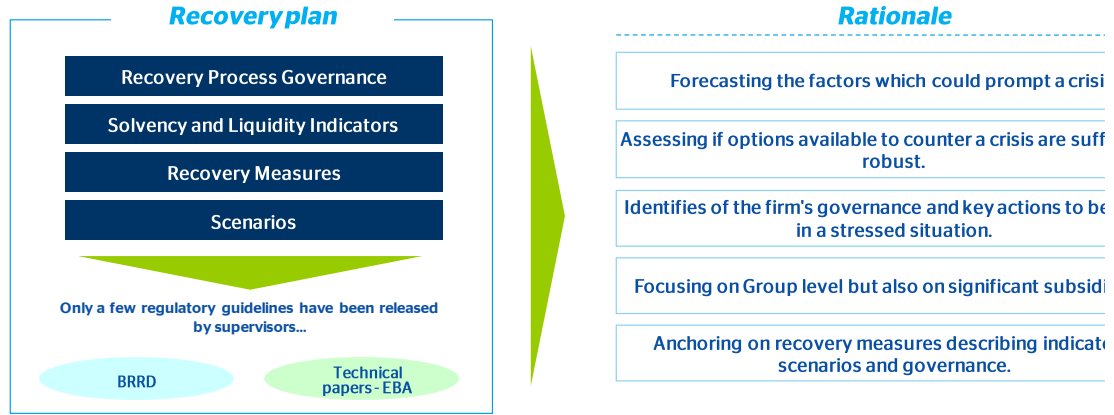
Moreover, the BRRD **sets out measures to be taken** by those institutions for the restoration of their financial position following a significant deterioration. Such plans should be detailed and based on realistic assumptions applicable in a range of robust and severe scenarios. Accordingly, the required content should also take into account the nature of the institution's sources of funding and the degree to which group support would be credibly available. **Institutions should be required to submit their plans to supervisors** for a complete assessment, including whether the plans are comprehensive and could feasibly restore an institution's viability, in a timely manner, even in periods of severe financial stress.

That is to say, **institutions will be required to draw up recovery plans** setting out arrangements and measures to enable it to take early action to restore their long term viability in the event of a material deterioration of their financial situation. In this sense, the recovery plan is each **firm's complete "menu of options"** for addressing extreme financial stress caused by internal or system failures. Additionally, the recovery plan should include a description of the governance procedure - roles, duties, decision-making process, etc. - when the institution is dealing an extreme stressed situation.



Figure 6

Recovery information to be disclosure in a resolution plan and rationale



Source: BBVA Research

In addition, recovery plans are required to be developed both at group level and for the individual institutions within the group. Moreover, **supervisors will assess and approve recovery plans annually**. Where an institution does not present an adequate recovery plan, supervisors are empowered to require that institution to take all measures necessary to redress the deficiencies of the plan.

Following this path, the rationale and main objectives of institutions developing recovery plans are:

- To forecast the factors that could prompt a crisis in the near term.
- Recovery plans assess if options available to counter a crisis are sufficiently broad and robust.
- The key component of recovery plans is a strategic analysis that identifies the firm's governance and sets out the key actions to be taken in a stressed situation.
- Recovery plans are focused on group level but also on significant subsidiaries.
- Recovery plans are anchored on recovery measures and complemented with a description of indicators, scenarios and governance.

Resolution plan

The **resolution plan is prepared ex-ante by the resolution** authorities in cooperation with supervisors and the institutions themselves. In fact, authorities may require institutions to assist them in the drawing-up and annual updating of the plans. Following the scope, content, output and the cornerstone of the resolution plans are explained in more detail:

- **Scope:** Group resolution plans shall include a plan for resolution of the group headed by the EU parent undertaking as a whole, either through resolution at the level of the EU parent undertaking or through break up and resolution of the subsidiaries.
- **Content:** The plan will set out options for resolving the institution (or its groups) in a range of scenarios, including systemic crisis when trigger conditions for resolution are reached. Such plans should include **details on the application of resolution tools** and ways to ensure the continuity of critical functions, in order to minimise the cost of resolution to public funds.



- **Output:** Based on the resolution plan, the resolution authorities shall assess whether an institution or group is resolvable. If resolution authorities identify significant impediments to the resolvability of an institution or group, they may require the institution or groups to take measures in order to facilitate its resolution.
- **Resolution plans' cornerstone:** It is define and assess the potential barriers when carrying out **the resolution strategy (MPE or SPE)** that is the responsibility of the competent resolution authority. For this purpose the resolution plan will need to include a **summary of the key elements of the plan**, a demonstration of how critical functions and core business lines could be legally and economically separated to the extent necessary from other functions, so as to ensure continuity on the failure of the institution. It also aims to estimate the necessary timeframe for executing each material aspect of the plan. Figure 6 summarises the resolution information pack.

