Regulation Outlook:

Compendium on bank resolution regimes: from the FSB to the EU and US frameworks

- **The FSB’s overall framework**: the design of a comprehensive, consistent and effective resolution regime.

- **The EU Bank Recovery & Resolution Directive**: a common resolution regime in Europe from 2015 onwards.

- **The Single Resolution Mechanism**: credibility and continuity of the Banking Union project in the eurozone.

- **The US Single-Point-of-Entry and orderly liquidation regime**: a resolution regime for systemic banks in the US.

- **The US versus EU resolution regime**: same goal but different paths.
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Executive Summary

The recent crisis has shown that dealing with failed banking groups which are global, large and complex has become a difficult and cost task, mainly due to two main features. First, failures of large banks are not only costly, in terms of the destruction of value, but also destabilising. In fact, their failure can threaten the operation of financial markets and the financial stability of the economy in general. Second, cross-border insolvencies involve multiple authorities and differing legal frameworks. During the crisis, the resolution process for global banking groups was, in most cases, cumbersome as it was not accepted as legally binding by all relevant stakeholders in the different jurisdictions.

For these reasons, following the crisis a broad consensus was agreed on the need to find a better legal framework that enables the authorities to resolve banks in a quick process, avoiding negative spill-over effects to the rest of the financial system so that the critical financial services they provide can be continued, but without the need to rely on the use of public funds and thus protecting tax payers.

To this end, in 2011 the G20 leaders and the Financial Stability Board (FSB) drew up new international standards for effective resolution regimes. They were aware that jurisdictions should have in place a resolution regime that provides the resolution authority with a broad range of powers and options to resolve failed or failing banks and, what is more relevant in global banks, to facilitate a coordinated resolution approach in multiple countries. This document was the first one of a package of policy recommendations on resolution to have been published by the FSB since the objective of ending “too big to fail” was endorsed at the Pittsburgh Summit in 2009. Some G-20 jurisdictions are in the process of adopting these reforms to further strengthen their resolution regimes. For example, European and US authorities have taken decisive steps forward in developing a resolution regime in their jurisdictions.

The aim of this note is to outline and contextualise the current advances in the US and EU resolution regimes. Thus, this paper is divided into five chapters.

A) The FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions;

This chapter outlines the core elements that the FSB considers to be necessary for achieving an effective resolution regime in each jurisdiction, in case any financial institution could be systemically significant or critical if it fails.

The basic elements that must be included in any effective resolution framework are: (i) an experienced resolution authority; (ii) adequate resources and statutory powers; (iii) adequate and varied resolution tools (certainly including bail-in mechanisms); (iv) legal enforcement of cross-border coordination during resolution processes, and (v) mechanisms to ensure that losses are ultimately borne by shareholders and unsecured creditors.

B) The European Union Bank Recovery and Resolution Directive (BRRD);

The BRRD sets a common procedure for the 28-EU countries to pre-empt bank crises and resolve any financial institution in an orderly manner in the event of failure, whilst preserving essential bank operations and minimising the cost to taxpayers.

The BRRD will be in force by January 2015, with the exception of the bail-in tool which will be applied from January 2016. Once it has entered into force this Directive will help to reduce the fragmentation and restore confidence in Europe’s financial sector.

The bail-in tool is the BRRD’s cornerstone, as it implies that a bank’s creditors will be written down or converted into equity in case of resolution and, thereby, they (and not taxpayers) will shoulder much of the burden to help recapitalise a failed bank.

1: See FSB (October 2011), “Key attributes of Effective Resolution Regimes for Financial Institutions”

2: On 15 April 2014 the Parliament approved Bank Recovery and Resolution Directive, and in December 2013 the US authorities outlined the resolution strategy and process for the orderly resolution of a large bank in the US.
The key question in assessing its operational feasibility is the interplay between the bail-in, the use of resolution funds and governmental support. In this regard, depending on the resolution requirements, the bail-in will be applied by taking into account the following three levels: first, a bail-in of 8% of total liabilities is initially applied; second, the Bank Resolution Fund may absorb losses up to 5% of total liabilities; and third, if more capital is needed, the bail-in will continue until all losses are absorbed.

C) The EU Single Resolution Mechanism (SRM): A key element of the EU’s Banking Union project is the SRM, and a necessary complement to the Single Supervisory Mechanism (SSM). In the eurozone, the BRRD will be implemented through a unique Resolution Authority and resolution fund which will mutualise losses among all eurozone banks. The ultimate goal of the SRM is to break the vicious circle between bank and sovereign risk, by anchoring expectations that banks will be resolved primarily by private means, through a centralised and effective application of common EU resolution rule and authority.

D) The US Resolution Framework: This chapter differentiates between two resolution processes: the process for insured depository institutions and the new process to resolve very large institutions under the Dodd-Frank Act, so-called Orderly Liquidation Authority (OLA). The OLA section of the Dodd-Frank Act and the consultation paper of the FDIC provide a detailed and comprehensive framework to resolve financial companies deemed to be "systemically significant", and whose failure would pose a "significant risk to the financial stability of the US". Under the OLA, the FDIC may be appointed as receiver for any US financial company. It is important to note that the FDIC is developing the SPE resolution strategy, which essentially executes a bail-in via the bridge financial company tool.

E) A comparative analysis between the US and EU resolution frameworks: This chapter highlights the points of consistency and divergence on the key questions in the US and EU resolution frameworks (what, when and how are institutions resolved?). In principle, the US resolution framework is more flexible than the EU’s resolution scheme. The European institutional framework makes the resolution process more cumbersome than the American procedure. In fact, there are so many players involved that it makes the decision-making process extremely complicated. Nevertheless, the EU framework is broader—covers all institutions with no limits on size, as is the case of the SIFIs in the US -- and involve authorities in third countries, with an effort to encompass both home and host perspectives, which is absent in the US.

A key take-away of this paper is the cross-border perspective. A key challenge for global banking groups is to develop a consistent solution that relies on a variety of legal regimes and overcomes all reluctance among the authorities involved. The effectiveness of a cross-border resolution will be restricted unless it is immediately accepted as legally binding and operationally effective by all parties, and national authorities act collectively in a coordinated and predictable way. In this context, EU regulation seems to provide a more comprehensive framework considering different resolution strategies (MPE and SPE) and trying to define the relationship with foreign authorities, whereas the US regime disregards the role of third countries.

Through these chapters, the paper allows an overview of the progress so far achieved on the resolution framework. Although none of the regimes described is yet fully implemented, it can be concluded that the bulk of the designing work has been done. Now what matters is implementation. The FSB will continue to develop guidelines and recommendations to achieve the final steps to establish an effective, consistent and coordinated resolution framework, both domestically and globally, however, national authorities should lead the process transposing them in a consistent manner.
Chapter A: The FSB’s overall resolution framework

1. Introduction

The Key Attributes of Effective Resolution Regimes for Financial Institutions (the Key Attributes) were endorsed by the G20 leaders at the Cannes Summit in November 2011. This document provides the main guidelines for the basic elements that must be included in any effective resolution framework, namely (i) an experienced resolution authority; (ii) adequate resources and statutory powers; (iii) adequate an varied resolution tools (certainly including bail-in mechanisms); (iv) legal enforcement of cross-border coordination during resolution processes, and (v) mechanisms to ensure that any losses are ultimately borne by shareholders and unsecured creditors.

In this sense, the Key Attributes describe the powers which should be available to designated public authorities in each FSB member jurisdiction to intervene in a swift and decisive manner (over a weekend, theoretically), to bring about the orderly resolution of a bank to safeguard both financial stability and public funds. To secure (close to) uninterrupted provision of critical financial services and minimise the uncertainty which can result in a loss of confidence, the Key Attributes say that it should be possible to carry out resolution without needing to seek the consent of affected parties (see Figure 1).

Figure 1
FSB’s key attributes resolution features

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Source: BBVA Research
2. Goals of the bank resolution regime

The general goal of any resolution regime is to resolve failing financial institutions quickly, ensuring the stability of the financial system and preserving the main banking operations. In addition, to be effective this resolution regime should:

- ensure continuity of systemically important financial services, payment, clearing and settlement functions;
- protect - where applicable and in coordination with the relevant insurance schemes and arrangements - depositors, insurance policyholders and investors as are covered by such schemes and arrangements, and ensure the rapid return of segregated client assets;
- allocate losses to the firm’s owners (shareholders) and unsecured and uninsured creditors in a manner that respects the hierarchy of claims;
- not rely on public solvency support and not create an expectation that such support will be available;
- avoid unnecessary destruction of value, and therefore seek to minimise the overall costs of resolution in home and host jurisdictions and, where consistent with the other objectives, the losses for creditors;
- provide for speed and transparency, and as much predictability as possible, through legal and procedural clarity and advanced planning for orderly resolution;
- provide a mandate in law for cooperation, information exchange and coordination, both domestically and with any relevant foreign resolution authorities before and during a resolution;
- ensure that non-viable firms can exit the market in an orderly way; and
- be credible, and thereby enhance market discipline and provide incentives for market-based solutions.

The FSB’s Key Attributes develop several minimum requirements in order to achieve these goals and effective resolution regimes for financial institutions that could be systemically significant or critical in the event of failure. The main characteristics of the FSB’s Key Attributes are explained in the following section.

3. Key Attributes proposed by the FSB

3.1 Scope of the resolution regimes

The Key Attributes establish that any bank “which could be systemically significant or critical if it fails” should be within the scope of an especial resolution regime. It is intended that this standard should be met, as appropriate in each jurisdiction, in relation to banks, securities firms, insurers and financial market infrastructures (both locally incorporated and the branches of foreign firms).

Banks may have a series of structural, financial and operational dependencies on other group entities, such as unregulated holding companies or affiliated operational entities. Recognising this, the Key Attributes say that it should also be possible to deploy resolution powers in relation to these other group entities.

The framework described by the Key Attributes establishes that an assessment would be needed, as a bank nears the point of non-viability, as to whether its failure could be systemically significant or critical, to decide if the bank must be liquidated or resolved as shown in Figure 2.
3.2 Resolution Authority

Under each jurisdiction, one or more public authorities should be designated to act as resolution authorities. These authorities should be operationally independent in their role and adequately resourced. Where there are multiple resolution authorities within a jurisdiction, their respective mandates, roles and responsibilities should be clearly defined and coordinated.

Additionally, the FSB’s Key Attributes state that a lead resolution authority should co-ordinate the resolution of financial services groups operating across the various sectors of a local financial system.

Moreover, the document says that the resolution authority’s actions should have statutory objectives and functions, requiring that they:

- pursue financial stability and ensure continuity of systemically important financial services, and payment, clearing and settlement functions;
- protect depositors, insurance policyholders and investors as are covered by such schemes and arrangements;
- avoid unnecessary destruction of value and seek to minimise the overall costs of resolution in home and host jurisdictions and losses to creditors, where that is consistent with the other statutory objectives; and
- duly consider the potential impact of its resolution actions on financial stability in other jurisdictions.

3.3 Resolution Powers

The FSB’s Key Attributes set a toolkit of resolution options and powers for the designated resolution authorities to enable them to step in and take speedy and decisive action to stabilise and restructure an entire institution’s business or, if appropriate, a part thereof.

These tools are the following:

- Remove and replace the senior management
- Appoint an administrator to take control of and manage the affected firm
- Operate and resolve the firm
- Ensure continuity of essential services and functions by requiring other companies in the same group to continue to provide essential services to the entity in resolution
Override rights of shareholders of the firm in resolution
Transfer or sell assets and liabilities
Establish a temporary bridge institution to take over and continue operating certain critical functions and viable operations of a failed firm
Establish a separate asset management vehicle
Carry out bail-in within resolution
Temporarily stay the exercise of early termination rights
Impose a moratorium with a suspension of payments to unsecured creditors and customers
Effect the closure and orderly wind-down (liquidation) of the whole or part of a failing firm

These tools could be classified in two groups:

a) Stabilisation options
   - Compulsory transfer of entire or some of its business to: i) another financial entity; or ii) abridge institution.
   - Bail-in: This is a new tool that enables resolution authorities to:
     i) write down - in a manner that respects the hierarchy of claims in liquidation - the equity or other instruments of ownership of the firm, unsecured and uninsured creditor claims to the extent necessary to absorb the losses;
     ii) convert into ordinary equity all debt or other instruments of ownership of the firm under resolution.

b) Dealing with residual parts of institution
   - Asset management vehicle.
   - Normal liquidation procedure.

3.4 Set off, netting, collateralization, segregation of client assets
The FSB’s Key Attributes states that the legal framework governing set-off rights, contractual netting and collateralisation agreements and the segregation of client assets should be clear, transparent and enforceable during a crisis or resolution of firms, and should not hamper the effective implementation of resolution measures.

3.5 Safeguards
To ensure an effective and orderly resolution, the Key Attributes establish a mechanism to compensate creditors for any losses that they could suffer over and above those they might have sustained in liquidation. This is called the “Principle of No Creditor Worse off than in Liquidation (NCWL).”
In this sense, resolution powers should be exercised in a way that respects the hierarchy of claims while providing flexibility to depart from the general principle of equal (paripassu) treatment of creditors of the same class, with transparency about the reasons for such departures, if necessary to contain the potential systemic impact of a firm’s failure or to
maximise the value for the benefit of all creditors as a whole. In particular, equity should absorb losses first, and no loss should be imposed on senior debt holders until subordinated debt (including all regulatory capital instruments) has been written-off entirely (whether or not that loss-absorption through write-down is accompanied by conversion to equity).

3.6 Funding of firms in resolution

The FSB’s Key Attributes states that jurisdictions should have in place privately-financed deposit insurance or resolution funds, and/or a funding mechanism for ex-post recovery from the industry of the costs of providing temporary financing to facilitate the resolution of the firm. The goal is to avoid bail-outs and protect public funds.

