Academic year 2017/2018

International Banking and Capital Markets II

Lesson 23

BRRD framework

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1. Overview

From last lesson, we know that the policies are focusing on **two main elements for facing the systemic risk** that the stress/failure of a financial institution can generate:

Reduce the probability of failure of G-SIBs by **increasing their going-concern loss absorbency**; and

Reduce the extent or impact of failure of G-SIBs, by **improving global recovery and resolution frameworks**.

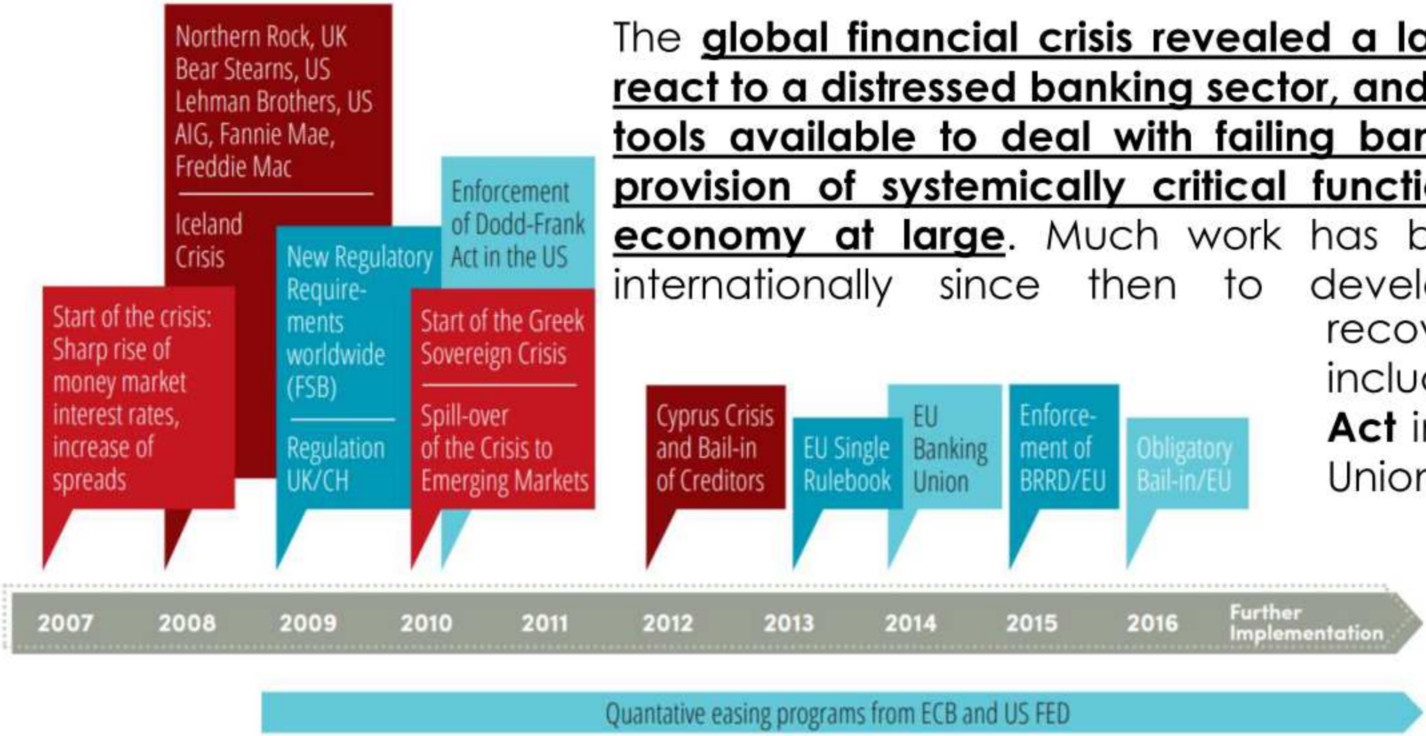
G-SIBs higher loss absorbency requirement → reduce the probability of failure

Key Attributes of Effective Resolution Regimes for Financial Institutions (the 'Key Attributes' KA) → In Europe the referring is the

Banking Recovery and Resolution Directive (BRRD)

2. Background

The **<u>global financial crisis revealed a lack of clarity about how to react to a distressed banking sector, and serious shortcomings in the tools available to deal with failing banks without interrupting the provision of systemically critical functions to customers and the economy at large</u>**. Much work has been done nationally and internationally since then to develop comprehensive bank recovery and resolution regimes, including **the 2010 Dodd-Frank Act** in the US and the European Union's **Bank Recovery and Resolution Directive (BRRD)**, adopted in **2014**. The new post-crisis resolution framework essentially aims to regulate **how bank should be organized** and **what instruments should be in place to preserve overall financial stability** while reducing the costs of a failed systemically important bank for **sovereigns and tax-payers.**