Consistent with the aims of the FSB Resolution Attributes, the resolution plan **will not assume any extraordinary public financial support** besides the use of the financing arrangements (see section 7 of this chapter) and any central bank emergency liquidity assistance.

Resolution plans deal with the orderly resolution of a financial institution by a relevant resolution authority, in the event that the entity has no time to undertake recovery measures, or if measures were implemented but were ineffective in restoring the institution's viability. In this situation, the resolution authorities would take control of the entity and would require information to enable a potential separation of any critical activities from other parts of the organisation.

## 4. Intra-group financial support

The intra-group financial support agreement for some banks could increase the effectiveness of crisis prevention measures, by providing a means to address the developing financial problems of individual group members in a pre-resolution states - recovery..

It is important to remark that the **intra-group financial support will be able, on a voluntary basis**, to enter into agreements to provide financial support (in the form of a loan, the provision of guarantees or the provision of assets for use as collateral in transactions) to other entities within the group that experience financial difficulties. In no case does it constitute a prerequisite to provide group financial support. Moreover, in cross-border groups with an SPE strategy the intragroup financial support is necessary.

The decision to provide group financial support shall be taken by the management body of the group entity providing financial support. The agreement may then be submitted for approval in advance by the shareholders' meetings of all participating entities, in accordance with national law. It will authorise the management bodies to provide any necessary financial support within the terms of the agreement, but before providing the support the management shall notify the competent authority, the consolidating supervisor and EBA (the competent authority shall transmit it to resolution authorities). Finally, the general terms of the agreement, and the names of the group entities that are party to it, must be make public and updated at least annually.

## 5. Early Intervention

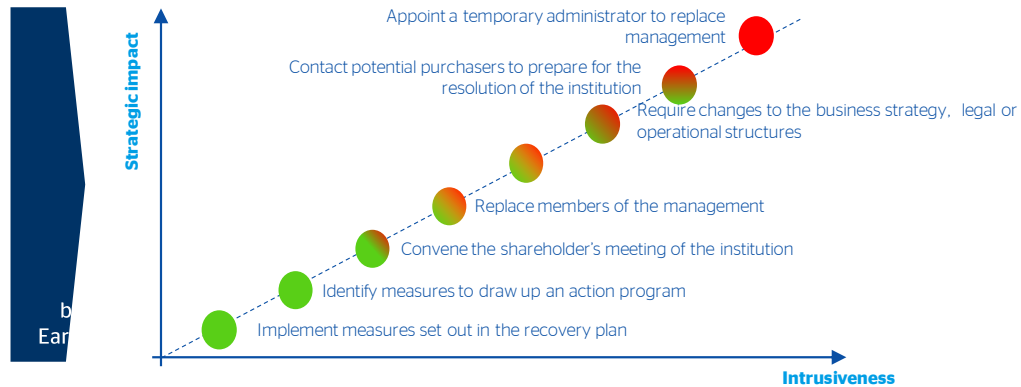
The Directive expands the powers of the resolution authority to intervene at an early stage in cases where an institution is in breach of or, due *inter alia* to a rapidly deteriorating financial condition, including deteriorating liquidity, increasing levels of leverage, non-performing loans



or concentration of exposures, as assessed on the basis of a set of triggers, which may include the institution’s own minimum funds plus 1.5 percentage points. Figure 7 shows the list of measures provided by the BRRD.

In case the early intervention measures are considered insufficient to address an institution’s deteriorating financial position, **the resolution authority will be able to appoint a temporary administrator by the interim replacement of the institution’s management with a “special manager”** for a maximum period of one year (which period may be renewed under exceptional circumstances). The main purpose of the appointment of a special manager is to facilitate the restoration of the institution’s financial stability and prudent management within the shortest time possible. In this sense, the special manager may, among other measures, even increase the firm’s capital or reorganise the ownership structure. In order to achieve these goals, the special manager shall have the qualifications, ability and knowledge required to carry out the requisite functions and be free of any conflicts of interest. Regarding the powers, the special manager will have the same competences and powers as the firm’s management.