Nevertheless, the Key Attributes recognises that in special circumstances, subject to strict conditions, the authorities could provide temporary funding:

- To foster financial stability and to permit the implementation of a resolution option that is best able to achieve the objectives of an orderly resolution, and where private sources of funding have been exhausted or cannot achieve these objectives.
- The allocation of losses to equity holders and residual costs, as appropriate, to unsecured and uninsured creditors and the industry through ex-post assessments, insurance premiums or other mechanisms.

The central bank’s role as lender-of-last-resort is critical in most banking crises in order to reduce the risk of unexpected spill-over effects and bank panics. Moreover, banks’ resolution normally takes place after liquidity problems, which implies that normally central banks are already heavily involved in the funding of the bank, with collateral not always of the highest quality. This has important implications in terms of resolution options.

3.7 Legal framework conditions for cross-border cooperation

In order to resolve cross-border entities, it is necessary to have coordinated and cooperative approaches among different jurisdictions. For this reason, the Key Attributes set several conditions to support coordination and cooperation.

The first of these conditions is that the “the statutory mandate of a resolution authority should empower and strongly encourage the authority wherever possible to act to achieve a cooperative solution with foreign resolution authorities.”

The second is that the resolution authority should have resolution powers over local branches of foreign firms and the capacity to use its powers either to support a resolution carried out by a foreign home authority or, in exceptional cases, to take measures on its own initiative where the home jurisdiction is not taking action or acts in a manner that does not take sufficient account of the need to preserve the local jurisdiction’s financial stability.

Finally, jurisdictions should provide for: (i) transparent and expedited processes to give effect to foreign resolution measures, and (ii) confidentiality requirements and statutory safeguards for the protection of information received from foreign authorities.

Although the FSB is fully aware that cross-border issues are critical, their high-level cooperation principles are very vague.

4: See FSB Key attribute paragraph 7.1
3.8 Crisis Management Groups (CMGs)

The Key Attributes require that a Crisis Management Group (CMG) must be established for each Global Systemically Important Financial Institution (G-SIFI) to facilitate the resolution of the institution.

The CMG allows authorities (home and host) to coordinate and develop the preferred resolution strategy of the financial institution. Moreover, CMGs should keep under active review and report on:

- progress in coordination and information sharing within the CMGs and with host authorities that are not represented on the CMGs;
- the recovery and resolution planning process for G-SIFIs under institution-specific cooperation agreements; and
- the resolvability of G-SIFIs.

3.9 Institution-specific cross-border cooperation agreements

The Key Attributes maintain that institution-specific agreements, containing the essential elements on how home and host authorities will cooperate, must be signed.

These agreements, among others, should establish the objectives and processes for cooperation through CMGs; define the roles and responsibilities of the authorities pre-crisis and during a crisis, and set out the process for information sharing.

3.10 Resolvability assessments

Resolution authorities are required to regularly undertake, at least for G-SIFIs, “resolvability assessments” that evaluate the feasibility of resolution strategies and their credibility in light of the likely impact of the firm's failure on the financial system and the overall economy.

In undertaking resolvability assessments, resolution authorities should in coordination with other relevant authorities assess, in particular:

- the extent to which critical financial services, and payment, clearing and settlement functions can continue to be performed;
- the nature and extent of intra-group exposures and their impact on resolution if they need to be unwound;
- the capacity of the firm to deliver sufficiently detailed accurate and timely information to support resolution; and
- the robustness of cross-border cooperation and information sharing arrangements.

3.11 Recovery and resolution planning (RRP)

The Key Attributes intend that each jurisdiction put in place an ongoing process for recovery and resolution planning, covering at minimum domestically incorporated firms that could be systemically significant or critical if they fail.

Firms' recovery plans should include:

- credible options to cope with a range of scenarios including both idiosyncratic and market wide stress;
- scenarios that address capital shortfalls and liquidity pressures; and
- processes to ensure timely implementation of recovery options in a range of stress situations.

Firms’ resolution plans should include:

- financial and economic functions for which continuity is critical;
- suitable resolution options to preserve those functions or wind them down in an orderly manner;
- data requirements on the firm’s business operations, structures, and systemically important functions;
- potential barriers to effective resolution and actions to mitigate those barriers;
- actions to protect insured depositors and insurance policy holders and ensure the rapid return of segregated client assets; and
- clear options or principles for the exit from the resolution process.

Both Recovery and Resolution plans should be updated regularly, at least annually or when there are material changes to a firm’s business or structure, and subject to regular reviews within the firm’s CMG. Moreover, if resolution authorities are not satisfied with a firm’s RRP, the authorities should require appropriate measures to address the deficiencies.

3.12 Access to information and information sharing

As a well-functioning resolution framework requires the highest level of cooperation and coordination between all the authorities involved in resolving a cross-border banking group, information sharing to support the resolution is key. The Key Attributes set some requirements in this regard:

- Jurisdictions should ensure that no legal, regulatory or policy impediments exist that hinder the appropriate exchange of information, including firm-specific information, between supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for guarantee schemes.

- Jurisdictions should require firms to maintain Management Information Systems (MIS) that are able to produce information on a timely basis, both in normal times, for recovery and resolution planning, and during resolution.
Box 1. Resolution Strategies: MPE & SPE

In July 2013, the FSB guidelines on recovery and resolution planning outlined the main characteristics of the two stylized approaches for resolving global financial institutions: the Multiple Point of Entry (MPE) and Single Point of Entry (SPE). Deciding between an MPE or an SPE resolution strategy depends on each firm’s particular characteristics.

Choosing the optimal resolution strategy is not a binary decision

Supervisory and resolution authorities involved in the Crisis Management Group will be responsible for defining the high-level resolution strategy outlining whether the firms should be resolved based on an SPE or MPE scheme. Both schemes are the opposite ends of a spectrum where many resolution options may lie in between. In practice, a combination might be necessary to accommodate the structure of a bank and the local regimes in the key jurisdictions where it operates. Thus, authorities will examine each firm’s particular characteristics: i) business models, ii) corporate and legal structures, iii) operational interdependencies, and iv) capital and liquidity management.

Both SPE and MPE differs in many different aspects

The SPE strategy is characterized by the home resolution authority, which applies resolution powers at the parent company level. After losses have occurred in any part of the group, a sole resolution process is initiated led by a sole home resolution authority. The implementation of the bail-in occurs at the parent level only and, therefore, losses in subsidiaries can be covered only through the holding company (by means of a downstream of new capital). That implies significant interconnections between the parent and subsidiaries, and requiring that Loss Absorption Capacity (LAC) should be located in the holding company.

On the contrary, the MPE strategy involves the application of resolution powers by two or more resolution authorities to different parts of the group, and this is likely to result in a break-up of the group into two or more separate parts preserving essential functions without causing contagion to the rest. Legal, financial and operational independence implies that the LAC is located at each point of entry, each subsidiary is resolved by local authorities and cross-border agreements can be focused on coordination and information exchange.

Decentralized retail banks meet inherently the MPE’s preconditions

The SPE is the best approach for the globally active and highly integrated wholesale institutions with concentrated funding and risk management structures with a systematic reliance on intra-group funding. On the other hand, the MPE is the natural resolution strategy for decentralized retail banks due to the following reasons: i) they are structured by local subsidiaries, ii) their client base is mainly local households and small and medium enterprises. Retail deposits are the main source of funding normally denominated in local currency and protected by the local deposit guarantee scheme, iii) Capital and liquidity are located in host countries with a standalone rating. Host subsidiaries manage their capital locally to support their own growth and are financially self-sufficient when needing to resort to the market, and finally, iv) There is no systematic intra-group support, either from the parent to the subsidiary or in the opposite direction. This support is however not excluded under certain circumstances, but always as a voluntary business decision.
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.

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.

**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.
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

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

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:5

- 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.
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 the 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**

<table>
<thead>
<tr>
<th>Bail-ineligible liabilities</th>
<th>Hierarchy of claims</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital</strong></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>✓</td>
</tr>
<tr>
<td>Subordinated debt</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Wholesale funding</strong></td>
<td></td>
</tr>
<tr>
<td>Senior debt</td>
<td>✓</td>
</tr>
<tr>
<td>Covered bonds</td>
<td>X</td>
</tr>
<tr>
<td>Securitizations</td>
<td>X</td>
</tr>
<tr>
<td>Promissory notes</td>
<td>✓</td>
</tr>
<tr>
<td>Commercial paper</td>
<td>✓</td>
</tr>
<tr>
<td>Certificate of deposit</td>
<td>✓</td>
</tr>
<tr>
<td>Deposits by central banks, deposits by other organizations (EIB) and deposits by the public administration</td>
<td>X</td>
</tr>
<tr>
<td>Deposits by credit institutions</td>
<td></td>
</tr>
<tr>
<td>Maturity&lt; 7 days</td>
<td>X</td>
</tr>
<tr>
<td>7 days&lt;maturity&lt; 30 days</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Collateral financing (REPOs)</strong></td>
<td>X</td>
</tr>
<tr>
<td>Customer deposits</td>
<td></td>
</tr>
<tr>
<td>DGS covered deposits</td>
<td>X</td>
</tr>
<tr>
<td>Non covered deposits</td>
<td></td>
</tr>
<tr>
<td>Retail deposits / SME - on demand</td>
<td>✓</td>
</tr>
<tr>
<td>Retail deposits / SME - fixed term</td>
<td>✓</td>
</tr>
<tr>
<td>Corporate deposits - on demand</td>
<td>✓</td>
</tr>
<tr>
<td>Corporate deposits -fixed term</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Collateral financing (REPOs)</strong></td>
<td>X</td>
</tr>
<tr>
<td><strong>Derivatives</strong></td>
<td></td>
</tr>
<tr>
<td>CCP derivatives</td>
<td>✓</td>
</tr>
<tr>
<td>OTC derivatives</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Employees’ liabilities, critical functions, taxes</strong></td>
<td>X</td>
</tr>
</tbody>
</table>

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 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.

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-in able 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 GSIFIs. 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).

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

- **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).

- **LAC ratio design**: Minimum GLAC should be based on “total liability” rather than “total RWA”.

- **Nature**: GLAC’s nature should be defined with a broad scope, including equity, capital instruments and long-term unsecured liabilities (senior debt).

- **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 crisis6); 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.

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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.
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.
Chapter C: The Single Resolution Mechanism: credibility and continuity of banking union project

1. Introduction

The euro zone will have a Single Resolution Mechanism in place since January 2015, composed of a Single Resolution Authority, a Single Resolution Fund and a single set of resolution tools that will be fully aligned with the BRRD.

The SRM is the second pillar of banking union, an ambitious project that the EU leaders are taking forward at record speed in order to get Europe out of the crisis and restore financial integration. In this context, the SRM will complement the other key pillar of banking union, the Single Supervisory Mechanism (SSM), elevates banking supervisory decisions in the EU to the same European-centralized level as that of monetary policy decisions. Under the SSM the ECB will assume, from November 2014 on, full responsibility for the supervision of all euro zone banks and will directly supervise the most significant ones (around 130 banks).

Figure 11

SRM overview

1. Firm Scope

A
• Directly supervised by ECB
• Request use of SRF

B
• Supervised by national supervisor
• SRF is not involved

2. How

1. ECB (or SRB) notifies that bank is (i) failing/likely to fail
2. SRB assesses if (ii) public interest & (iii) no private solution
3. SRB* adopts the resolution scheme (if (i), (ii) and (iii))
4b. EC proposes Council to object
5b. Council objects only to (i) veto plan if not in public interest & (ii) change SRF use
7. NRAs implement

24h

A
SRB: Executive
Chair, Vice-chair, 3 permanent members (+concerned NRAs)

B
SRB: Plenary
Same as in Executive+ rest of NRAs

As a general rule UNLESS...
• If > 5bn in one resolution (10bn for liquidity support)
• If > 5bn (accumulated in 12month): future guidance to Executive
• Es-post contributions and borrowing of the Fund

Source: BBVA Research

The Single Resolution Authority will take on resolution powers since January 2016. From that moment on, whenever the ECB raises the flag for a given ailing bank, the Single Resolution Authority will step in to conduct resolution in order to preserve the public interest. Bank resolution will be conducted by a new Single Resolution Board, in which the national authorities of all participating member states will be represented. The Single Resolution Board will directly resolve significant banks, cross border EU banks and all banks which resolution required the use of the Single Resolution Fund. The rest of banks will be resolved by the national resolution authorities but the Single Authority will be able to step in at any time.

Resolution processes will be guided by the Bank Recovery and Resolution Directive (BRRD), which the Single Resolution Authority will apply uniformly across all countries participating in the banking union project. The Commission and the Council will have the power to change or veto the
resolution plan proposed by the Single Resolution Board, but they will have to do so quickly (24h) and generally owing to some pre-established conditions. There will be a private Single Resolution Fund with and ex-ante €55bn capacity at the disposal of the Authority in order to help cover resolution costs after having applied a bail-in over the bank.

2. What is the main purpose of the SRM and when will it be operational?

By introducing a centralized mechanism for banking resolution in the euro zone, the SRM will provide a credible counterparty to the SSM in resolution aspects. The SRM will also contribute to the Single Market in different ways:

- Preserving the level playing field by ensuring a uniform implementation of the EU bank resolution rules (BRRD) across the SSM-area. The wide discretionality allowed in the BRRD does not sit well with the uniformity of rules that is required at the Eurozone level. The SRM will bring certainty and predictability on the application of the BRRD and the DGSD within the SSM, avoiding gaps arising from divergent national positions.

- Enhancing cross-border resolution processes in the EU. The Single Market needs to rely on an effective cross-border resolution framework to ensure financial stability and avoid competitive distortions. In the SSM, the Single Resolution Authority would act in the interest of the whole area, facilitating the signature of Cross-border Resolution Agreements wherever needed.