LIQUIDITY CRISIS	Limited interbank borrowings, credit crunch
VOLATILE STOCK MARKETS	Constant uncertanties of values
BANK AND SOVEREIGN CRISIS	Economic downturn and low growth
CREDIT CRUNCH	Limited access to funds and therefore limited investments

COSTS OF THE CRISIS (2007–2009)

Nationalization of Banks*	29
Gross restructuring support for countries concerned*	In % of GDP 0,7–7,7
Liquidity support*	%-points 1,1–18,3
Asset purchases and guarantees*	In % of GDP 0,2–13,4
Other measures taken included guarantees for liabilities and bail-in of creditors (Cyprus)	

Source: The World Bank Group

2. Background

2011

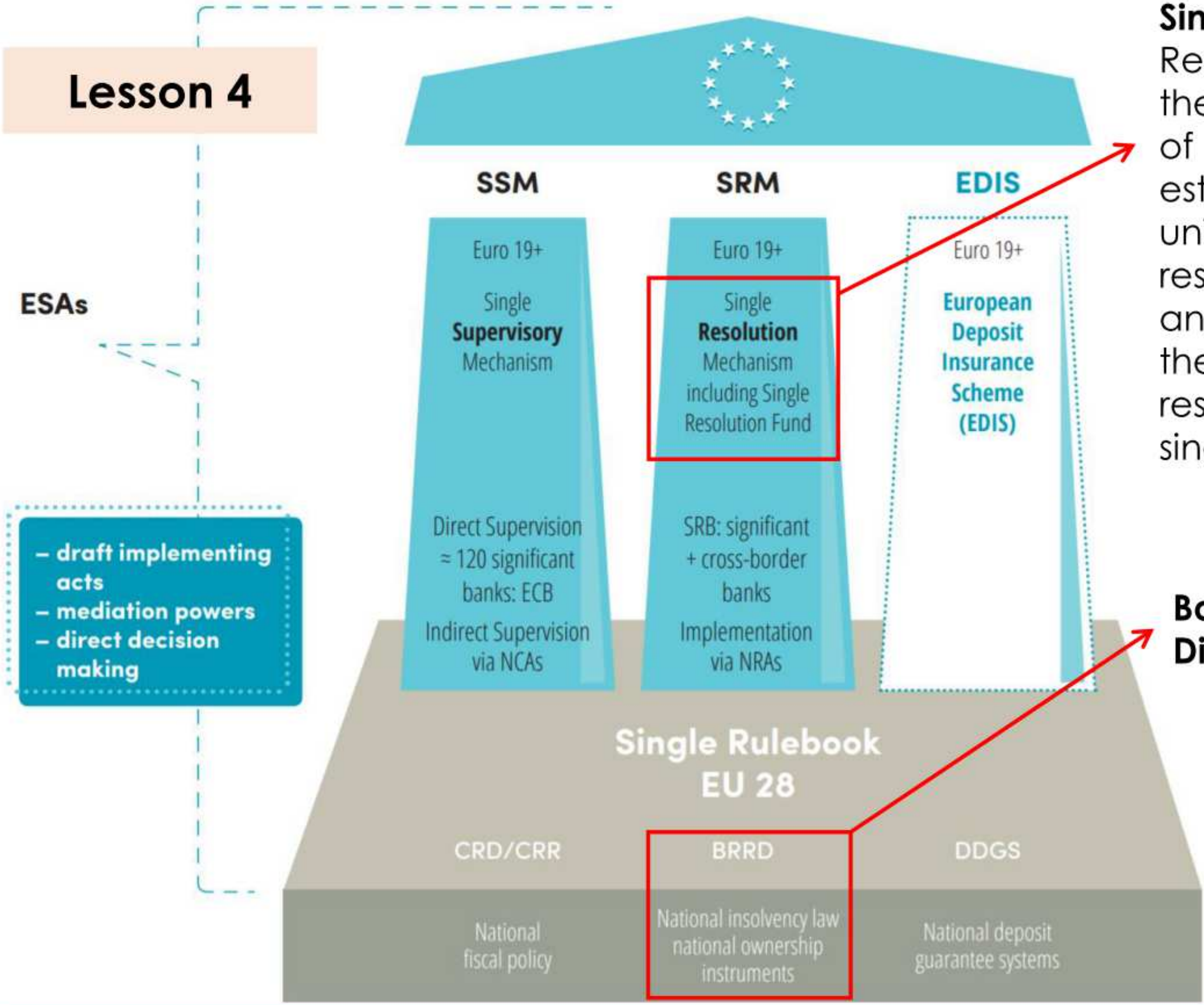
The **FSB** developed the '**Key Attributes of Effective Resolution Regimes for Financial Institutions** as the international umbrella standard for resolution regimes covering financial institutions of all types that could be systemic in failure.
The Key Attributes **were published in October 2011** and extended to financial market infrastructures and insurers in 2014.