Figure 7  
**Early intervention measures**



Source: BBVA Research

It is also important to keep in mind that during the recovery and early intervention phases provided for under the BRRD, shareholders should retain full responsibility and control of the institution except when a **temporary administrator** has been appointed by the competent authority. They should no longer retain any such responsibility once the institution has been put under resolution.

## 6. Resolution triggers- the point of non-viability (PONV)

The most important pillar of the resolution regime is the one that develops the resolution powers and tools of the resolution authorities. The BRRD sets **four objectives and some general principles** to protect the firm’s financial stability with a special order for the allocation of losses. Moreover, this section includes **trigger conditions to activate the resolution process**.

During the development of the BRRD, some concerns have arisen regarding the subjective nature of the resolution condition, suggesting that it could lead to uncertainty, and consequently aggravate volatility if the market believes that an institution may be nearing a situation in which those conditions could be satisfied. Due to these doubts, and in order to



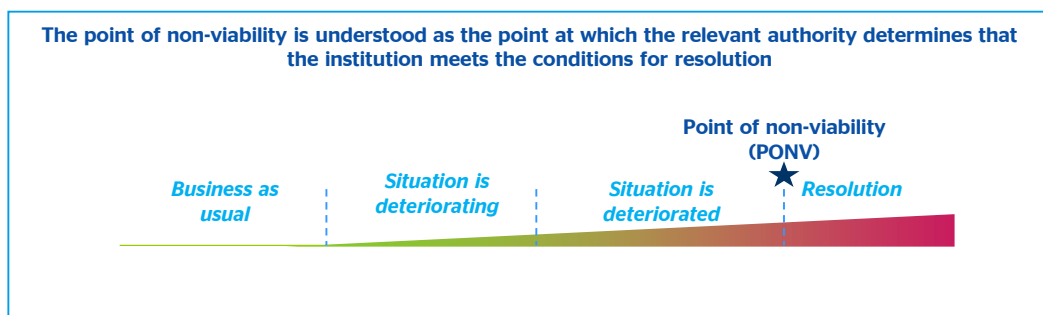
develop a consistency of application, the **EBA will develop a guidance of the resolution conditions.**

### Trigger conditions

The BRRD establishes common parameters (resolution conditions) for triggering the application of resolution tools. In this sense, the authorities shall be able to take action when an institution is either insolvent or very close to insolvency, to the extent that if no action is taken the institution will be insolvent in the near future.

Figure 8

#### Determination of the trigger for resolution



Source: BBVA Research

As figure 8 shows, the **point of non-viability** is understood as the point at which the relevant authority determines that the **institution meets the conditions for resolution.**

In this sense, the BRRD establishes that resolution actions should be taken when all the following conditions are met:

- The determination that the institution is failing or likely to fail shall be made by the competent authority, after consulting with the resolution authority.
- The competent authority, or the resolution authority after consultation with the competent authority, has made a determination that the institution is failing or likely to fail.
- Having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector measures would prevent the failure of the institution within a reasonable timeframe.
- A resolution action is necessary in the public interest.

Moreover, the BRRD establishes that an institution is **failing or likely to fail** if one or more of the following circumstances are met:<sup>5</sup>

- The institution infringes, or there are objective elements to support a determination that the institution will infringe, the requirements for continuing authorisation.
- The assets of the institution are, or there are objective elements to support a determination that the assets of the institution will in the near future be, less than its liabilities.

5: EBA will issue by December 2014 guidelines to promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution shall be considered to be failing or likely to fail.



- The institution is, or there are objective elements to support a determination that the institution will be in the near future be unable to pay its debts as they fall due.
- Extraordinary public financial support is required, except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms:
  - A state guarantee to back liquidity facilities provided by central banks, according to the central banks' conditions;
  - A state guarantee of newly issued liabilities; or
  - An injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution. In this case, it should be limited to injections necessary to address a capital shortfall established in the national/Union/SSM-wide stress tests, asset quality reviews or equivalent exercises conducted by ECB, EBA or national authorities, where applicable, and confirmed by the competent authority.

## 7. Resolution tools and powers

Resolution authorities will have the following resolution tools to resolve an institution, when the trigger conditions for resolution are satisfied:

- **Sale of business tool:** the sale of the bank or the whole or part of its business on commercial terms without shareholders' consent or other procedural requirements.
- **Bridge institution tool:** the transfer of all or part of the bank's business to a "bridge bank," which is wholly owned by a public authority (intended to be a temporary measure pending sale to the private sector).
- **Asset separation tool:** the transfer of certain high-risk assets of the bank to an asset management vehicle owned by a public authority. Due to moral hazard concerns, this tool must be used in conjunction with another resolution tool.
- **Bail-in tool:** the write-down of the claims of unsecured creditors of a failing bank or the conversion of debt claims into equity.