The SRM Regulation was agreed in March 2014 and will be formally passed by the Council at some point along the summer. It will be officially published around September 2014 and will enter into force in January 2015. Still, the SRM will not undertake resolution action until January 2016 (along with the bail-in tool introduced by the BRRD). The SRM legislative pack also includes an Intergovernmental Agreement which rules the main aspects of the Single Resolution Fund and which is expected to be passed along a similar timescale as the SRM Regulation (assuming all Contracting Parties ratify it on time).

3. The decision-making process under the SRM

Most of the resolution decisions will be taken by a Single Resolution Board (SRB) although from the legal standpoint the ultimate resolution authorities are both the Commission and the Council. The SRB will meet in two different sessions. The Executive session will be composed of a Chair (appointed for a non-renewable term of 5 years), a Vice-chair, three independent members (appointed by the Council) and a representative from each National Resolution Authorities of the countries involved in the resolution file. The Plenary session includes all these members plus a representative from the national resolution authorities of the rest of countries participating in the SSM/SRM.

A bank resolution decision will be taken in less than a weekend (32 hours) in a process in which political interferences will be minimized to the maximum extent possible. The decision-making process will be as follows:

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7 There will also be one a representative from the ECB, one from the EC and one from the EU Parliament. These representatives will not have a vote.
- **Resolution trigger.** A bank will be placed in resolution only after the ECB determines that it is about to fail, and the Board decides that there are no private alternatives to resolution and that such resolution is in the public interest.

- **Approval of resolution plan.** Once the SRB communicates a resolution plan to the Commission, the EC has 12 hours to react if it does not agree with it. In that case it may ask the Council, after due reasoning, to (i) veto the resolution if it is not in the public interest, or (ii) materially change the amount of money that would be used from the Fund.

- **Council (potential) action.** The Council has 12 hours to decide upon the EC proposal, and if it accepts it (acting by simple majority) the Board then has 8 hours to amend the resolution plan. If no objection is raised by either the Council or the EC within 24 hours, the Board's original plan will be adopted. Regarding the Board, most decisions will be taken by its Executive session.

- **Potential Plenary involvement.** Only when the resolution plan requires tapping more than €5bn from the Resolution Fund (or twice this amount if it is used only for liquidity purposes) will the Plenary session, and always upon express request from at least one of its members) be able to veto or amend the Executive proposal. When the accumulated use of the Fund over the previous 12 months reaches the €5bn threshold, the Plenary will be allowed to step in to give the Executive guidance on future resolution decisions.

4. **How will the Single Resolution Mechanism be funded? Will there be appropriate backstops?**

On the funding front, there will be a Single Resolution Fund ("the Single Fund") in place from 2016 on. It will therefore not be used in the context of the recapitalizations associated to the legacy assets.

The Single Fund will be composed of national compartments and will be built-up from the individual contributions of banks in an eight-year period, when it will reach an overall ex-ante capacity to cover resolution costs of €55bn. Banks’ contributions will be determined by the Council in the coming months, in line with the BRRD principles and on the basis of riskiness and overall significance for the banking sector. Full mutualisation of costs will also be achieved within an 8-year period but reaching 60% already in the second year (40% first year, 20% second year, then increasing by 6.6% annually). The sequence for bearing resolution costs will be as follows:

- **Step 1.** The national compartments of the affected host and host Member States would be used first in order to cover the resolution costs remaining after the bail-in

- **Step 2.** If this is not enough, then a portion of all compartments (including those of the concerned Member State) would be used.

- **Step 3.** If still insufficient, any remaining funds of the concerned compartments would be used

Since 2016 the Fund will be able to rely on a private loan facility in order to borrow funds when needed to cover any residual resolution costs. The details of this credit are not yet defined (for example, regarding the collaterals to be used) but the SRM text calls on both the Council and the Board to establish such a facility in due time (i.e. by January 2016 at the latest). There will be no public guarantee or support for the time being in terms of collateral, so it is assumed that the Fund would be borrowing funds, using the banks’ future contributions as collateral.
Overall, this design represents a substantial improvement over the Council's December agreement, as it not only shortens the transition period but also enhances the credibility of the Fund and guarantees a significant pooling of European private contributions in the first two years (60%, vis-à-vis the 20% initially supported by the Council). This is very positive to breaking the link between sovereign and banks.

The €55bn overall capacity ex-ante of the Single Fund has been criticized for being too low. However, it is important to keep in mind that the Single Fund would be used as a private backstop, after an 8% bail-in has already been applied to cover the capital gap, in line with the BRRD. Moreover, a cap of 5% of the banks liabilities would apply in the use of the Single Fund (again in line with the BRRD) which makes it extremely unlikely that the Fund might get depleted prematurely (indeed this sum would have been sufficient to cover losses in most of the recent banking crises in Europe, according to the EC). Finally it must be recalled that the €55bn refer to an ex-ante target level and that ex-post financing mechanisms are also foreseen to increase the firepower of the Single Fund in case of need (ex-post contributions, private loans from the markets or a credit facility).

Even if extremely unlikely, the scenario under which the Single Fund needs to raise extra resources ex-post or even resort to a public backstop cannot be fully discarded, be it because the 5% cap has been exceeded or because the Single Fund has run out of funds. In this sense, the lack of details regarding the loan facility that the Council and the EC shall establish by 2016 introduces some elements of uncertainty that should be dispelled as soon as possible. Moreover, the absence of a common (European) public backstop until 2026 is clearly a weakness as it somehow undermines the credibility of the SRM and could eventually jeopardize the positive perceptions about the stabilization effects anticipated from banking union. During the ten-year transition period a bridge financing will be available either from national sources, backed by bank levies, or from the ESM in line with existing tools, which points to a potential significant role to be played by the ESM direct recapitalization tool.
Box 3. Interlinks between the EU Resolution and Deposit Guarantee Funds

From the resolution standpoint, the Deposit Guarantee Scheme Directive (DGSD), the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) Regulation include interlinked elements that are related to the procedures and financing arrangements to be used in case of bank failure.

In this sense, EU Member States shall establish two types of financing arrangements. On one hand, the BRRD sets up the Resolution Fund to ensure the effective application of the resolution tools and powers that are needed to resolve a failed bank. Moreover, this fund is always used as a private backstop only after an 8% bail-in has already been applied to cover losses. On the other hand, the DGS reimburses a limited amount of deposits (up to €100,000) to depositors whose bank has failed.

When thinking about interlinks among these funds, four key questions arise to understand the connection between them.

**Can the Resolution Fund and the DGS be merged?**

Although the Resolution Fund and the DGS have different goals and may, in principle, be used at different stages of the crisis management process, the BRRD establishes that Member States may use the same administrative structure as their financing arrangements for the purposes of their DGS.

Nevertheless, in the Eurozone, the Single Resolution Fund will co-exist with its national DGS (until the single DGS pillar gets incorporated into banking union, which may require a revision to the Treaty and hence will take some years).

**Could the contribution be replaced?**

The BRRD states that contributions to the DGS shall not count towards the target level for resolution financing. Thus, the contributions would be at least 1.8% of total covered deposits (1% from the resolution fund contribution and 0.8% of the deposit guarantee scheme contribution).

**Will the contribution for the Resolution Fund change between 2015 and 2016?**

The calculation of individual contributions to the resolution fund will change for the banks in the eurozone, as in 2015 the contribution will be determined in proportion to the weight of the banks’ adjusted liabilities (that is, net of shareholders’ fund and covered deposits) with respect to the national total. However, from 2016 when the Single Resolution Fund is implemented, the individual contribution will be calculated pro rata to the relative weight of entities’ liabilities vs. the total liabilities of the new system that comprises the banking union.

**When will the resolution fund be used?**

In the case of the DGS and national resolution funds, the mutualisation of funds is not feasible, but voluntary borrowing is allowed. So the DGS may lend to other schemes within the EU. For banks, this new scenario implies new costs in the form of contributions to the new resolution fund and potentially higher contributions to the DGS.

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**Figure 12**

**Institutional Resolution Scheme based on current regulatory framework (BRRD, SRM and DGS)**

<table>
<thead>
<tr>
<th>Region</th>
<th>In 2015</th>
<th>From 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eurozone</td>
<td>Local DGS + Local RF (*)</td>
<td>Local DGS + Single RF (SRM)</td>
</tr>
<tr>
<td>Non-Eurozone</td>
<td>Local DGS + Local RF (*)</td>
<td>Local DGS + Local RF (*)</td>
</tr>
</tbody>
</table>

(*) Merger is possible in the same jurisdiction.

Source: BBVA Research
5. Next Steps

- **Intergovernmental agreement:** Despite having been a central element in the negotiations, most key details of the Single Resolution Fund (i.e. the build-up and mutualisation transition profiles) will not be included in the SRM Regulation text, but rather in an Intergovernmental Agreement to be signed by the Member States. The final IGA text is expected to be finalised soon, and its enactment also requires endorsement by all the national parliaments. The chances of any negative surprises on this front are low considering today's agreement, which officially concerns the SRM text but in fact also relates to the key elements of the IGA.

- **SRM text:** After Parliament's approval the text will be published in the Official EU Journal (after due translation into the 28 official EU languages).

- **ESM direct recapitalisation:** This would be a new tool for the European Stabilization Mechanism, to directly recapitalise ailing banks in stressed sovereigns, and would be available once the single supervisor becomes fully operational (November 2014). The Eurogroup already agreed on draft rules for the direct recapitalisation tool in June 2013, and is expected to finalise them this May, in its next meeting. At this moment there some uncertainty remains as regards the future role that the ESM might play in bank resolution. It is expected that it will be available as a very last resort measure, to recapitalise banks that are found to be in a very poor condition after the AQR/Stress test exercise (see below), but this has not yet been confirmed. On the other hand, once the single supervisor is launched, it is assumed that the ESM could again play a pivotal role as a last resort public backstop, but again this has yet to be decided by EU leaders.

- **Legacy issue:** The ECB is now embarked on a comprehensive assessment of the health of the Eurozone banks that it will be directly supervising from November onwards. Those banks showing a capital shortfall as a result of the AQR exercise and/or the stress test will be recapitalised using private sources (markets and partial bail-in among others). If needed, public national sources would be tapped after all private solutions have been used, but applying for European aid is only foreseen as the very last resort measure (either through the sovereign or as a direct recapitalisation if EZ leaders agree, but in any case involving strong conditionality). The idea is thus to solve the legacy issue before even one euro of the Single Resolution Fund is used to resolve a European bank. From January 2016 on, any resolution of a Eurozone bank will be dealt with in the context of the SRM, which means that all significant decisions will be taken at the EU level, from the ECB's initial warning flag to the final SRB decision to trigger resolution (including, in between possible actions required by both the Council and the Commission as the ultimate resolution authorities).
Chapter D: The US Single-Point-of-Entry and orderly liquidation regime

1. Introduction

The financial crisis that began in late 2007 demonstrated the lack of sufficient resolution planning on the part of market participants. In the absence of adequate and credible resolution plans on the part of global systemically important financial institutions (G-SIFIs), the financial crisis highlighted deficiencies in existing U.S. financial institution resolution regime as well the complexity of the international structures of G-SIFIs. At that time, the FDIC’s receivership authorities were limited to federally insured banks and thrift institutions. The lack of authority to place a holding company or affiliates of an insured depository institution (IDI) or any other non-bank financial company into an FDIC receivership to avoid systemic consequences limited policymakers’ options, leaving them with the poor choice of bail-outs or disorderly bankruptcy.

In the aftermath of the crisis, Congress enacted the Dodd-Frank Act in July 2010. It should be stressed that the application of such a strategy can be achieved only within a legislative framework that provides authorities with key resolution powers. In the US, these powers had already become available under the Dodd-Frank Act.

Figure 13 shows the new framework for resolving large, complex financial institutions (entities with consolidated assets greater than or equal to USD50bn) in an orderly way in any future crisis.

Figure 13
Resolution scheme in the US: The decision tree

Source: BBVA Research
Title I and Title II of the Dodd-Frank Act provide significant new authorities to the FDIC and other regulators to address the failure of a SIFI. Title I requires all companies covered under it to prepare resolution plans, or "living wills," to demonstrate how they would be resolved in a rapid and orderly manner under the Bankruptcy Code (or other applicable insolvency regime) in the event of material financial distress or failure. On regards of Title II, therefore, provides a back-up authority to place a SIFI into an FDIC receivership process if no viable private-sector alternative is available to prevent the default of the financial company and if a resolution through the bankruptcy process would have serious adverse effects on U.S. financial stability. Title II gives the FDIC new OLA that provides the tools necessary to ensure the rapid and orderly resolution of a covered financial company.

Finally, the annexes cover some major issues related to resolution, such as the FDIC's role and the definition of insured deposits, the timeline of the title of resolution, an example of the US resolution regime for SIFIs and a comparative analysis of US and EU bank resolution regimes.

2. Traditional resolution process in the US

The protection of insured deposits in the event of a bank or thrift failure is one of the FDIC's most critical roles. When an insured depository institution is about to fail, the FDIC takes immediate action to resolve it, following a resolution process with two different stages.

The resolution stage is the process of resolving failed banks. Here the FDIC values the assets of the failed bank, solicits bids for the sale of the bank and evaluates the bids to determine which one is the least costly for the insurance fund. In the next sub-section the resolution process and types of resolution methods of the FDIC are summarized.

- The liquidation stage is the process of liquidating the assets of the failed bank (e.g., the receivership process). This receivership process is used for all resolution episodes except open-bank assistance. In this phase the FDIC liquidates any remaining assets of the failed bank and distributes the proceeds, first to unsecured depositors, then to the general creditors and finally to the shareholders. In this sense, the National Depositor Preference amendment and related statutory provisions provide that claims are to be paid in the following order:
  1. Administrative expenses of the receiver
  2. Deposit liability claims (the FDIC claim takes the position of the insured deposits)
  3. Other general or senior liabilities of the institution
  4. Subordinated obligations
  5. Shareholder claims

2.1 Resolution process

The resolution process involves valuing a failing federally-insured depository institution, marketing it, soliciting and accepting bids for the sale of the institution, determining which bid is the least costly to the insurance fund, and working with the acquiring institution through the closing process (or ensuring the payment of insured deposits in the event there is no acquirer). The process follows these steps:

- Resolution strategy: the FDIC's resolution activities begin with the receipt of the Failing Bank Letter. After a planning team has contacted the chief executive officer of the failing bank or thrift, the FDIC sends in a team of specialists to complete an information
package. Part of the information package is an asset valuation review. The appropriate resolution structures are then chosen and the FDIC conducts an on-site analysis to prepare a plan for the closing.