2014

The **BRRD creates a common framework for bank resolution across all EU Member States.** Its key elements are
– recovery and resolution planning;
– enhanced set of early intervention measures by the supervisor
– strong set of resolution tools and powers in the case of an actual bank failure
– cooperation and coordination between national authorities.

Source: The World Bank Group

2. Background



Single Resolution Mechanism
Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a single resolution mechanism and a single resolution fund

Bank Recovery and Resolution Directive

Source: The World Bank Group

3. Single Resolution Mechanism («SRM»)

Banks cannot be completely protected against failure, even with strong supervision and the use of early intervention tools. The second pillar of Banking Union, the Single Resolution Mechanism (**SRM**), allows their resolution to be managed effectively, with the aim of reducing costs to taxpayers and minimizing any negative effects to the real economy at the European level.

Bank resolution within the euro area is managed by the Single Resolution Board (**SRB**), which is responsible for resolution planning and decides on the application of resolution tools as well as on the use of the Single Resolution Fund (**SRF**), financed by the banking industry and owned by the SRB. Both the SRB and the SRF became fully operational in **January 2016**.

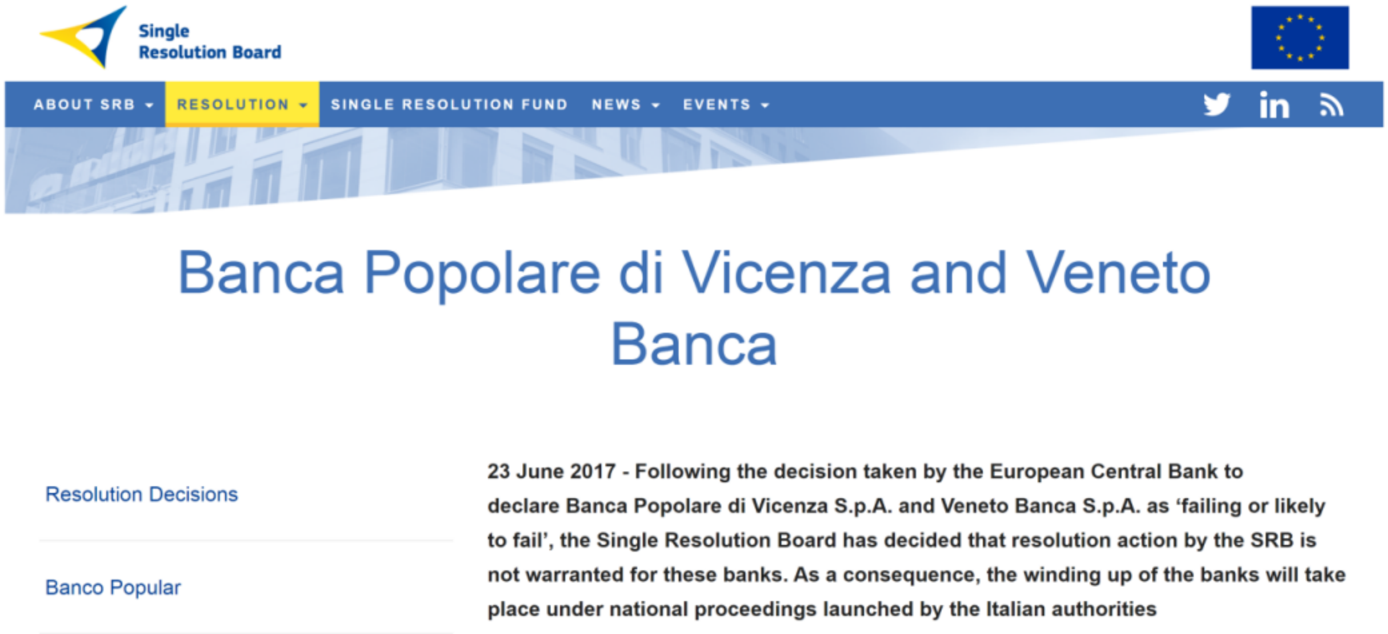
The **SRM applies** – in parallel to the SSM – to all banks in the euro area, and in addition to cross-border banks (around 15 have been identified by the SRB, between them Banca Leonardo S.p.A. and Banca Mediolanum S.p.A.). ECB actions and powers in its capacity as the single supervisor and SRB actions under the SRM are intertwined and partially mutually dependent. While the ECB is the main authority empowered to decide if a bank is considered **Failing Or Likely To Fail** ("**FOLTF**") it is up to the SRB to trigger the resolution procedure and assess if the conditions for resolution are fulfilled. Moreover, the ECB is represented in a non-voting capacity on the SRB Board.