Additionally, in the very extraordinary situation of a systemic crisis, the resolution authority may seek funding from alternative financing sources, through the use of government stabilisation tools – public funds – that are explained in this section.

### The sale of business tool

This tool gives the power to the resolution authorities to sell the institution under resolution, without the consent of the shareholders or other procedural requirements. **Authorities may sell any of its shares or other instruments representing ownership**, all or any of its assets, rights and liabilities.

It is important to mention that the sale must be conducted on "commercial terms" and in a reasonable way, that means that authorities shall market the instruments to be transferred in accordance with market value principles. If the resolution authority markets a pool of assets, rights and liabilities, it may do it separately. The marketing should be as transparent as possible, free from any conflict of interest, take account the necessity for a rapid resolution action and that its aim should be to maximise the sale price without discrimination between potential purchasers or conferring any unfair advantage on a potential purchaser. The sale of the business should fulfil these principles only if they do not jeopardise the resolution objectives.



The authorities can exercise the sale of business tool more than once in the course of resolution. Furthermore, they may, with the prior consent of the purchaser, transfer the property back to the institution.

In cases where the sale could result in the acquisition of, or an increase in qualifying holding in an institution, the competent authority should carry out the assessment of the sale on an expedited basis and in a timely manner that does not delay the application of the sale of business tool or prevent the resolution action from achieving the relevant resolution objective.

### Bridge institution tool

This tool gives resolution authorities the power to (i) *transfer*, without the consent of the shareholders or third party, shares, the assets, rights and liabilities of the institution to abridge institution (more than once in the course of the resolution process), and (ii) if certain conditions are met, **to transfer these instruments from the bridge institution back to the institution under resolution**; or alternatively transfer them from the bridge institution to a third party.

In applying the bridge bank option, some requirements must be fulfilled:

The bridge institution must be a legal entity wholly owned or controlled by one or more public authorities (which may include the resolution authority or the resolution financial arrangement), and created for the purpose of receiving some or all of the shares, assets, rights and liabilities of an institution with a view to carrying out some or all of its services and activities.

As the bridge institution is a public owned legal entity, it is to be considered a continuation of the institution under resolution. The resolution authorities have power to decide on: the content of its constitutional documents, the appointment of the institution’s management (they decide on the remuneration and determine their responsibilities) and the risk profile of the bridge institution.

The goal of this tool is selling the assets, rights and liabilities of the institution to private parties, based on open and transparent marketing and on commercial terms, in accordance with the state aid framework and within a short period. For this reason, the bridge institution may only operate for two years; however, this period may be extended for one or more additional one-year periods. After the expiry of this period, the operation of the bridge institution shall be terminated by liquidation. Additionally, the operation of the bridge bank shall also be terminated if the bridge institution merges with another. In this case, either the third party assumes all or substantially all of its assets, rights or liabilities or a bridge institution’s assets are completely wound down and its liabilities are completely discharged.

### Asset separation tool

This tool should be used when the resolution authority determines that:

- liquidation of “bad assets” under insolvency proceeding could have an adverse effect on financial markets,
- it is necessary for the proper functioning of the institution under resolution or a bridge institution; or
- it maximises the liquidation proceeds.

The asset separation tool’s goal is to **separate the distressed, problematic assets of the institution from the others, and to manage them in such a way as to maximise their value**. As referred to above, this tool shall only be used in conjunction with another resolution tool. The resolution authorities therefore have the right to transfer the assets, rights or liabilities of an institution to an asset management vehicle at the market value or, under certain conditions, transfer them back to the institution. This asset management vehicle is a legal entity owned by



public authorities, which may also include the resolution authorities. As with the bridge institution tool, the resolution authority will appoint the asset managers who shall either maximise the value of the instruments through sale or wind down the business in an orderly manner.

### Bail-in tool

The bail-in tool is the cornerstone of the BRRD and it implies that that **banks' creditors will be written down or converted** into equity in case of resolution and, thereby, shoulder much of the burden to help recapitalize a failed bank instead of the taxpayers. Resolution Authority is the responsible to carry out it for the following resolution purposes:

- Recapitalize the institution, if there is a reasonable prospect to restore the institution.
- Convert to equity or reduce the principal amount of claims or debt instruments that are transferred to bridge institution or under the sale of business or asset separation.