- **Marketing a failing institution**: once all the possible resolution methods have been assessed, the FDIC begins to market the failing bank as widely as possible to encourage competition among bidders. An information meeting is held to discuss the details of the failing institution with the approved bidders. All bidders performing due diligence are provided with the same information, so no bidder has an advantage.

- **Bid Submission**: bids are submitted in two parts: the first amount is the premium for the franchise value of the failed institution’s deposits, and the second amount is for all or part of the institution’s assets.

- **Least Cost Analysis**: the new procedures require the FDIC to choose the resolution alternative that is least costly to the FDIC among all possible methods for resolving the failed institution.

- **Calculation of Cash Amount Due to Acquirer**: the FDIC transfers cash to an acquiring or agent institution in an amount equal to the liabilities assumed minus the amount of assets purchased, and minus the amount of the premium if any.

- **FDIC Board of Directors Approval**: the FDIC staffs submit a written recommendation to the FDIC Board of Directors requesting approval of the resolution transaction. The FDIC Board of Directors may direct that the determination of the winning bid should be delegated to the appropriate division director. Once the FDIC Board of Directors has approved the transaction, FDIC staffs notify the acquirer, all unsuccessful bidders, and their respective regulatory agencies.

- **Closing the Institution**: the final step in the resolution process occurs when the institution is closed and the assets and deposits are passed to the acquirer. The chartering authority closes the institution and appoints the FDIC as receiver.

- **Resolution timeline**: the entire resolution process is generally carried out in 90 to 100 days, not including the post-closing settlement time-frames.

### 2.2 Types of resolution methods

To execute the resolution, the FDIC can choose between two alternatives: (i) “closed bank transaction” that includes two tools: purchase and assumption transactions (P&A), and deposits pay-off, in both of which cases the entity disappears, or (ii) “open bank” in which the bank remains “alive” (support loans, guarantees, capital injection).

#### 2.2.1 Purchase and assumption (P&A)

Purchase and assumption is the most common resolution method in the US. In a P&A, a healthy bank purchases some or all of the assets of a failed bank, and assumes some or all of the liabilities. Occasionally, the acquirer may receive assistance from the FDIC to complete the transaction. As part of the P&A transaction, the acquiring bank usually pays a premium to the deposit insurer for the deposits it acquires; the premium reduces the total resolution cost to the insurer. The reason the acquirer pays this premium is because the deposit base has value in terms of the established customer relationships, usually referred to as franchise value.

As each failed bank is different, there are several P&A formats: loan purchase P&As, modified P&As, P&As with put options, P&As with asset pools and whole bank P&As, but the most
common are i) loss-sharing transactions and ii) bridge banks, which have been widely used during the last years.

A. Loss-sharing transaction

The FDIC designated “loss-sharing transactions” to address the problems associated with marketing large banks with substantial commercial loan and commercial real estate portfolios. The aim of this tool is to limit the downside risk of those portfolios to the acquirers. The FDIC absorbs a significant portion (typically 80%) of credit losses on shared-loss assets, usually commercial loans and commercial real estate loans, and the acquiring institutions assume the remaining 20% loss.

By having the acquirer absorb a limited amount of credit loss, the FDIC hopes to pass most of the failed institution’s commercial loans and commercial real estate loans to the acquirer while still receiving a premium for the institution’s deposit franchise. In addition, the FDIC also attempts to induce rational and responsible credit management behaviour from the acquirer.

During the shared-loss period, generally the first five years of the agreement, the receiver reimburses the acquiring institution for 80% of net charge-offs (charge-offs minus recoveries) of the shared-loss assets, plus reimbursable expenses.

During the recovery period, generally the last two-year period of the agreement, the acquiring institution pays the receiver 80% of recoveries, less recovery expenses. Loss-sharing provisions apply to all loans in a designated shared-loss category, for example, commercial loans or commercial real estate loans, whether the loans are performing or not. Figure 14 shows an illustrative example of a loss-sharing agreement.

Figure 14
Loss-sharing agreements

B. Bridge bank

The FDIC acts temporarily as the acquirer, taking over the operations of a failing bank and maintaining banking services for the customers. As the name implies, the bridge bank structure is designed to “bridge” the gap between the failure of a bank and the time when the FDIC implements its satisfactory resolution.

The main characteristics of the bridge bank process are described below:

- **Period:** initially the FDIC organizes a bridge bank for up to two years, with the possibility of as many as three one-year extensions. The temporary bridge structure provides the FDIC with time to take control of the business of the failed bank, stabilize
the situation, and determine an appropriate permanent resolution. It also enables the FDIC to have sufficient flexibility for reorganizing and marketing the bank.

- **Goal:** its management goal is to preserve the franchise value and lessen any disruption to the local community. It accepts deposits, makes low-risk loans to regular customers and honors the commitments made by the failed bank if those commitments would not create additional losses. By continuing the failed bank's lending relationships, it supports the franchise value of the bank.

- **Lending:** the bridge bank is expected to make limited loans to the local community and to honor commitments made by the previous institution that would not create additional losses for the institution, including advancing funds necessary for the completion of unfinished projects.

- **Assets:** the bridge bank officials’ primary focus on the asset side is to ensure that the value of the performing loans is retained, and to identify problematic assets that should be transferred to the receivership.
  - **Market value:** realistic market values are developed for assets by marking them to market (determining a realistic value based on present market conditions) and assigning appropriate loss reserves. If appropriate, assets may be sold. A complete asset inventory is taken to identify, evaluate and work out the failed bank's troubled assets. The most problem-ridden assets with the least potential for improvement, including nonperforming loans, owned real estate and fraud-related assets remain in the failed bank receivership or are transferred to the receivership as soon as they are identified.
  - **Period:** for a period of 30 to 90 days after the bridge bank is chartered, assets may be transferred to the receivership or they may be returned to the bridge bank from the receivership. The bridge bank strives to "work out", or reduce, the volume of non-performing assets.

- **Liabilities:** before its chartering authority closes the failing bank, the FDIC decides whether to pass all deposits or only insured deposits to the bridge bank. Usually, only insured deposits are passed when there is an expected loss to the receivership.

- **Liquidity:** the FDIC reviews the failing bank's liquidity during the bridge bank preparation phase. It monitors liquidity levels to determine if the bridge bank can meet its own funding needs or if it requires access to the FDIC's revolving credit facility. The bridge bank also attempts to re-establish lines of credit and correspondent banking relationships that were maintained by the failing institution.

- **Resolution:** the sale and closing of a bridge bank is similar to the sale and closing of other failed banks.
  - The FDIC requires at least 16 to 24 weeks to properly prepare for the sale, which includes gathering information, soliciting interest from potential acquirers, arranging for due diligence by potential acquirers and receiving and analyzing bids. The bridge bank may be resolved through a P&A transaction, a merger, or a stock sale, although the most common resolution method for bridge banks is the P&A.

### 2.2.2 Deposit pay-off

This option is only executed if the FDIC does not receive a bid for a P&A. In this method the appropriate authority closes the bank, and then the deposit insurer pays all of the failed bank's depositors the full amount of their insured deposits. No assets or liabilities are assumed by another bank; the receiver is responsible for liquidating the assets and paying off the claimants. There are two types of deposit pay-off:
3. New resolution process for US SIFIs under the Dodd-Frank Act

3.1 Pre-resolution phase: early remediation

Section 166 of the Dodd-Frank Act in Title I establishes a regime for the early remediation of financial distress at covered companies (over USD50bn in assets) that includes four levels of remediation requirements and several forward-looking triggers designed to identify emerging or potential issues before they develop into larger problems.

Figure 15
Levels of remediation

- **Heightened supervisory review**, in which the Federal Board would conduct a targeted level review of the covered company to determine if it should be moved to the next level of remediation;
- **Initial remediation**, in which a covered company would be subject to a prohibition on growth and capital distributions;
- **Recovery**, in which a firm would be subject to a prohibition on growth and capital distributions, limits on executive compensation, and requirements to raise additional capital, and additional requirements on a case-by-case basis;
- **Recommended resolution**, in which the Board would consider whether to recommend to the Treasury Department and the FDIC that the firm be resolved.

3.1.1 Early remediation triggers

The early remediation triggers consist of regulatory capital-based triggers; forward-looking triggers based on a supervisory stress test which provides an assessment of the covered...
company’s ability to withstand adverse economic and financial market conditions; market indicators, which provide a third-party assessment of the covered company’s financial position; and risk management and risk committee requirements, as well as the liquidity risk management standards.

Figure 16 shows each level of remediation with its main early remediation triggers.

Figure 16
**Early remediation triggers**

<table>
<thead>
<tr>
<th>Triggers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Heightened supervisory review</strong></td>
</tr>
<tr>
<td>Tier 1 RBC* ratio &gt; 6%; Total RBC ratio &gt; 10%; Tier 1 Leverage ratio &gt; 5%. However, the covered company has demonstrated capital structure or capital structure or capital planning weaknesses.</td>
</tr>
<tr>
<td><strong>Initial remediation</strong></td>
</tr>
<tr>
<td>4%&lt; Tier 1 RBC ratio &lt; 6%%; 10% &lt; Total RBC ratio &lt; 8%; 4% &lt; Tier 1 Leverage ratio &lt; 5%. Under the supervisory stress test severity adverse scenario the Tier 1 common RBC ratio &lt; 5%.</td>
</tr>
<tr>
<td><strong>Recovery</strong></td>
</tr>
<tr>
<td>3% &lt; Tier 1 RBC ratio &lt; 4%; 6% &lt; Total RBC ratio &lt; 8%; 3% &lt; Tier 1 Leverage ratio &lt; 4%. Under the adverse scenario the Tier 1 common RBC ratio &lt; 3%. Or risk-based capital ratios are Tier 1 RBC ratio &lt; 6%; Total RBC ratio &lt; 10%; Tier 1 Leverage ratio &lt; 5%.</td>
</tr>
<tr>
<td><strong>Recommended resolution</strong></td>
</tr>
<tr>
<td>Tier 1 RBC ratio &lt; 3%; Total RBC ratio &lt; 6%; Tier 1 Leverage ratio &lt; 3%.</td>
</tr>
</tbody>
</table>

Source: BBVA Research

If the resolution assessment is triggered because the covered company did not meet any of the risk-based capital and leverage requirements, the Board would consider whether to recommend to the Treasury Department and the FDIC that the firm be resolved under the Orderly Liquidation Authority provided in the Title II of the Dodd-Frank Act, based on whether the covered company is in default or in danger of default and poses a risk to the stability of the US financial system.

### 3.1.2 Resolution plan

As a preventive action before an entity enters the resolution phase, Section 165 in Title I of the Dodd-Frank Act requires each non-bank financial company supervised by the Board of the Federal Reserve System and each bank holding company with total consolidated assets of USD50bbn or more to report periodically to the Board and the FDIC on its resolution plans, so called 'living will', to demonstrate how it would be resolved in a rapid and orderly manner under the Bankruptcy Code, in the event of material financial distress or failure. Although the statute makes clear that bankruptcy is the preferred resolution framework in the event of the failure of a SIFI, Congress recognized that a SIFI might not be resolvable under bankruptcy without posing systemic risk.

The FDIC and the Federal Reserve are required to review the plans to determine whether a company’s plan is credible. If a plan is found to be deficient and adequate revisions are not made, the FDIC and the Federal Reserve may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities, or operations of the company, including its subsidiaries. Ultimately, the company could be ordered to divest assets or operations to facilitate an orderly resolution under bankruptcy in the event of failure. Once submitted and accepted, the SIFI’s plans for resolution under bankruptcy will support the FDIC’s
planning for the exercise of its resolution powers by providing the FDIC with an understanding of each SIFI's structure, complexity and processes.

As has been explained above, for SIFIs the bankruptcy process would have serious adverse effects on US financial stability. For this reason, Title II of the Dodd-Frank Act provides a back-up authority to place a SIFI into an FDIC receivership process, if no viable private-sector alternative is available to prevent the financial company's default. Moreover, this Title provides the FDIC with the new Orderly Liquidation Authority (OLA), which provides the necessary tools to ensure the rapid and orderly resolution of a covered financial company.

3.2 Resolution phase

Title II, the Orderly Liquidation provision of the Dodd-Frank Act, provides a process to quickly and efficiently liquidate a large, complex financial company that is close to failing and poses a significant risk to the financial stability of the United States, in a manner that mitigates such risk and minimizes moral hazard.

In this regard, Title II provides an alternative to the bankruptcy law, in which the Federal Deposit Insurance Corporation (FDIC) is appointed as the receiver to carry out the liquidation and wind-up of depositary institutions and systemically important firms.

This section summarizes the main provisions stated in the Orderly Liquidation Process of the Dodd-Frank Act in Title II as follows:

A. Determination for receivership

A financial company should be placed in receivership when all the following conditions are met:

- The bank is in default or in danger of default (when it is likely to file for bankruptcy, has incurred debts that will exhaust all or most of its capital, has greater debts than assets, or will probably be unable to pay its debts in the normal course of business);
- The failure of the financial company and its resolution under other applicable law would have serious adverse effects on financial stability in the US; and
- No private alternative is available to prevent the default of the financial company.