The SRM creates a **uniform institutional framework** for the application of the BRRD, including a SRF, for participating Member States. **Resolution decisions are taken – for the largest institutions and cross-border banks – by the SRB**. The application of specific resolution tools to deal with a failing institution, the "resolution scheme", is decided by the SRB in a rather complex voting procedure between the Member States, with veto powers by the European Commission and the Council.

3. Single Resolution Mechanism («SRM»)

<u>The SRM Regulation is complementary to the BRRD, and not a replacement or substitute.</u> Proper and comprehensive transposition of the BRRD by each Member State establishing a national resolution authority (**NRA**) that is **powerful and capable of acting** is essential.

The SRB can apply its own tools and powers under the SRM Regulation (which is directly applicable in all Member States). The SRB's resolution scheme decisions are as a rule directed towards NRAs, for their enforcement under national law. <u>Only exceptionally, if the NRA fails to comply with the SRB's decisions, may the SRB address orders directly to the bank under resolution. NRAs within the euro area are responsible for the resolution of national banks not covered by the SRB</u> (small, non-cross-border banks with no use of the SRF).



4. Bank recovery and resolution

A bank resolution occurs when authorities determine that a failing bank cannot go through normal insolvency proceedings without harming public interest and causing financial instability.

To manage the bank's failure in an orderly manner, authorities use resolution tools that:

- ✓ **ensure continuity of the bank's critical functions**
- ✓ **avoid significant adverse effects on the financial system;**
- ✓ **protect public funds by minimizing reliance on extraordinary public financial support for failing banks;**
- ✓ **protect insured depositors; and**
- ✓ **protect client funds and client assets.**

Meanwhile, any part of the bank that cannot be made viable again goes through **normal insolvency proceedings**.

After the recent financial crisis, the EU adopted a number of measures to harmonize and improve the tools for dealing with bank crises in its member countries.

4. Bank recovery and resolution

The **Bank Recovery and Resolution Directive (BRRD)** was adopted in spring **2014** to provide authorities with **comprehensive and effective arrangements** to deal with **failing banks at national level cooperation** arrangements to tackle cross-border banking failures.

The directive requires banks to prepare **recovery plans** to overcome financial distress. It also grants national authorities powers to ensure an orderly resolution of failing banks with minimal costs for tax-payers.

The directive includes rules to set up a **national resolution fund** that must be established by each EU country. All financial institutions have to contribute to these funds. Contributions are calculated on the basis of the institution's size and risk profile.

The EU's bank resolution rules ensure that the **banks' shareholders and creditors pay** their share of the costs through a "**bail-in**" mechanism. If that is still not sufficient, the national resolution funds set up under the BRRD can provide the resources needed to ensure that a bank can continue operating while it is being restructured.

4. Bank recovery and resolution

The BRRD regulates the **different stages and elements** of a problem bank's recovery and resolution process, including advanced planning and restructuring. It rests upon the following **key elements**:

– **Recovery and resolution planning** including the removal of obstacles to resolvability;

– An **enhanced set of early intervention measures** to foster forward looking supervision and crisis prevention;

– A **harmonized set of resolution tools and powers to manage bank failure**, aiming to ensure that losses are absorbed by shareholders and creditors while allowing the continuity of critical functions. The four main resolution tools are the:

1. **Bail-in tool**
2. **Sale of business tool**
3. **Bridge institution tool**
4. **The asset separation tool**

– The **limitation of government support**, only foreseen as a last resort under special circumstances;

– An **ex-ante resolution funding sourced from bank contributions** to ensure the implementation of resolution tools when preconditions are met;

– An **enhanced cooperation between Member States** as well as with authorities in third countries in all phases of preparation, intervention and resolution (via resolution colleges).