The bail-in tool may have the following characteristics:

- **Scope:** Certain liabilities are always excluded from bail-in, in particular, covered deposits; secured liabilities including covered bonds and another instruments that according to national law are secured in a way similar to covered bonds, liabilities arising from a participation in payment systems, which have a maturity of less than seven days, and inter-bank liabilities with a maturity of less than seven days. In addition, it can be neither bailinable the liabilities arisen from: employ remuneration, trade creditor arising from the provision of the institution, tax and social security authorities and Deposit Guarantee Scheme. (see Table 1)



Table 1  
**Bail-in scope and creditor hierarchy**

	Bail-inable liabilities	Hierarchy of claims
<b>Capital</b>		
Equity	✓	1
Subordinated debt	✓	2
<b>Wholesale funding</b>		
Senior debt	✓	3
Covered bonds	X	X
Securizations	X	X
Promissory notes	✓	3
Commercial paper	✓	3
Certificate of deposit	✓	3
<b>Deposits by central banks, deposits by other organizations (EIB) and deposits by the public administration</b>		
<b>Deposits by credit institutions</b>		
Maturity < 7 days	X	X
7 days < maturity < 30 days	✓	3
<b>Collateral financing (REPOs)</b>		
<b>Customer deposits</b>		
DGS covered deposits	X	X
<b>Non covered deposits</b>		
Retail deposits / SME - on demand	✓	4
Retail deposits / SME - fixed term	✓	4
Corporate deposits - on demand	✓	3
Corporate deposits -fixed term	✓	3
<b>Collateral financing (REPOs)</b>		
<b>Derivatives</b>		
CCP derivatives	✓	3
OTC derivatives	✓	3
<b>Employees' liabilities, critical functions, taxes</b>		
	X	X

Source: BBVA Research

- Conditions for exclusion of bail-in tool:** Resolution authorities can exclude (or partially exclude) any liabilities from the bail-in according to the following criteria/purpose: i) if they can't be bailed in time, ii) to ensure continuity of critical functions, iii)- to avoid contagion that could cause a serious disturbance to the economy of a Member State or of the Union or iv)-to avoid value destruction that would increase losses of other creditors. Losses not absorbed by excluded liabilities must be borne by other creditors (under No Creditor Worse Off liquidation principle) or by the resolution fund.
- Hierarchy of claims:** As it was expected the deposit preference has been established. In this sense, the hierarchy of claims when applying the bail-in tool follows this order: i)- Common Equity Tier1 instruments; ii)- if writing down CET1 is not sufficient then authorities should reduce to zero the principal of Additional Tier 1 instruments and Tier 2 instruments, iii)- only then followed by subordinated debt not classified as Additional Tier 1 or Tier2, iv)- senior debt and uncovered corporate deposits, v)- uncovered SME and retail deposits, vi)- and, finally, covered deposits by DGS. (See Table 1)
- Minimum loss-absorbing capacity:** the objective behind MREL is to ensure that there is an appropriate level of loss absorbing capacity for the relevant group to be resolvable. In this sense, the minimum required eligible liabilities (MREL) ratio shall be



calculated as the amount of own funds and eligible liabilities expressed as a percentage of the institution's total liabilities and own funds.

Figure 9

**Minimum Required Eligible Liabilities (MREL) calculation**



Source: BBVA Research

The MREL has the following characteristics:

- EBA will develop a Regulatory Technical Standard to specify further the assessment criteria in the definition of MREL. This also includes the right for Member States to provide for additional criteria on the basis of which MREL shall be determined.
- The agreement does not set a legal minimum requirement of bail-inable liabilities in a strict sense, but the 8% threshold for internal absorption (see figure 9 below) can be seen as something very similar. The European Commission will make a proposal on the harmonised application of the minimum requirements by the end of 2016.
- There will not be a pre-established minimum for all banks but it will be established on a case-by-case basis (taking into account the size, business model, funding model and risk profile of the institution).
- The MREL requirement will be on either an individual or consolidated basis, depending on the resolution strategy of each entity- multiple-point-of-entry (MPE) or a single-point-of-entry (SPE) resolution. Under an SPE and MPE strategy, the point of entry occurs at consolidated group and individual subsidiary level, respectively.