B. FDIC's roles and duties as a resolution authority

The FDIC as receiver or liquidator has to fulfil the following obligations:

In taking action as a receiver, the FDIC must:

- Determine that resolution actions are necessary for the purpose of preserving the financial stability of the US, and not for the purpose of preserving the financial company.
- Ensure that shareholders do not receive payment until after all other claims and the Orderly Liquidation Fund are fully paid.
• Ensure that unsecured creditors bear losses in accordance with the priority of claims.
• Ensure that management responsible for the failed condition of the covered financial company is removed.
• Ensure that the members of the board of directors responsible for the failed condition of the covered financial company are removed.
• Not take an equity interest in or become a shareholder of any covered financial company or any covered subsidiary.

Rulemaking by the FDIC regarding receiverships

• Another obligation of the FDIC as a receiver is issuing rules and regulations to implement Title II, regarding the resolution approach and how particular creditors will be treated.
• Moreover, it is important to keep in mind that the Dodd-Frank Act provides the FDIC with a high level of flexibility in carrying out its resolution and liquidation responsibility (as, for instance, in establishing a bridge financial company and the way that creditors will bear the losses).

Powers and duties of the FDIC

• Operation of the covered financial company: the FDIC is directed to liquidate the company in a manner that the FDIC deems appropriate, including through the sale of assets, and the transfer of assets to a bridge financial company.
• Merger; transfer of assets and liabilities: the FDIC as receiver may (i) merge the covered financial company with another company, or (ii) transfer any asset or liability.
• Payment of valid obligations: the FDIC is required, to the extent that funds are available, to pay all valid obligations of the covered financial company that are due.
  o Treatment of shareholders and creditors of the covered financial company: the FDIC is required to ensure that shareholders and unsecured creditors shall bear losses.
  o Suspension of legal actions: the FDIC may require a stay in any legal action or proceeding in which the covered financial company is or becomes a party for a period not to exceed 90 days.
  o Objectives in the disposition of assets: the FDIC, in exercising its powers as receiver, has to (i) maximize the net present value return from any sale or disposition, (ii) minimize the amount of any loss realized in the resolution of cases, (iii) mitigate the potential for serious adverse effects to the financial system, and (iv) ensure fair treatment.
  o Priority of claims: the FDIC has to approve valid claims against the company that will need to be paid.
  o Treatment of similarly-situated creditors: all claimants of a covered financial company that are similarly situated in terms of priority are to be treated in a similar manner, except if the FDIC determines to the contrary.

C. Claim priority

Title II provides a claims process to assert claims against a defaulting financial company, and a series of rules to allow for the liquidation of assets and the payment of claim holders, according to a list of priority payments. Claims are paid in the following order:

1. administrative costs;
2. the government;
3. wages, salaries or commissions of employees;
4. contributions to employee benefit plans;
5. any other general or senior liability of the company;
6. any junior obligation;
7. salaries of executives and directors of the company; and
8. obligations to shareholders, members, general partners, and other equity holders.

This priority schedule helps to achieve the goal of ensuring that the executives, directors and shareholders bear the losses of the failed company by being last in line to receive payment. Regardless of how the FDIC conducts the liquidation, it must be taken into account that all action under Title II must be taken to preserve the financial stability of the economy as a whole, not merely to preserve the specific company in question.

D. SPE strategy and bridge financial company at holding level

Last December the FDIC published a consultation document on “The resolution of Systemically Important Financial Institutions: the single point of entry strategy” that describes in greater detail the preferred resolution strategy in the US, highlights some of the issues identified in connection with the strategy and requests public comment on various aspects of the strategy. The central point of the SPE strategy is that a resolution should take place at the holding company level only, leaving subsidiaries to continue operations.

The key idea under the US SPE scheme is that the FDIC will be appointed receiver of only the top-tier US parent holding company of the failed firm. That is to say, failure and significant losses of any operational banks would always be assumed by the holding company, and subsidiaries would remain open and continue operations. It is important to explain that once a holding enters receivership, the FDIC would organize a bridge financial company (implementation of the combination of two resolution tools, bail-in and bridge bank), as follows:

- **Transfer to Bridge Company:**
  - The FDIC would organize a bridge financial holding company into which it would transfer assets from the receivership, leaving the liabilities behind as has been explained above.
  - Therefore, the newly formed bridge financial holding company would continue to provide the holding company functions of the failed parent. The company’s subsidiaries would remain open and operating, allowing them to continue critical operations and avoid the disruption that would otherwise accompany their closure.
  - To the extent necessary, the FDIC would then use available parent holding liabilities to recapitalize the new bridge holding bank through a bail-in tool. Equity claims of the failed parent’s shareholders would effectively be wiped-out, and the claims of its unsecured debt holders would be written down as necessary, to reflect any losses or other resolution costs in the receivership.

- **Structure of Bridge Company:** The FDIC, upon its appointment as receiver would establish a board of director and chairman from “a pre-screened pool of eligible candidates” which in turn would appoint a chief executive officer of the bridge financial company.

- **Operating agreements:** The FDIC would require the company to enter into an initial operating agreement requiring certain actions including, among others:
  - review of the risk management policies and practices of the SIFI that led to the failure and prompt development of a plan to address them;
o preparation and delivery of a business plan for the bridge financial company (including asset disposition strategies);

o preparation of a capital, liquidity and funding plan consistent with the terms of any mandatory repayment plan and the capital and liquidity requirements established by regulators with respect to the SIFI’s operating entities;

o retention of FDIC-approved accounting and valuation consultants; and

o preparation of a restructuring plan to make the emerging company resolvable under the US Bankruptcy Code.

- **Claims priority**: FDIC must conduct a claims process and establishes a claims priority hierarchy for the satisfaction of claims without the use of taxpayer funds. Following the claims process, claims against the receivership would be satisfied through a debt-for-securities exchange in accordance with their priority under OLA through the issuance of debt and equity in a new holding company. Prior to the exchange of securities for claims, the FDIC would determine the value of the bridge financial company based upon a valuation performed by the consultants selected by the board of the bridge financial company.

- **Timing**: The bridge financial company should be ready to execute the bail-in tool within six to nine months.

In this sense, the common legal structure of US banking firms, through non-operating holding companies, facilitates the implementation of an SPE approach. The liabilities of the top-tier holding company are structurally subordinated to the customer obligations and other direct liabilities at the firm’s operating subsidiaries. Therefore, under the Single Point of Entry approach, the equity and debt at the holding company level can form a buffer that must first be exhausted before any customer or creditor of a subsidiary suffers losses. As has been explained before, Figure 17 illustrates how the bridge bank operates and bail-in. (See annex for further details)

**Figure 17**

**US Bridge bank bail-in**

<table>
<thead>
<tr>
<th>Business-as-usual</th>
<th>US bail-in and bridge bank process</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image1" alt="" /></td>
<td><img src="image2" alt="" /></td>
</tr>
</tbody>
</table>

Source: BBVA Research

This SPE approach, as outlined above, will only be successful if there is sufficient debt and equity at the holding company to both absorb losses in the failed firm and fully capitalise the new bridge holding bank. In this sense, as the current US law does not set a specific required amount of bail-inable debt, it is expected that in the next few months the Federal Reserve, in consultation with the FDIC, will be issuing a proposal that would require the largest, most complex banking firms to hold minimum amounts of long-term, unsecured debt at the holding company level.
E. Orderly Liquidation Fund

An Orderly Liquidation Fund (OLF) is established in the Treasury that would be available to the FDIC in connection with its receivership operations. In this sense, the FDIC is authorized to issue obligations to the Treasury Secretary to borrow funds. It is important to keep in mind that the OLF provides neither capital nor guarantees.

Initially, the Fund should be capitalized over a period no shorter than five years, but no longer than ten. However, in the event that the FDIC needs to make use of the Fund before it is fully capitalized, the Secretary of the Treasury and the FDIC are permitted to extend the period as determined to be necessary.

The Orderly Liquidation Fund is financed as follows:

- The FDIC is authorized to issue obligations (debt securities) to the US Treasury to initially fund the Orderly Liquidation Fund, not exceeding:
  - During the 30-day period immediately following the appointment of the receiver, an amount that is equal to 10% of the total consolidated assets of the covered financial company, and
  - After such 30-day period, 90% of the fair value of the total consolidated assets of each covered financial company that is available for repayment.

- Amounts in the Fund become available to the FDIC with regard to a bank, only after the FDIC has developed an orderly liquidation plan for the company.

- Any Orderly Liquidation Fund borrowing must be repaid either from recoveries on the assets of the failed firm or from contributions of other financial institutions with consolidated assets of USD50bn or more, based on their risk-based assessments. The Orderly Liquidation Fund is financed ex-post and the FDIC, if needed at all, anticipates that Orderly Liquidation Fund borrowings would only be issued in limited amounts for a brief transitional period in the initial phase of the resolution process, and would be repaid promptly once access to private funding is resumed.

In the event that the OLF and other sources of capital are insufficient, the FDIC is authorised to buy and sell securities on behalf of the company (or companies) in receivership, to raise additional capital.
Box 4. Bail-in and the review of the US bank holding ratings

On November 14, 2013, Moody’s Investors Service (Moody’s) concluded its review of eight large US banking groups to reflect strengthened US bank resolution tools. Moody’s removed all rating uplift from US government support in the ratings for a bank holding company as a consequence of the FDIC’s Single-Point-of-Entry and bail-in framework that influence risks for bondholders at the bank holding company level.

Since 2012, credit rating agencies have been reviewing their criteria methodologies of the company ratings of all systemically-important US banking groups, whose debt ratings benefit from ‘uplift’ due to government support above what they would be rated, based solely on their stand-alone credit quality. The methodology’s review reflects the progress the FDIC has made in devising a mechanism to implement the Orderly Liquidation provision.

On November 14, 2013, Moody’s announced the review of the eight largest US banking groups’ credit ratings (Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan, Morgan Stanley, State Street and Wells Fargo).

Moody’s acted on the systemic support assumptions as follows:

1) removed all uplift from US government support in the ratings for bank holding company debt → negative effects on bank holding ratings.

2) reduced loss severity assumptions for bank holding company debt → positive effects on bank holding ratings.

3) reduced uplift for bank-level subordinated debt → negative effects on operational bank rating.

4) did not change the support assumptions for bank-level senior debt → neutral effects on operational bank rating.

The key rationale behind those changes, as Robert Young, Managing Director of Moody’s, stated, “Bank holding company creditors will be bailed in and, thereby, shoulder much of the burden to help recapitalize a failing bank”.

Take aways for Europe

On 4 March, 2014 Standard & Poor’s (S&P) released a report warning of potential downgrades for European banks due to the review of the government support criteria in the context of the Bank Recovery and Resolution Directive (BRRD). The S&P review is likely to be completed and could result in a gradual downgrade by one or two notches in the next two years – the bail-in will come into force in 2016.

The bail-in tool reflect a new paradigm in dealing with ailing banks - avoiding bail-outs by using bail-ins. Removing the sovereign “uplift” reveals two effects: i) resolution regimes are credible and predictable, and ii) the bail-in of creditors could become a common practice in case of bank failure. Whether the elimination of parent support will be total or partial will depend on the degree of flexibility that the government retains.

Removing government support in the bank credit rating would have the following considerations:

- A positive step towards eliminating fragmentation in the European financial sector. The recent crisis has shown the pernicious effects of the sovereign/banking loop on the European economy. This vicious circle has been reinforced by credit rating methodologies. Chart 1 illustrates this phenomenon, highlighting the different outcomes that sovereign uplifts and/or downgrades provoke on final bank ratings between core and non-core European banks.

- Each bank’s fundamentals and liability structures will become more relevant under the new resolution regimes. The use of a sovereign rating as the measure of available support and also as the ceiling for a bank rating, regardless of its inherent fundamentals, may create misclassifications across European banks. As a result of the removal of the sovereign rating link, bank creditors should exert more efforts in monitoring their stand-alone credit quality, thus reducing moral hazard and enhancing market discipline.
Chapter E: The US versus EU resolution regime

1. Introduction

Resolution frameworks should always seek two objectives. First, resolving banks should be a quick process and must avoid negative spill over effects to the rest of the financial system. Second, resolution regimes must be designed to protect taxpayers’ money. Besides common principles, there are major differences on how countries design the resolution regimes to achieve those two goals. A clear example of those divergences is the EU and US resolution frameworks.

Table 2 shows a high-level comparative analysis between the US and the EU resolution regimes.

<table>
<thead>
<tr>
<th>Table 2: High-level comparative analysis between the US and EU resolution regimes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>US (Dodd-Frank Act-Title II)</strong></td>
</tr>
<tr>
<td><strong>Goal</strong></td>
</tr>
<tr>
<td>i) To resolve failing financial institutions quickly, ensuring the stability of the financial system</td>
</tr>
<tr>
<td>ii) To minimize taxpayer contributions to resolution episodes</td>
</tr>
<tr>
<td><strong>Scope</strong></td>
</tr>
<tr>
<td><strong>Resolution Authority</strong></td>
</tr>
<tr>
<td><strong>Trigger for resolution</strong></td>
</tr>
<tr>
<td>i) Failing or likely to fail institutions</td>
</tr>
<tr>
<td>ii) To protect public interest and financial stability; and</td>
</tr>
<tr>
<td>iii) No private alternatives to prevent the default of the institution.</td>
</tr>
<tr>
<td><strong>Recovery Plan</strong></td>
</tr>
<tr>
<td><strong>Resolution Plan</strong></td>
</tr>
<tr>
<td><strong>Resolution Strategy</strong></td>
</tr>
<tr>
<td><strong>Bail-in - Hierarchy of claims</strong></td>
</tr>
<tr>
<td><strong>Resolution Fund - Liquidity support</strong></td>
</tr>
<tr>
<td><strong>Public support</strong></td>
</tr>
</tbody>
</table>

Source: BBVA Research

This Chapter compares the differences between the US and the EU resolution frameworks, and is an attempt to answer three key questions: what, when and how are institutions resolved? As such, the Chapter is divided into three sections. First, it describes the scope and the resolution authorities of each resolution framework. Second, it describes the trigger conditions that activate the resolution process in the US and EU. And finally, it covers the resolution strategies and tools under both regimes.