Source: The World Bank Group

4.1. Bank recovery

Art. 5–9 BRRD and section A of the Annex

Recovery plans are both a **preparative and a preventive tool**: they have added value for banks and supervisors, also under business as usual conditions.
As supervisory authorities in all EU Member States now work on a common legal basis, **banks are expected to deliver more structured and consistent Recovery Plans** that should also enable a more effective cross-border approach.
Furthermore, the **<u>BRRD creates a solid basis for supervisory authorities</u>** to share Recovery Plans with resolution authorities, enhancing cooperation between the respective authorities. **<u>Resolution authorities can use the Recovery Plan to identify whether any actions in the plan may adversely impact the resolvability of the institution</u>** and make recommendations in that regard to the competent authority.
Recovery Plans are drawn up and maintained by the bank. **<u>This is very different from resolution planning, where the authorities draft the plan</u>**.
<u>In its Recovery Plan</u>, the bank sets out **how it monitors** relevant negative developments (early warning thresholds and recovery indicators) and **how it could steer away** from severe stress should it occur.
By **using adverse scenarios**, including system-wide and idiosyncratic stress events, the bank substantiates that it could take early action to handle a (progressively) deteriorating capital and/or liquidity position and, by doing so, is in a position to independently return to "business as usual".

Source: The World Bank Group

4.2. Early Intervention Measures (EIM)

Art. 27–30 BRRD

Early intervention measures empower supervisors – **not the resolution authority** – to react to an escalation of financial problems at an early stage, **well before an institution fails**.

Triggers: Qualitative Indicators With Some Quantitative Elements

The generic trigger in the BRRD for early intervention measures is a "**rapidly deteriorating financial condition**".

This is assessed against a specific set of triggers, which include

1. a **deteriorating liquidity situation**,
2. an **increasing level of leverage**,
3. an **increase of non-performing loan (NPL) portfolios**, or a concentration of exposures.

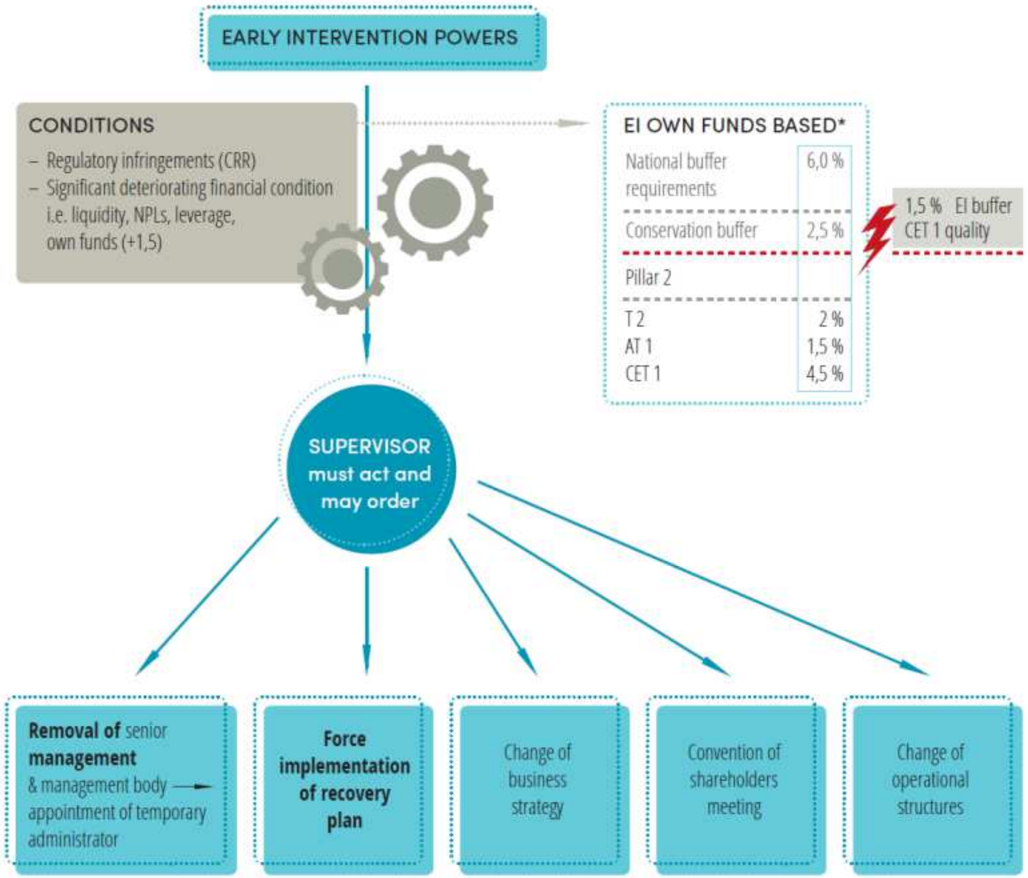
In relation to **own funds**, the **BRRD suggests that (4.) a trigger set 1.5 percentage points above the level of an institution's own funds requirement may be provided for supervisor to act when infringement is likely in the near future before a material breach occurs.**

More generally, any infringement of EU capital requirements (CRR/CRD IV) also triggers consideration of early intervention measures.