**Box 2. FSB’s gone-concern loss-absorbing capacity (GLAC) vs. EU MREL**

The minimum gone-concern loss-absorbing capacity (GLAC) is a new concept which is growing in relevance in the global regulatory discussion. In this regard, the goal of establishing a GLAC is to facilitate the recapitalization of a failed bank and reduce the cost borne by taxpayers in an eventual winding down. Moreover, it is considered as an additional requirement that complements other capital, liquidity or leverage ratio requirements.

During 2011 and 2012, politicians, authorities, and the financial sector in general have been strongly working on a strengthened capital regime requiring additional going-concern loss-absorbing capacity (GLAC) for the GSIFs. However, public authorities consider that the **current loss-absorbing regime is not enough** to facilitate a recapitalization or orderly wind down of a failed bank and avoid the need for a bail-out with public funds.

The Financial Stability Board (FSB) is working on guidelines for GLAC, which should be agreed within the FSB and by the G20 countries by the end of 2014 (\*). Those guidelines will mainly **focus on the nature, amount, and location within the group structure, and the possible disclosure of GLAC.**

Nowadays, **the FSB’s discussion of GLAC is in its early stages and the consultation paper is not expected until mid-2014.** However, it is worth mentioning that the regulatory debate is several steps ahead in some jurisdictions. In particular, European authorities got a final GLAC agreement in the Bank Recovery and Resolution Directive (BRRD) in December 2013 (\*\*), and the US authorities will launch a consultation paper during the coming weeks.

Against this backdrop, the main concern that the FSB should take into account is that the **LAC framework should be consistent around the globe since** the final design of the GLAC requirement and its consequences for banks’ liability structures is not yet clear, nor is it yet consistent between countries. (See Figure 10).

Figure 10

Main loss-absorbing capacity characteristics under different proposals

	FSB	European Authorities	UK	US
	GCLAC (*)	MREL (**)	PLAC / SLAC (***)	Long-term unsecured debt
<b>Nature</b>	Pending	Equity, sub, senior unsecured debt, and others	Equity and sub (PLAC) and senior unsecured debt (SLAC)	Senior unsecured debt
<b>Amount</b>	Pending	Over total liabilities	Over total RWA	Pending
<b>Location within the group</b>	Pending	At group or individual level depending the strategy	Individual level	Consolidated level (holding)

(\*) GCLAC - gone-concern loss-absorbing capacity  
 (\*\*) MREL - minimum requirement of eligible liabilities  
 (\*\*\*) PLAC - primary loss-absorbing capacity, and SLAC - secondary loss-absorbing capacity

Source: BBVA Research

Moreover, some technical issues that the FSB should also take into account when designing the global GLAC framework are the following:

- o **Adequate amount:** The size of GLAC should maintain an economic perspective for a trade off between efficiency and financial stability. Additionally, the minimum level should be established on a case-by-case basis (accounting for size, business model, funding model, and risk profile of each institution).
- o **LAC ratio design:** Minimum GLAC should be based on “total liability” rather than “total RWA”.
- o **Nature:** GLAC’s nature should be defined with a broad scope, including equity, capital instruments and long-term unsecured liabilities (senior debt).
- o **Location:** Location should be aligned with the resolution strategy, in fact, MPE groups at individual level and SPE groups on consolidated level.

(\*) See the FSB (22 - 23 February 2014) letter to the G20 Finance Ministers and Central Bank Governors.

(\*\*) Under the BRRD, LAC is known as Minimum Requirements for Eligible Liabilities (MREL).



- **Use of bail-in, resolution fund, and public bail-out:** A minimum level of losses equal to 8% of total liabilities including own funds will have to be imposed on an institution's shareholders and creditors before access can be granted to the resolution fund. The contribution of the resolution fund is capped at 5% of a bank's total liabilities. In extraordinary circumstances, where this limit has been reached, and after all unsecured, non-preferred liabilities other than eligible deposits have been bailed in, the resolution authority **may use public alternative financing sources** (see below for further details).
- **Bail-in's entry into force:** Bail-in tool would be applicable from 1 January 2016.