---

8: Although the US regulation does not recognize the bail-out as a feasible alternative, the IMF considers that “excluding the possibility of government support for SIBs may be neither credible nor socially desirable” (See Chapter 3 of the Global Financial Stability Report, April 2014)
2. Different scope of institutions

In both cases, in the US and in the EU, much effort has recently been made to improve the legal framework for resolution of financial institutions. In this regard, both frameworks enable authorities to resolve failing financial institutions quickly, ensuring the stability of the financial system and preserving the main banking operations. In addition, both regulatory initiatives try to minimize taxpayer contributions to resolution episodes.

Each resolution framework will cover different types of institutions

In the US, the bankruptcy code is the common resolution framework. Nevertheless, large and complex financial companies (entities with consolidated assets of USD50bn or more) must be resolved under Title II of Dodd Frank Act called “Orderly Liquidation Authority” (OLA).

On the contrary, the BRRD covers all credit institutions and investment firms established in the European Union.

<table>
<thead>
<tr>
<th>Table 3</th>
<th>Legal framework to resolve non-SIFIs and SIFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>NonSIFIs</td>
</tr>
<tr>
<td></td>
<td>Traditional resolution process</td>
</tr>
<tr>
<td>EU</td>
<td>Resolution framework for SIFIs</td>
</tr>
<tr>
<td></td>
<td>BRRD</td>
</tr>
<tr>
<td></td>
<td>BRRD</td>
</tr>
</tbody>
</table>

Source: BBVA Research

The FDIC is the Resolution Authority

As explained before, in the US, under the Dodd-Frank Act\(^9\), the FDIC is the resolution authority for SIFIs. To be more precise, the FDIC as the resolution authority established the Single Point of Entry (SPE) as the resolution strategy using the bridge financial company tool.

However, in the EU, under the BRRD, each Member State will designate public authorities to act as resolution authorities. In case of the Eurozone (EU-18) the BRRD\(^10\) will define a Single Resolution Authority (SRA), which will be the European Commission, or the Council. In any case, independently of the SRA in Europe, the resolution decision scheme will be more complex and less agile than in the resolution decision scheme in the US, due to the "more complex" EU institutional structure.

3. When is resolution activated?

The trigger conditions for activating the resolution process are similar in the US and the EU. They share the three key conditions to start a resolution process: i) an institution is failing or likely to fail, ii) to protect public interest and financial stability; and iii) there are no private alternatives to prevent the default of the institution. However, the US has one additional condition, when a regulatory agency has ordered the institution to convert all of its convertible debt instruments. This condition is not included in the BRRD (see Table 4).

---

\(^9\): Title II of the Dodd Frank Act provides the FDIC with new powers to resolve SIFIs by establishing the orderly liquidation authority (OLA). Under the OLA, the FDIC may be appointed as receiver for any US financial company that meets specified criteria, including being in default or in danger of default, and whose resolution under the US Bankruptcy Code (or other relevant insolvency process) would be likely to create systemic instability.

\(^10\): The BRRD provides the technical tools for the SRM to develop resolution powers in the Eurozone in the near future.
Resolution actions should be taken when all the following conditions are met:

<table>
<thead>
<tr>
<th>Table 4</th>
<th>Trigger conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>US</strong></td>
<td><strong>EU</strong></td>
</tr>
<tr>
<td><strong>Likely to fail</strong></td>
<td>Institution is in default or in danger of default (when it is likely to file for bankruptcy, has incurred debts that will exhaust all or most of its capital, has greater debts than assets, or will likely be unable to pay its debts in the normal course of business)</td>
</tr>
<tr>
<td></td>
<td>Institution is failing or likely to fail (when it is in breach, has greater debts than assets, or will likely be unable to pay its debts, extraordinary public financial support is required).</td>
</tr>
<tr>
<td><strong>Public Interest &amp; Stability reasons</strong></td>
<td>The failure of the institution resolution under other applicable law would have serious adverse effects on financial stability in the US. Any effect on the claims or interests of creditors, counterparties and shareholders of the financial company and other market participants, as a result of actions to be taken is appropriate on financial stability in the US.</td>
</tr>
<tr>
<td></td>
<td>A resolution action is necessary in the public interest.</td>
</tr>
<tr>
<td><strong>No private alternatives</strong></td>
<td>No viable private-sector alternative is available to prevent the default of the financial company.</td>
</tr>
<tr>
<td></td>
<td>There is no reasonable prospect of any alternative private-sector measures.</td>
</tr>
<tr>
<td><strong>Debt Conversion</strong></td>
<td>A Federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order.</td>
</tr>
</tbody>
</table>

Source: BBVA Research

4. How is the resolution implemented?

In the resolution phase, we can differentiate two types of tools: ex-ante resolution tools which have a pre-emptive character meanwhile ex-post measures that come into force once the resolution starts.

**Ex-ante resolution tools**

The ex-ante resolution tools' goals are i) to build up buffers to deal with bank losses and therefore to protect taxpayers' money in the case of resolution; ii) to make plans to help financial institutions to recover - or be allowed to fail - and thereby ensure a quick resolution process.

Setting a Gone-Concern Loss-Absorbing Capacity (GLAC) ratio and defining recovery and resolution plans are examples of ex-ante measures.

**Has a Gone-Concern Loss-Absorbing Capacity (GLAC) requirement been defined?**

The GLAC is an additional requirement that institutions must fulfil to overcome the "too big to fail" issue and complements other solvency requirements such as capital, liquidity or leverage ratios.

The discussion about the definition of a minimum GLAC in the FSB is at an early stage and the consultation paper is not expected until mid-2014. However, it is worth mentioning that the regulatory debate in some jurisdictions is several steps ahead. In particular, European authorities obtained a final agreement on the BRRD in December 2013 and the US authorities
have launched a consultation paper requesting comment on, inter alia, the GLAC’s level and cost concerns.

In Europe, the BRRD establishes the Minimum Requirement of Eligible Liabilities (MREL) ratio. This ratio is defined as an institution’s own funds and eligible liabilities expressed as a percentage of its total liabilities and own funds, excluding net derivatives. At present, the EU framework does not set a legal minimum requirement of bail-inable liabilities but the European Banking Authority (EBA) will be responsible for defining it by October 2016. In this respect the difference in business models and individual idiosyncrasy will be considered. US regulators have used the language of ‘gone concern’ loss absorbency and a regulatory proposal is expected imminently.

**The Recovery and Resolution Plans’ requirements**

In the US, the Dodd-Frank Act requires that bank holding companies with total consolidated assets of USD50bn or more periodically submit resolution plans to the Federal Reserve (Fed) and the Federal Deposit Insurance Corporation (FDIC). (See Table 5). However, in the US there is no framework for elaborating recovery plans.

Table 5

<table>
<thead>
<tr>
<th>Number and type of banks that have submitted resolution plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>More than USD250bn</td>
</tr>
<tr>
<td>Between USD100bn and USD250bn</td>
</tr>
<tr>
<td>Between USD50bn and USD100bn</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Source: BBVA Research

In Europe, the BRRD requires all entities to submit recovery plans to the resolution authority on an annual basis. Nevertheless, the resolution authority is the one responsible for elaborating the resolution plan in collaboration with the institution. The recovery plan is the firm’s complete “menu of options” for addressing extreme financial stress caused by internal or system failures. Figure 18 summarizes the resolution information pack.

In the US, there is no legal framework that requires developing a recovery plan. Nevertheless the resolution plan has to be developed by the institution. The US resolution plan includes the following information: i) a map of their core business lines, and critical operations to material entities; ii) summary financial information; iii) Summary financial information regarding assets, liabilities, capital and funding; iv) derivative and hedging activities; v) memberships of material payment, clearing, and settlement systems; vi) description of foreign operations; vii) material supervisory authorities ix) principal officers; x) resolution planning corporate governance structure and related processes; xi) description of material Management Information Systems and xii) summary of resolution strategies.

In contrast, in the EU the resolution plan is prepared by the resolution authorities in cooperation with supervisors in normal times. Authorities may require institutions to assist them in the drawing up and annual updating of the plans. 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. It will set out options for resolving the institution (or its groups) in a range of scenarios, including systemic crisis when trigger conditions for resolution is reached. Such plans

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11: FDIC (December 2013), consultation paper on ‘The resolution of systemically important financial institutions: the Single Point of Entry’

12: The Fed’s Governor D. Tarullo and FDIC’s Chairman M. Gruenberg recently signaled that they will issue a proposal that requires US banks to hold minimum amounts of long-term unsecured debt at the holding company level
Ex-post resolution tools

The ex-post resolution tools constitute the effective comprehensive tools in case a resolution takes place.

What are the resolution strategies and tools?

As the FSB published in July 2013, there are two stylised resolution strategies that global banks may apply: the Single-Point-of-Entry (SPE) and the Multiple-Point-of-Entry (MPE). The application of these resolution strategies should take into account the firms’ particular characteristics - business model, corporate and legal structure (See Box 1 for further details).

In this context, it is important to note that the majority of the US SIFIs are domestic and are generally organized in a holding company structure with a top-tier parent and operating subsidiaries that comprise hundreds, or even thousands, of interconnected entities. As a result of this, Dodd Frank Act establishes the SPE strategy as the benchmark for resolving banks in the US. The central point of the SPE strategy is that a resolution should take place at the holding company level only, leaving subsidiaries to continue operations. In the European context, the BRRD leaves more room for manoeuvre and allows both strategies, MPE and SPE.

When can the resolution fund be used?

The way in which the resolution fund is used and the discretionality that is applied in its use by the resolution tools are the key differences regarding the resolution framework.

In the US, the Orderly Liquidation Fund (OLF) is established at the Treasury and it is available to the FDIC in order to borrow funds (neither capital nor guarantees). On the other hand, under the BRRD, where each Member State establishes its own financing arrangements, these EU resolution funds would be available to support institutions under resolution via loans, guarantees, asset purchases or capital for bridge banks.

The main difference is that in the US there is no strict trigger to activate the use of the resolution fund to funding the bridge financial company. The OLF is used only when customer sources of funding are not available. Meanwhile, in the EU, when resolution authorities decide to exclude an eligible liability from bail-in, the resolution fund could be used after a minimum level of 8% of total liabilities have been bailed-in. At this stage, the resolution fund is used to cover any losses which have not been absorbed by eligible liabilities excluded from bail-in up to 13% of total liabilities. In addition it can be used to purchase shares or other instruments of ownership or capital instruments of the institution under resolution.

Another notable aspect is that the EU resolution fund must be financed ex-ante (the target level is 1% of the covered deposits in 10 years), while in contrast, in the US there is no ex-ante level.

The following table summarizes the comparison between the main aspects of the US and EU resolution funds.

---

In Europe, in addition to the resolution tools, in a very extraordinary situation of a systemic crisis and when some conditions are met (after application of bail-in, complying with State Aid rules), the resolution authority may seek funding from alternative financing sources, including the use of government stabilization tools. These tools are temporary public ownership and a public equity support tool. That is to say, in the EU resolution framework public bail-out share not dismissed in very extraordinary situations (systemic crises). However, the US resolution regime does not envisage any public ownership.

**What is the creditor hierarchy?**

As regards the priority of claims, it is worth mentioning the similarities between the two resolution frameworks. In both regimes, the deposit preference has been established as a general principle. Under the US regime, insured and uninsured depositors are ranked ahead of unsecured creditors. However, in the EU there are different layers differentiating therefore the seniority of certain deposits (covered deposits have a higher priority ranking than that part of eligible deposits from households and SMEs, which exceed the coverage level), for that reason the risk of funding arbitrage and market fragmentation should not be minimized in the EU.

Moreover, under the EU framework, the Deposit Guarantee Scheme (DGS) funded by banks would be established to guarantee deposit amount up to EUR 100,000 per depositor. However, the FDIC insures an amount of USD 250,000 per depositor.

In both cases the deposit guarantee scheme will only absorb losses under liquidation but not in the resolution scheme. In the EU, the DGS has been excluded from the bail-in tool.

The following table shows the hierarchy of claims for both frameworks (from the first to the last to absorb losses).

---

**Table 6**

<table>
<thead>
<tr>
<th>Resolution fund</th>
<th>US</th>
<th>EU</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purpose of resolution fund</strong></td>
<td>Funding the bridge financial company</td>
<td>• Cover any losses of eligible liabilities excluded from bail-in Recapitalisation.</td>
</tr>
<tr>
<td><strong>Instruments</strong></td>
<td>Funding (liquidity). No recapitalization.</td>
<td>Loans, guarantees, asset purchases or capital for bridge banks.</td>
</tr>
<tr>
<td><strong>When the resolution fund is used</strong></td>
<td>Customer funding is not available.</td>
<td>After 8% of total liabilities has been bailed.</td>
</tr>
<tr>
<td><strong>Cap level of the use of the resolution fund</strong></td>
<td>10% of the total consolidated assets of the covered financial company.</td>
<td>The contribution of the resolution fund will be capped at 5% of total liabilities.</td>
</tr>
<tr>
<td><strong>Financing</strong></td>
<td>Repayment of OLF-ex-post contribution: • Sale or refinancing of bridge financial company assets. • If not sufficient the receiver would impose risk-based assessments on eligible financial companies.</td>
<td>• Ex-ante target level: at least 1% of the covered deposits in 10 years. • Ex-post contribution • If the two previous options are insufficient, there are alternative financing sources as borrowings or other forms of support.</td>
</tr>
</tbody>
</table>

Source: BBVA Research
### Table 7
**Order of loss absorption**

<table>
<thead>
<tr>
<th>US Title II Dodd Frank Act</th>
<th>EU</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Obligations to shareholders, members, general partners and other equity holders;</td>
<td>1. Common Equity Tier1 instruments;</td>
</tr>
<tr>
<td>2. Salaries of executives and directors of the company;</td>
<td>2. If writing down CET1 is not sufficient then authorities should reduce to zero the principal of Additional Tier 1 instruments and Tier 2 instruments,</td>
</tr>
<tr>
<td>3. Any junior obligation;</td>
<td>3. Only then followed by subordinated debt not classified as Additional Tier 1 or Tier2;</td>
</tr>
<tr>
<td>4. Any other general or senior liability of the company;</td>
<td>4. Senior debt and uncovered corporate deposits,</td>
</tr>
<tr>
<td>5. Contributions to employee benefit plans;</td>
<td>5. Uncovered SME and retail deposits,</td>
</tr>
<tr>
<td>6. Employee wages, salaries or commissions;</td>
<td>6. Deposits covered by the DGS.</td>
</tr>
<tr>
<td>7. The government;</td>
<td></td>
</tr>
<tr>
<td>8. Administrative costs.</td>
<td></td>
</tr>
</tbody>
</table>

Source: BBVA Research
Conclusion

Since the FSB objective of ending "too big to fail" was endorsed at the Pittsburgh Summit in 2009, a lot of work has been done by policy-makers in dealing with failed banks. Resolving banks quickly, ensuring the stability of the financial system and minimising taxpayers’ contribution to resolution episodes have been becoming a key priority. In this sense, the FSB papers on designing the key attributes of effective resolution regimes have been the first milestone in defining a new global crisis management regime to resolve failing systemically important financial institutions in the near future.