Source: The World Bank Group

4.2. Early Intervention Measures (EIM)

Art. 27–30 BRRD



* The buffers figures in the "EI Own funds based" box are examples.

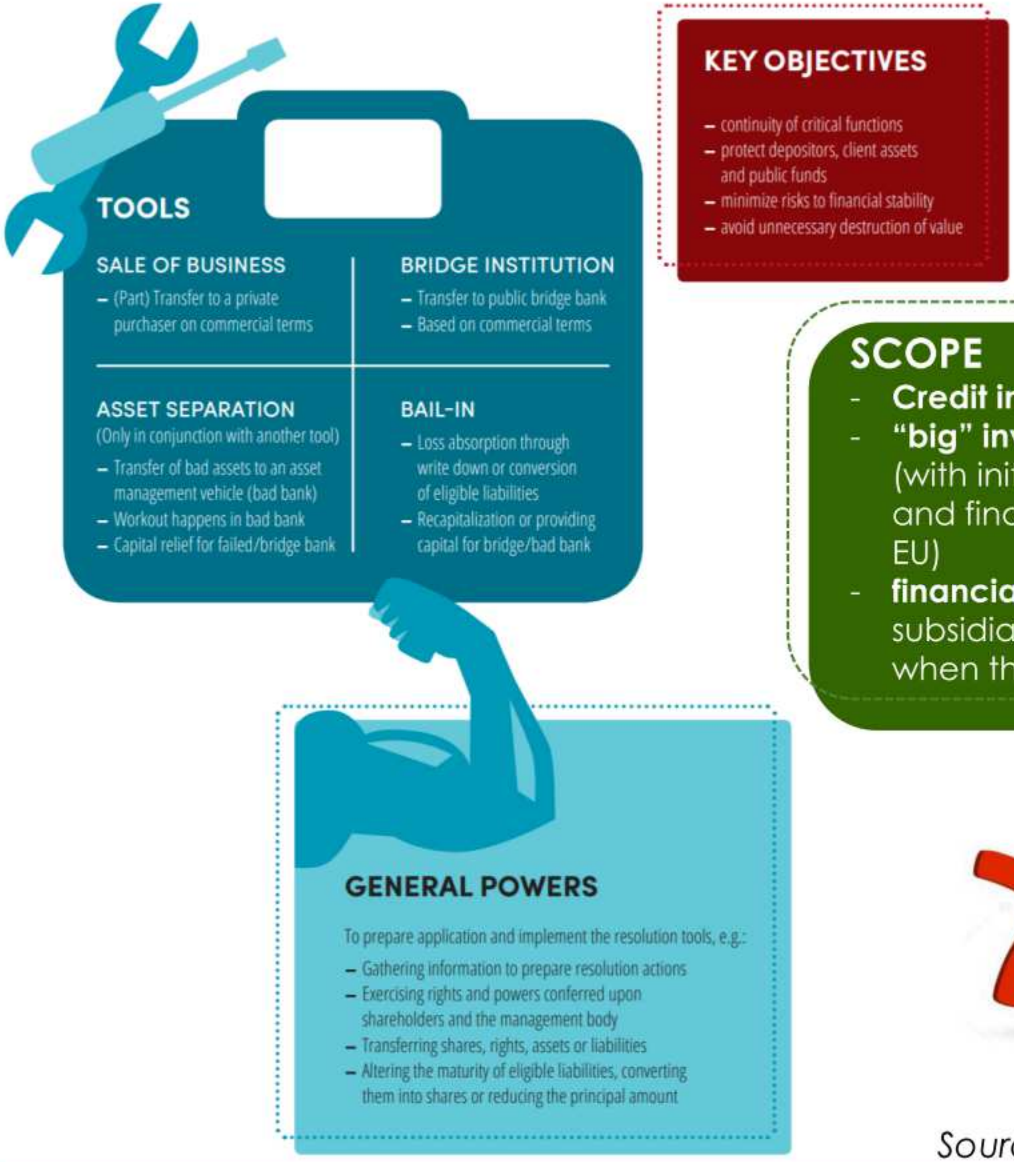
Source: The World Bank Group

Early Intervention Measures

1. Supervisor may require the management body of an institution to **implement the appropriate arrangements and measures set out in the dedicated recovery plan**
2. Supervisor may require an **immediate update of the recovery plan**
3. Supervisor may **instruct the management body to address identified problems by developing an appropriate action program**
4. Supervisor may require more robust alternative measures, e.g. **changes to the institution's business strategy, or to its legal or operational structures.**
5. Supervisor may demand **the preparation of corporate actions to increase the institution's own funds** in order to stabilize the institution
6. Supervisor may also require the management body **to draw up a plan to negotiate debt restructuring**

EXTREME SITUATION: the Supervisor may indicate that those individuals are to be replaced and appoint a **temporary administrator** (= Conservatorship)

4.3. Bank resolution



BRRD

SCOPE

- **Credit institutions**
- **"big" investment firms**
  (with initial capital > EUR 730,000
  and financial holding companies established in the EU)
- **financial institutions** as defined in the CRR that are subsidiaries of institutions or holding companies when they are supervised on a consolidated basis.