### Government Stabilization Tools

The Directive provides that in a very extraordinary situation (i.e. systemic crisis<sup>6</sup>); the resolution authority may seek funding from alternative financing sources through the use of government stabilisation tools when the following conditions are met:

- **Application of government support.** A contribution to loss absorption and recapitalisation equal to an amount not less than 8% of total liabilities including own funds of the institution has been made by shareholders and the holders of other instruments of ownership, the holders of relevant capital instruments and other eligible liabilities through write-down, conversion or otherwise.
- **State Aid.** This shall be conditional on prior and final approval under the State Aid rules.
- **Last resort option.** The government stabilisation tools must be used as a last resort, after having assessed and exploited the other resolution tools to the maximum extent practicable whilst maintaining financial stability, and after the application of other resolution tools sufficient to:
  - avoid significant adverse effects on financial stability or
  - protect the public interest, where extraordinary liquidity assistance from the central bank or equity support has already been provided.
- **When using the tool of temporary public ownership:** it must be ensured that no other resolution tool (bridge bank, asset separation, bail-in etc.) can adequately protect the public interest.

The government stabilisation tools include a temporary public ownership tool and a public equity support tool (public injections of capital).

- **Temporary public ownership tool:** This would entail the full takeover of equity securities by Member States. The entity will be managed in a commercial and professional manner and re-privatisation must be ensured as soon as business and financial conditions permit.
- **Public equity support tool:** Member States complying with national law may participate in the recapitalisation of the institution, providing capital in exchange for common equity Tier 1 (core equity), additional Tier 1 instruments or Tier 2 instruments. Entities that receive aid will be managed in a commercial and professional manner. Furthermore, Member States should sell their shares as soon as business and financial conditions permit.

6: "Systemic crisis" is defined as a disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy. All types of financial intermediaries, markets and infrastructure may be potentially important to some degree.



## 8. Financing arrangements: Resolution Fund

The BRRD states that a European system of financing arrangements shall be established and shall consist of:

- national financing arrangements;
- borrowing between national financing arrangements, and
- the mutualisation of national financing arrangements.

To these ends, Member States shall **establish one or more financing arrangements** for the purpose of ensuring the effective application by the resolution authority of its resolution tools and powers. Moreover, the Member States may use the same administrative structure as their financing arrangements for the purposes of their deposit guarantee scheme (DGS).

The national **financing arrangements shall be established through a fund**, the use of which may be triggered by its resolution authority. All institutions authorised in a territory must contribute to the national financing arrangements. Nevertheless, contributions to DGS shall not count towards the target level for resolution financing. Notwithstanding this,

### Use of the resolution funds

The resolution funds would be available to support institutions under resolution via loans, guarantees, asset purchases or capital for bridge banks. In particular, resolution authorities could use resolution funds only to the extent necessary to ensure the effective application of the resolution tools, for the following purposes:

- To guarantee the assets or the liabilities of the institution under resolution, its subsidiaries, a bridge institution or an asset management vehicle.
- To make loans to the institution under resolution, its subsidiaries, a bridge institution or an asset management vehicle.
- To purchase assets of the institution under resolution.
- To make contributions to a bridge institution and an asset management vehicle.
- To pay compensation to shareholders or creditors.
- To make a contribution to the institution under resolution instead of the contribution which would have been achieved by the write down of certain creditors, when the bail-in tool is applied and the resolution authority decides to exclude certain creditors from the scope of bail-in.
- To lend to other financing arrangements on a voluntary basis.
- To take any combination of the previous actions.

### Target funding level

By **31 December 2014**, the available financial means of the financing arrangements must reach **at least 1%** of the amount of covered deposits of all the credit institutions.

Member States may **extend the initial period for a maximum of four years** if the financing arrangements have made cumulative disbursements in excess of 0.5% of covered deposits.

After the target level has initially been reached, when the available financial means have subsequently been **reduced to less than two-thirds of the target level**, the regular contributions shall be set at a level allowing the target level to be restored within six years.



## Ex-ante, ex-post contributions and alternative funding means

In order to reach the target level, contributions are **raised at least annually** from institutions, including Union branches. Moreover, the contribution of each institution shall be *pro rata* to the amount of its liabilities (excluding own funds) less covered deposits with respect to the aggregate liabilities (excluding own funds) less covered deposits of all the institutions authorised in the territory of the Member State. These contributions shall be adjusted in proportion to the risk profile of institutions. Moreover, the share of irrevocable payment commitments shall not exceed 30% of the total amount of contributions.

Where the available financial means are not sufficient to cover the losses, costs or other expenses incurred by the use of the financing arrangements, Member States shall ensure **that extraordinary ex-post contributions are raised from the institutions authorised in their territory**, in order to cover the additional amounts (extraordinary ex-post contributions shall not exceed three times the annual amount of contributions).

Finally, if the two previous options are insufficient, there are **alternative financing sources** such as borrowings or other forms of support.