Based on the FSB guidelines, the new regulatory regime has been significantly improved, particularly with the steps done in Europe and the US.

- The EU Banking Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) approved last April represent a major step forward in aligning the resolution regimes of the EU member states and the eurozone respectively. Through these new rules, Europe establishes a common and consistent resolution toolkit among all EU countries; and the SRM sets a single resolution authority and resolution fund which complements the new ECB’s supervision role in the eurozone. The bail-in tool (fully effective from 2016) is becoming the cornerstone of the BRRD helping to reduce the fragmentation in the EU financial markets and breaking the vicious circle between banks and sovereigns. Additionally, a consistent framework across Europe would avoid mistakes that have occurred in the past in terms of coordination and effectiveness aided by the stricter framework for the countries that are part of the SSM.

- The US is the other region that has changed its legislation to improve its resolution regime, particularly focused on the large US financial institutions. These recent reforms demonstrate a clear trend towards the introduction of a specific resolution regime for SIFIs and tools aimed at “public interest” objectives, such as the maintenance of financial stability, avoiding finance public contributions, and the protection of retail depositors.

From a cross-border resolution standpoint, a key challenge for global banking groups is to develop a consistent solution that relies on a variety of legal regimes and overcomes all reluctance among the authorities involved. The effectiveness of a cross-border resolution regime will be limited unless it is immediately accepted as legally binding and operationally effective by all parties, and national authorities act collectively in a coordinated and predictable way. In this sense, EU regulation provides a more comprehensive framework considering different resolution strategies (MPE and SPE) and trying to define the relationship with foreign authorities, whereas the US regime disregards the role of other countries.

The current trends are focused on banks and the resolution of single legal entities in a block of jurisdictions (e.g., the EU and US) but not in a global and international perspective. In this sense, national authorities need to address the impediments to cross-border cooperation and coordination. Authorities should work together minimizing any issue arising from current divergences (e.g., different hierarchy of claims, mutual cross-border recognition, etc.). In this regard, the resolution plans could be a valuable tool to enhance cooperation among all relevant resolution authorities.

Last but not least, while major legislative reforms have already been undertaken by both Atlantic regions, it is clear that implementation of the FSB’s recommendations is still at an early stage in other regions such as Latam or Asia either with a home or host perspective. This is not surprising as these are “new” international standards, and the reforms needed to implement them may involve significant legislative changes that will take time, and regional priorities differ. Global regulators should work on improving these frameworks but must take into account the specifics of each jurisdiction.

The technical standards and guidelines delegated to the EBA related to BRRD are shown in Table 8.

Table 8

<table>
<thead>
<tr>
<th>No.</th>
<th>Article</th>
<th>Topic</th>
<th>Type</th>
<th>Description</th>
<th>Deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>4(5), 4(6)</td>
<td>Simplified obligations</td>
<td>Guidelines followed by RTS</td>
<td>Specifying the criteria for assessing the impact of an institution’s failure on financial markets, on other institutions and on funding conditions for the purpose of simplified obligations.</td>
<td>Guidelines within 12 months of publication, followed by RTS within 36 months.</td>
</tr>
<tr>
<td>2</td>
<td>4(11)</td>
<td>Simplified obligations</td>
<td>ITS</td>
<td>Specifying uniform formats, templates and definitions for the identification and transmission of information by competent authorities and resolution authorities to EBA on how they have applied simplified obligations.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>3</td>
<td>5(7)</td>
<td>Recovery plans</td>
<td>Guidelines</td>
<td>Specifying the range of scenarios to be used for the purposes of recovery planning. In close cooperation with the ESRB.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>4</td>
<td>5(10)</td>
<td>Recovery plans</td>
<td>RTS</td>
<td>Specifying information to be contained in recovery plans.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>5</td>
<td>6(8)</td>
<td>Assessment of recovery plans</td>
<td>RTS</td>
<td>Minimum criteria for the assessment of recovery plans.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>6</td>
<td>9(2)</td>
<td>Recovery plan indicators</td>
<td>Guidelines</td>
<td>Specifying the minimum list of qualitative and quantitative recovery plan indicators.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>7</td>
<td>10(9)</td>
<td>Resolution plans</td>
<td>RTS</td>
<td>Specifying the contents of resolution plans.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>8</td>
<td>11(3)</td>
<td>Resolution plans</td>
<td>ITS</td>
<td>Procedures and a minimum set of standard forms and templates for provision of information for resolution planning.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>9</td>
<td>12(6)</td>
<td>Resolution plans</td>
<td>RTS</td>
<td>Specifying the contents of group resolution plans.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>10</td>
<td>15(4)</td>
<td>Resolvability assessments</td>
<td>RTS</td>
<td>Specifying the matters and criteria for the assessment of the resolvability of institutions or groups.</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td>11</td>
<td>17(8)</td>
<td>Impediments to resolvability</td>
<td>Guidelines</td>
<td>Specifying further details on the measures to address impediments to resolvability and the circumstances in which each measure may be applied.</td>
<td>Within 12 months.</td>
</tr>
</tbody>
</table>
| 12 | 23(2) | Intra-group financial support | RTS | “Specify” the following conditions:  
- there is a reasonable prospect that the support provided significantly redresses the financial difficulties of the group entity receiving the support;  
- the financial support is provided on terms, including consideration, in accordance with Article 16(4);  
- the provision of the financial support would not jeopardise the liquidity or solvency of the group entity providing the support; and  
- the provision of the financial support would not undermine the resolvability of the group entity providing the support. | Within 12 months. |
| 13 | 23(3) | Intra-group financial support | Guidelines | To promote convergence in practices to specify the conditions in paras. (b), (d), (ea), (f) and (fa) of Article 19(1). | Within 18 months. |
| 14 | 26(2) | Disclosure | ITS | Concerning the form and content of the public description of the general terms intra-group financial support agreements. | Within 12 months. |
| 15 | 27(4) | Early intervention | Guidelines | To promote consistent application of the trigger for use of early intervention measures. | Within 12 months. |
| 16 | 27(5) | Early intervention | RTS (optional) | EBA may develop RTS in order to specify a minimum set of triggers for the use of early intervention measures. | No deadline (optional). |
| 17 | 32(4)(d) | Conditions for resolution | Guidelines | The type of stress tests, asset quality reviews or equivalent exercises conducted by ECB / EBA / national authorities for which extraordinary public financial support is permissible under Article 27(2)(d). | Within 6 months. |
| 18 | 32(6) | Conditions for resolution | Guidelines | To promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail. | Within 12 months. |
| 19 | 36(14) | Valuation | RTS | Specifying the criteria for the circumstances in which a person is independent from both the resolution authority and the institution or entity referred to in points (b), (c) or (d) of Article 1 for the purpose of valuation. | Within 12 months. |
| 20 | 36(15) | Valuation | RTS (optional) | EBA may develop RTS to specify the following criteria for the purposes of paragraphs 1, 2 and 5 of Articles 30 and 66:  
- the methodology for assessing the value of the assets and liabilities of the institution or entity referred to in points (b), (c) or (d) of Article 1;  
- the separation of the valuations under Articles 30 and 66;  
- the methodology for calculating and | No deadline (optional). |
<table>
<thead>
<tr>
<th>Page</th>
<th>Paragraph</th>
<th>Type</th>
<th>Description</th>
<th>Deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Factual circumstances amounting to a material threat and the elements related to the effectiveness of the sale of business tool which mean that marketing is not required.</td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>42(14)</td>
<td>Guidelines</td>
<td>Asset separation tool</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>To promote the convergence of supervisory and resolution practices regarding the determination when, in accordance with Article 36(4) the liquidation of the assets or liabilities under normal insolvency proceeding could have an adverse effect on the financial market.</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>45(2)</td>
<td>RTS</td>
<td>MREL</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Specifying further the assessment criteria for assessing MREL.</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>45(17)</td>
<td>ITS</td>
<td>MREL</td>
<td>Within 12 months.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Specifying uniform formats, templates and definitions for the identification and transmission of information by resolution authorities to the EBA on MREL set for each institution.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Guidelines on when it is appropriate to dilute, transfer or cancel shares when bailing in or writing down equity.</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>48(6)</td>
<td>Guidelines</td>
<td>Sequence of write-down and conversion in bail-in</td>
<td>No deadline.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Guidelines for any interpretation relating to the interrelationship between the BRRD provisions and those set out in CRD and CRR relating to the sequence of write-down and conversion of liabilities.</td>
<td></td>
</tr>
<tr>
<td>27</td>
<td>49(5)</td>
<td>RTS</td>
<td>Bail-in of derivatives</td>
<td>Within 18 months.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Specifying methodologies and principles for the valuation of liabilities arising from derivatives.</td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>50(4)</td>
<td>Guidelines</td>
<td>Conversion of debt to equity</td>
<td>Within 18 months.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Setting of conversion rates for the conversion of debt to equity.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>The guidelines shall indicate, in particular, how affected creditors may be appropriately compensated by means of the conversion rate, and the relative conversion rates that might be appropriate to reflect the priority of senior liabilities under applicable insolvency law.</td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>52(12)</td>
<td>RTS</td>
<td>Business reorganization plans</td>
<td>Within 18 months.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Specifying further:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(a) the minimum elements that should be included in a business reorganization plan; and</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(b) the minimum contents of the reports on progress of implementation of business reorganization plans.</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>52(13)</td>
<td>Guidelines</td>
<td>Business reorganization plans</td>
<td>Within 18 months.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Specifying further the minimum criteria that a business reorganization plan must fulfil.</td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>52(14)</td>
<td>RTS (optional)</td>
<td>Business reorganization plans</td>
<td>No deadline (optional)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>EBA may develop draft regulatory technical standards in order to specify further the minimum criteria that a business reorganization plan must fulfil.</td>
<td></td>
</tr>
<tr>
<td>Source: Bank Recovery and Resolution Directive (BRRD)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>32</td>
<td>55(3)</td>
<td>Contractual recognition of bail-in</td>
<td>RTS</td>
<td>To further determine the list of liabilities excluded from the requirement for contractual recognition provisions and the contents of the contractual recognition term.</td>
</tr>
<tr>
<td>33</td>
<td>65(5)</td>
<td>Power to require the provision of services and facilities</td>
<td>Guidelines</td>
<td>Specifying the minimum list of services or facilities that are necessary to enable a recipient to effectively operate a business transferred to it.</td>
</tr>
<tr>
<td>34</td>
<td>71(8)</td>
<td>Stay on termination</td>
<td>RTS</td>
<td>RTS on: (a) a minimum set of the information on financial contracts that should be contained in the detailed records; and (b) the circumstances in which the requirement should be imposed.</td>
</tr>
<tr>
<td>35</td>
<td>74(4)</td>
<td>Valuation for NCWOL (optional)</td>
<td>RTS</td>
<td>EBA may draft RTS specifying the methodology for carrying out the valuation in Article 66, in particular the methodology for assessing the treatment that shareholders and creditors would have received if the institution under resolution had entered insolvency proceedings for the purposes of the NCWOL principle.</td>
</tr>
<tr>
<td>36</td>
<td>82(3)</td>
<td>Notice procedures</td>
<td>RTS</td>
<td>Specifying the procedures, contents related to the following requirements: (a) the notifications referred to in Article 74 paragraphs 1 to 3; and (b) the stay notice referred to in Article 75.</td>
</tr>
<tr>
<td>37</td>
<td>84(7)</td>
<td>Confidentiality</td>
<td>Guidelines</td>
<td>Specifying how information should be provided in summary or collective form for the purposes of the exception from confidentiality provisions in Article 76(2).</td>
</tr>
<tr>
<td>38</td>
<td>88(7)</td>
<td>Resolution colleges</td>
<td>RTS</td>
<td>Specifying the operational functioning of resolution colleges.</td>
</tr>
</tbody>
</table>
Annex II: The US Single-Point-of-Entry and orderly liquidation regime: Timeline of a Title II Resolution

The FDIC’s anticipated timeline for the resolution of a SIFI under Title II authorities is covered in this annex. As the figure shows, pre-failure resolution planning will be critical, including the information obtained as a result of the review of the Title I plans. The window between imminent failure and placement into a Title II receivership would be very short, and the FDIC anticipates having the bridge financial company ready to be terminated 180-270 days following its charting, subject to the conditions described above.