OUT OF SCOPE

Counterparty Clearing Houses (CCPs)
Central Securities Depositories (CSDs)
Insurance companies

Source: The World Bank Group and author's own elaboration

4.3. Bank resolution

The overarching objective of the BRRD resolution regime is to **make sure a bank can be resolved swiftly with minimal risk to financial stability**.

This should be **<u>achieved without negative impacts on the real economy and without the need to spend taxpayer money to stabilize a failing bank (bail-in instead of bail-out)</u>**. Resolution objectives are much broader than the objectives of regular insolvency proceedings, which commonly focus on the interests of creditors and to maximize the value of the insolvency estate.

The BRRD resolution regime aims to ensure overall financial stability, ending the nexus between bank risk and sovereign risk.

BRRD objectives are explicitly defined in law as:

- ensuring the continuity of critical functions;
- avoiding significant adverse effects on the financial system;
- protecting public funds by minimizing reliance on extraordinary public financial support for failing banks;
- protecting insured depositors; and
- protecting client funds and client assets.

These resolution objectives are of **equal significance**, and resolution authorities have to balance them as appropriate to the nature and circumstances of each case. To achieve these objectives, the BRRD broadly speaking regulates **four key elements**:

i) the **preparation and prevention of resolution via recovery and resolution planning**;
ii) the **taking of early intervention measure by the supervisor**;
iii) the **application of resolution tools and powers in the case of an actual bank failure**; and
iv) the **cooperation and coordination between national authorities**.

Source: The World Bank Group

4.3. Bank resolution

Liquidation vs Resolution

The key advantage of a resolution is that it **allows for some continuity and the maintenance of a bank's critical functions**. If a bank goes into liquidation, all liabilities (except those exempted from the insolvency estate) fall due and the insolvency estate is protected by the imposition of a collective stay of creditor action (no further enforcement by individual creditors).
A **trustee** is appointed to dispose of the assets and distribute the proceeds among the creditors. The rationale in insolvency is that **all creditors** (with some exceptions such as secured creditors) **should be treated the same and receive their pro rata share of the estate**. However, this can result in stress, interruptions, and contagion risks for financial systems. The "fire sale" that liquidation entails may also be detrimental to the interests of creditors.
In terms of financial stability, as seen during the last financial crisis, **the application of bank insolvency rules has proven inadequate and politically unacceptable**. Although covered depositors would be reimbursed by deposit guarantee schemes, the risk of wider contagion was, in most cases, deemed too great, especially for large and complex "too big to fail" institutions (TBTF).

The resolution authority should be able to cope with the crisis by **allocating incurred losses among creditors and restructuring the institution while maintaining uninterrupted access to deposits and critical functions**. Covered depositors have continuous access to their deposits (instead of reimbursement). In return for ensuring uninterrupted access to deposits, the deposit guarantee scheme is, under certain circumstances, liable to make in lieu contributions in the context of resolution

Source: The World Bank Group

4.3. Bank resolution

Power, tools and other measures

Three transfer tools

1. Sale of Business
It allows for a swift transfer of shares, assets, rights and liabilities of the institution under resolution to a purchaser "on commercial terms"

2. Bridge institutions
It allows for a temporary transfer of shares, (good) assets, rights and liabilities to a (publicly owned) bridge bank in order to maintain critical functions of the problem bank

3. Asset separation
(impaired) assets, rights and liabilities are transferred to a (publicly owned) asset management vehicle, also known as a "bad bank". This allows for a value improving workout of assets and avoids possible value restruction caused by a fire sale under liquidation