## Borrowing between resolution funds

A resolution fund under one jurisdiction **may make a request to borrow from another one within the Union**, taking into account the following premises:

- In order to apply borrowings between resolution funds, all other funding alternatives must have been exhausted.
- Regarding the borrowing programme, the resolution funds will have to examine the proposal and decide whether to participate.
- The rate of interest, repayment period and other terms and conditions of the loans have to be agreed between the resolution funds and the other financing arrangements which have decided to participate. The contribution will be proportional to the amount of covered deposits.
- An outstanding loan to a resolution financing arrangement of another Member State shall be treated as an asset of the resolution financing arrangement which provided the loan, and may be counted towards that financing arrangement's target level.

## Use of deposit guarantee schemes in the context of resolution

When resolution authorities take resolution action, the **DGS to which the institution is affiliated shall be liable for:**

- **when the bail-in tool is applied**, the amount by which covered depositors would have been written down in order to absorb the losses in the institution, had covered deposits been included within the scope of bail-in and been written down to the same extent as creditors with the same level of priority under the national law governing normal insolvency proceedings; or
- **when one or more resolution tools** other than the bail-in tool is applied, the amount of losses that covered depositors would have suffered, had covered depositors suffered losses in proportion to the losses suffered by creditors with the same level of priority under the national law governing normal insolvency proceedings.

If the available financial means of the DGS are used and subsequently are reduced to less than two-thirds of the target level, the regular contribution to DGS shall be set at a level allowing for the target level to be restored within six years.



In all cases, the liability of the DGS shall not be greater than the amount equal to 50% of the target funding level prescribed for the DGS under applicable Union law, however, Member States have the ability to set a higher cap than 50%. In any circumstances, the deposit guarantee scheme's participation under this Directive shall not exceed the losses it would have incurred in a winding-up under normal insolvency proceedings.

In case the DGS's contributions to resolution was greater than the net losses it would have incurred had the institutions been wound up under normal insolvency proceedings, then the difference must be paid from the resolution financing arrangements.

## 9. Cross-Border issues

Cross-border resolution will be done through **measures that will require enhanced cooperation between national authorities and the creation of incentives** for applying a group approach in all phases of preparation, recovery and resolution. In this sense, the Directive sets some general principles to the correct cooperation among authorities when making a decision or taking action, and requires the establishment of resolution colleges and agreements with third countries.

### Resolution colleges

Group level resolution authorities will be responsible for establishing resolution colleges with the participation of the European Banking Authority (EBA). The objective of the resolution colleges is to provide a framework for resolution plans with other resolution authorities and, where appropriate, competent authorities and consolidating supervisors to perform the following tasks:

- exchanging information relevant for the development of group resolution plans, for the application to groups of preparatory and preventative powers and for group resolution;
- developing group resolution plans;
- assessing the resolvability of groups;
- exercising powers to address or remove impediments to the resolvability of groups;
- deciding on the need to establish a group resolution scheme;
- facilitating agreement on a group resolution scheme;
- coordinating public communication of group resolution strategies and schemes;
- coordinating the use of financing arrangements once established, and
- setting MREL minimum requirements for groups at consolidated and subsidiary levels.

EBA will develop regulatory standards in order to specify the operational functioning of resolution colleges for the tasks outlined above.

### European Resolution College

If a third institution or parent undertaking has two or more subsidiary institutions established in the EU, the resolution authorities of the member states in which these subsidiaries are established will form a European Resolution College. This European Resolution College will perform the same tasks as a national resolution college, explained above.

If the subsidiary institutions are owned by a holding company, the resolution authority of the Member State in which the holding company is established will chair the European Resolution



College. In the absence of a holding company, the members of the European Resolution College will decide who will be the chairman.

**Relations with third countries**

As many EU institutions and banking groups are active in third countries, an effective framework for resolution needs to provide for cooperation with third country authorities.

The Directive provides Union authorities with the necessary powers to support foreign resolution actions of a failed foreign bank by giving effect to transfers of its assets and liabilities that are located in or governed by the law of their jurisdiction. However, such support would only be provided if the foreign action ensured fair and equal treatment for local depositors and creditors, and did not jeopardise financial stability in the Member State.

These cooperation agreements shall establish the procedures and arrangements between the participating authorities for sharing necessary information and for cooperation in carrying out the following tasks:

- The development of the resolution plan;
- The assessment of the resolvability of such institutions and groups;
- The application of early intervention measures; and
- The application of the resolution tools.