Figure 18
Timeline of a Title II resolution

<table>
<thead>
<tr>
<th>Phase</th>
<th>Activity</th>
<th>Pre-failure</th>
<th>Determination, appointment and bridge period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resolution planning</td>
<td>Resolution plan review, Title II planning</td>
<td>Ongoing</td>
<td>Day</td>
</tr>
<tr>
<td></td>
<td>FDIC valuation</td>
<td>-5</td>
<td>0</td>
</tr>
<tr>
<td>Determination</td>
<td>FDIC board case / Orderly Liquidation Plan</td>
<td>-2</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>Joint recommendation to UST Secretary (3 key)</td>
<td>-1</td>
<td>60</td>
</tr>
<tr>
<td></td>
<td>UST Secretary determination (with the President)</td>
<td>0</td>
<td>90</td>
</tr>
<tr>
<td></td>
<td>Judicial review (if applicable)</td>
<td>30</td>
<td>120</td>
</tr>
<tr>
<td>Appointment</td>
<td>Receiver appointed, bridge chartered, board/CEO</td>
<td>60</td>
<td>150</td>
</tr>
<tr>
<td>Bridge / receivership</td>
<td>Remove management responsible for failure</td>
<td>90</td>
<td>180</td>
</tr>
<tr>
<td></td>
<td>Operating agreement effective</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Claims class determination</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Claims bar</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Valuation / prepare new financials / fairness opinion</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Recapitalization &amp; business / capital / liquidity plans</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Issue new securities / terminate bridge</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Agreement to Continue Restructuring Plan/ Approval</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Post-bridge</td>
<td>Restructuring / divestiture complete, resolvable in</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: BBVA Research
Annex III: Example of US resolution regime for SIFIs

The purpose of this annex is to describe the US resolution approach, and to provide an illustrative example of the SPE resolution strategy based on the bail-in and bridge bank tool.

In this sense, the following stages of a US resolution regimen for systemically important financial institutions are:

Figure 19
Stages of a US resolution regime

1. Starting point
2. Subsidiary significant losses
3. Bridge institution
4. Bail-in tool
5. Final situation

Source: BBVA Research

We suppose that there is an entity, the parent holding company, which has three different subsidiaries. Moreover, it is assumed that we are in a centralised subsidiary model - SPE - and the instrument issues are carried out by the holding entity.

Figure 20
Starting point

Source: BBVA Research

Parent Holding Company

<table>
<thead>
<tr>
<th>Deposits / Advances to subsidiaries</th>
<th>Equity in subsidiaries</th>
<th>Other assets</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>45</td>
<td>45</td>
<td>10</td>
<td>100</td>
</tr>
</tbody>
</table>

Public shareholders

Public debtholders

Unsecured long-term debt 50
Unsecured short-term debt 5
Secured liabilities 0
Other liabilities 0
Equity 45
Total 100

Source: BBVA Research
Figure 21

**Subsidiary A registers significant losses**

**Parent Holding balance-sheet**

<table>
<thead>
<tr>
<th></th>
<th>Deposits / advances to subsidiaries</th>
<th>Equity in subsidiaries</th>
<th>Other assets</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unsecured long-term debt</strong></td>
<td>50</td>
<td></td>
<td></td>
<td>50</td>
</tr>
<tr>
<td><strong>Unsecured short-term debt</strong></td>
<td>5</td>
<td></td>
<td></td>
<td>5</td>
</tr>
<tr>
<td><strong>Secured liabilities</strong></td>
<td>0</td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td><strong>Other liabilities</strong></td>
<td>0</td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td></td>
<td></td>
<td>25</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>80</td>
<td></td>
<td></td>
<td>80</td>
</tr>
</tbody>
</table>

*Source: BBVA Research*

Figure 21 shows how losses registered by any subsidiary are absorbed by the parent holding through the write-down of the equity participation.

**Figure 22**

**Bridge institution process**

**Receivership Parent Holding balance sheet**

<table>
<thead>
<tr>
<th></th>
<th>Deposits / advances to subsidiaries</th>
<th>Equity in subsidiaries</th>
<th>Other assets</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Deposits / advances to subsidiaries</strong></td>
<td>45</td>
<td></td>
<td></td>
<td>45</td>
</tr>
<tr>
<td><strong>Equity in subsidiaries</strong></td>
<td>5</td>
<td></td>
<td></td>
<td>5</td>
</tr>
<tr>
<td><strong>Other assets</strong></td>
<td>10</td>
<td></td>
<td></td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>60</td>
<td></td>
<td></td>
<td>60</td>
</tr>
</tbody>
</table>

**New Bridge Holding balance sheet**

<table>
<thead>
<tr>
<th></th>
<th>Deposits / advances to subsidiaries</th>
<th>Equity in subsidiaries</th>
<th>Other assets</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Deposits / advances to subsidiaries</strong></td>
<td>25</td>
<td></td>
<td></td>
<td>25</td>
</tr>
<tr>
<td><strong>Equity in subsidiaries</strong></td>
<td>25</td>
<td></td>
<td></td>
<td>25</td>
</tr>
<tr>
<td><strong>Other assets</strong></td>
<td>10</td>
<td></td>
<td></td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>80</td>
<td></td>
<td></td>
<td>80</td>
</tr>
</tbody>
</table>

*Source: BBVA Research*

Figure 22 shows that there is an asset transfer from the receiver to the bridge institution.
Figure 23
The bail-in tool process

Source: BBVA Research

Figure 23 shows that, when executing the bail-in tool, the new bridge institution writes down intragroup assets to recapitalise the failed subsidiary.

Figure 24
The old holding company liquidation process

Source: BBVA Research

Figure 24 shows how the subsidiary’s unsecured long-term debt holders become the bridge bank’s new shareholders.
Figure 26  
The new holding company with new shareholders

Source: BBVA Research

Figure 26 shows how the bridge bank becomes a new entity, where the new shareholders are the old debt holders of the failed bank but have suffered a stock dilution.
Annex IV: Links to the regulations

Table 9 presents the links to the main regulations presented in this note.

<table>
<thead>
<tr>
<th>Description</th>
<th>Link</th>
</tr>
</thead>
<tbody>
<tr>
<td>FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2011)</td>
<td><a href="https://www.financialstabilityboard.org/publications/r_111104cc.pdf">https://www.financialstabilityboard.org/publications/r_111104cc.pdf</a></td>
</tr>
<tr>
<td>Section 165 of the Dodd-Frank Act in Title I. Resolution plans or ‘living will’ (January 2010)</td>
<td><a href="https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf">https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf</a></td>
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<td>Section 166 of the Dodd-Frank Act in Title I. Regime for the early remediation of financial distress at covered companies - over USD50bn in assets. (January 2010)</td>
<td><a href="https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf">https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf</a></td>
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</table>

Source: BBVA Research
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>AIFMD</td>
<td>Alternative Investment Fund Managers Directive</td>
</tr>
<tr>
<td>AQR</td>
<td>Asset Quality Review</td>
</tr>
<tr>
<td>BCBS</td>
<td>Basel Committee on Banking Supervision</td>
</tr>
<tr>
<td>BIS</td>
<td>Bank for International Settlements</td>
</tr>
<tr>
<td>BoE</td>
<td>Bank of England</td>
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<tr>
<td>BoS</td>
<td>Bank of Spain</td>
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<tr>
<td>BRD</td>
<td>Bank Recovery and Resolution Directive</td>
</tr>
<tr>
<td>CCAR</td>
<td>Comprehensive Capital Analysis and Review</td>
</tr>
<tr>
<td>CCP</td>
<td>Central Counterparty</td>
</tr>
<tr>
<td>CET</td>
<td>Common Equity Tier</td>
</tr>
<tr>
<td>CFTC</td>
<td>Commodity Futures Trading Commission</td>
</tr>
<tr>
<td>AMC</td>
<td>Company for the Management of Assets proceeding from Restructuring of the Banking System (Bad bank)</td>
</tr>
<tr>
<td>CNMV</td>
<td>Comisión Nacional de Mercados de Valores (Spanish Securities and Exchange Commission)</td>
</tr>
<tr>
<td>COREPER</td>
<td>Committee of Permanent Representatives to the Council of the European Union</td>
</tr>
<tr>
<td>CPSS</td>
<td>Committee on Payment and Settlement Systems</td>
</tr>
<tr>
<td>CRA</td>
<td>Credit Rating Agency</td>
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<tr>
<td>CRD IV</td>
<td>Capital Requirements Directive IV</td>
</tr>
<tr>
<td>CRR</td>
<td>Capital Requirements Regulation</td>
</tr>
<tr>
<td>CSD</td>
<td>Central Securities Depository</td>
</tr>
<tr>
<td>DGSD</td>
<td>Deposit Guarantee Schemes Directive</td>
</tr>
<tr>
<td>DFA</td>
<td>The Dodd-Frank Wall Street Reform and Consumer Protection Act</td>
</tr>
<tr>
<td>EBA</td>
<td>European Banking Authority</td>
</tr>
<tr>
<td>EC</td>
<td>European Commission</td>
</tr>
<tr>
<td>ECB</td>
<td>European Central Bank</td>
</tr>
<tr>
<td>ECON</td>
<td>Economic and Monetary Affairs Committee of the European Parliament</td>
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<tr>
<td>EFSF</td>
<td>European Financial Stability Facility</td>
</tr>
<tr>
<td>EIOPA</td>
<td>European Insurance and Occupational Pensions Authority</td>
</tr>
<tr>
<td>EMIR</td>
<td>European Market Infrastructure Regulation</td>
</tr>
<tr>
<td>EP</td>
<td>European Parliament</td>
</tr>
<tr>
<td>ESA</td>
<td>European Supervisory Authority</td>
</tr>
<tr>
<td>ESFS</td>
<td>European System of Financial Supervisors</td>
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<tr>
<td>ESM</td>
<td>European Stability Mechanism</td>
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<tr>
<td>ESMA</td>
<td>European Securities and Markets Authority</td>
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<tr>
<td>ESRB</td>
<td>European Systemic Risk Board</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>EZ</td>
<td>Eurozone</td>
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<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<tr>
<td>FBO</td>
<td>Foreign Bank Organizations</td>
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<tr>
<td>FCA</td>
<td>Financial Conduct Authority</td>
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<tr>
<td>FDIC</td>
<td>Federal Deposit Insurance Corporation</td>
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<tr>
<td>Fed</td>
<td>Federal Reserve</td>
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<tr>
<td>FPC</td>
<td>Financial Policy Committee</td>
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<tr>
<td>FROB</td>
<td>Spanish Fund for Orderly Bank Restructuring</td>
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<tr>
<td>FSAP</td>
<td>Financial Sector Assessment Program</td>
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<tr>
<td>FSB</td>
<td>Financial Stability Board</td>
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<tr>
<td>FTT</td>
<td>Financial Transactions Tax</td>
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<tr>
<td>IASG</td>
<td>International Association of Insurance Supervisors</td>
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<tr>
<td>IASB</td>
<td>International Accounting Standards Board</td>
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<tr>
<td>IHC</td>
<td>Intermediate Holding Company</td>
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<tr>
<td>IIF</td>
<td>Institute of International Finance</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IOSCO</td>
<td>International Organization of Securities Commissions</td>
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<tr>
<td>ISDA</td>
<td>International Swaps and Derivatives Association</td>
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<tr>
<td>ITS</td>
<td>Implementing Technical Standard</td>
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<tr>
<td>Joint Forum</td>
<td>International group bringing together IOSCO, BCBS and IAS</td>
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<tr>
<td>LCR</td>
<td>Liquidity Coverage Ratio</td>
</tr>
<tr>
<td>LEI</td>
<td>Legal Entity Identifier</td>
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<tr>
<td>MAD</td>
<td>Market Abuse Directive</td>
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<tr>
<td>MIFID</td>
<td>Markets in Financial Instruments Directive</td>
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<tr>
<td>MIFIR</td>
<td>Markets in Financial Instruments Regulation</td>
</tr>
<tr>
<td>MMFs</td>
<td>Money Market Funds</td>
</tr>
<tr>
<td>MoU</td>
<td>Memorandum of Understanding</td>
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<tr>
<td>MPE</td>
<td>Multiple Point of Entry</td>
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<tr>
<td>MS</td>
<td>Member States</td>
</tr>
<tr>
<td>NRAs</td>
<td>National Resolution Authorities</td>
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<tr>
<td>NSA</td>
<td>National Supervision Authorities</td>
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<tr>
<td>NSFR</td>
<td>Net Stable Funding Ratio</td>
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<tr>
<td>OJ</td>
<td>Official Journal of the European Union</td>
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<tr>
<td>OTC</td>
<td>Over-The-Counter (Derivatives)</td>
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<tr>
<td>PRA</td>
<td>Prudential Regulation Authority</td>
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<tr>
<td>QIS</td>
<td>Quantitative Impact Study</td>
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<tr>
<td>RRP</td>
<td>Recovery and Resolution Plans</td>
</tr>
<tr>
<td>RTS</td>
<td>Regulatory Technical Standards</td>
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<tr>
<td>SCAP</td>
<td>Supervisory Capital Assessment Program</td>
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<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<tr>
<td>SIB (G-SIB, D-SIB)</td>
<td>Global/Systemically Important Bank, Domestic/Systemically Important Bank</td>
</tr>
<tr>
<td>SIFI (G-SIFI, D-SIFI)</td>
<td>Global/Systemically Important Financial Institution, Systemically Important Financial Institution</td>
</tr>
<tr>
<td>SII (G-SII, D-SII)</td>
<td>Systemically Important Insurance</td>
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<tr>
<td>SPE</td>
<td>Single Point of Entry</td>
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<td>SRB</td>
<td>Single Resolution Board</td>
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<tr>
<td>SREP</td>
<td>Supervisory Review and Evaluation Process</td>
</tr>
<tr>
<td>SRF</td>
<td>Single Resolution Fund</td>
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<tr>
<td>SSM</td>
<td>Single Supervisory Mechanism</td>
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<tr>
<td>UCITS</td>
<td>Undertakings for Collective Investment in Transferable Securities Directive</td>
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