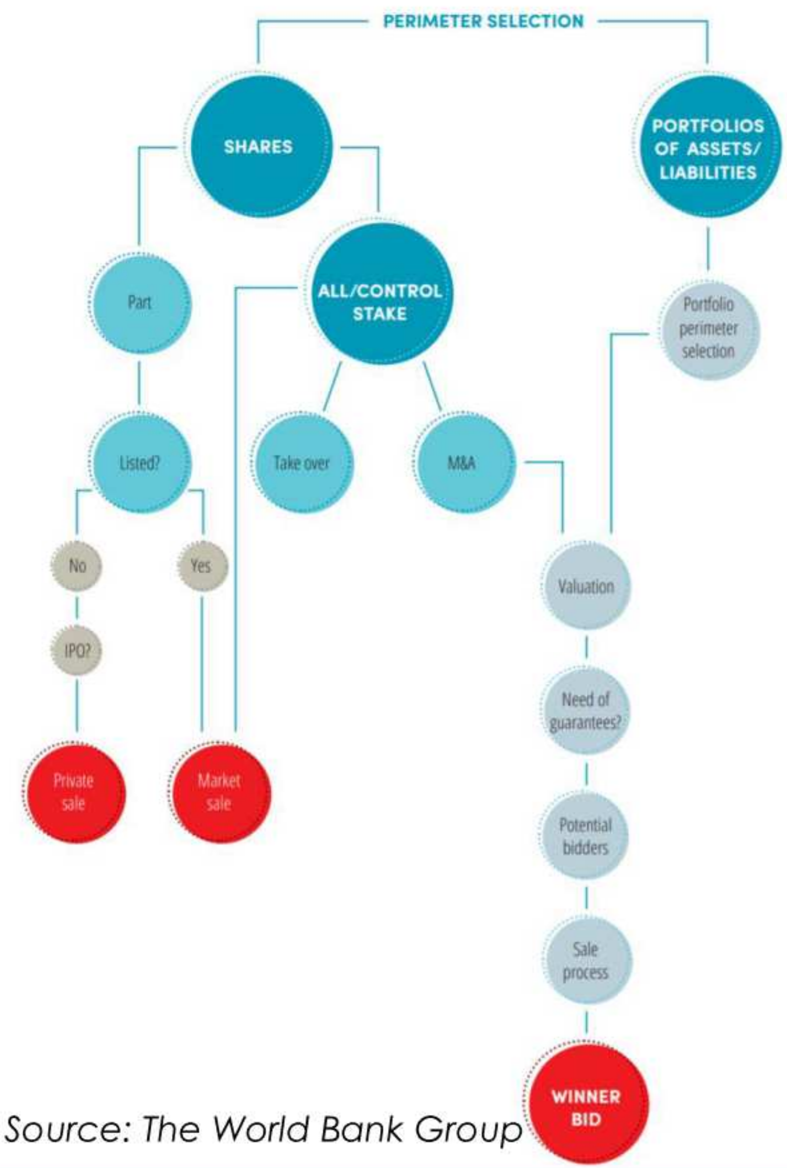
4. Bail-in tool
It allows the resolution authority to allocate incurred losses to the owners and debt holders of the institution: the interests of existing shareholders are cancelled, diluted, or transferred, and the claims of unsecured creditors are written down and/or converted into equity to recapitalize the firm

Source: The World Bank Group

5. government Stabilization
Last resort tool in the very extraordinary situation of systemic crisis and after having exploited all resolution tools.

4.3.1. Sale of business

Art. 38, 39 BRRD



Source: The World Bank Group

The sale of business tool enables resolution authorities **to sell the institution** (or parts of its business) **to one or more purchasers with or without the consent of shareholders**. The resolution authority has the power to transfer shares or other instruments of ownership issued by an institution under resolution; and all or any assets, rights or liabilities of an institution under resolution to a purchaser that is not a bridge institution. The sale of business tool may be applied individually or in combination with other tools.

To achieve the highest possible sale price within the allocated timing, <u>a **competitive tendering process** open to all relevant potential domestic and international investors is expected</u>. However, <u>if urgency</u> prevents a full sale process, <u>preselected potential buyers must have passed a fit and proper assessment and the sale will occur once the entity has been declared failing or likely to fail</u>.

4.3.2. Bridge institution

Art. 40, 41 BRRD

The bridge institution tool aims **to bridge time until a private sector solution is found**, preserving the critical functions of the failing bank. The tool allows for the transfer of:

a) instruments of **ownership** issued by one or more institutions under resolution (share transfer); and/or

b) all or any **assets, rights or liabilities** of one or more institutions under resolution (property transfer) – depending on the corporate structure of the entity under resolution – to a bridge institution.

A temporary bridge institution (also known as a "**bridge bank**") is created and, for **up to two years**, critical functions will be maintained while a sale to a private purchaser, of either the whole or part, can be concluded

Source: The World Bank Group

4.3.2. Bridge institution

Art. 40, 41 BRRD

The bridge institution shall be wholly (or partially) **owned by public authorities** (either through:

i) direct state ownership;
ii) the resolution financing arrangement;
iii) one or more public authorities except when the institution has been fully recapitalized by shareholders and creditors).

The resolution authority may use the **<u>resolution financing arrangement to recapitalize or make a loan to a bridge bank, and/or to guarantee assets or liabilities transferred from the entity under resolution into the bridge bank</u>**.

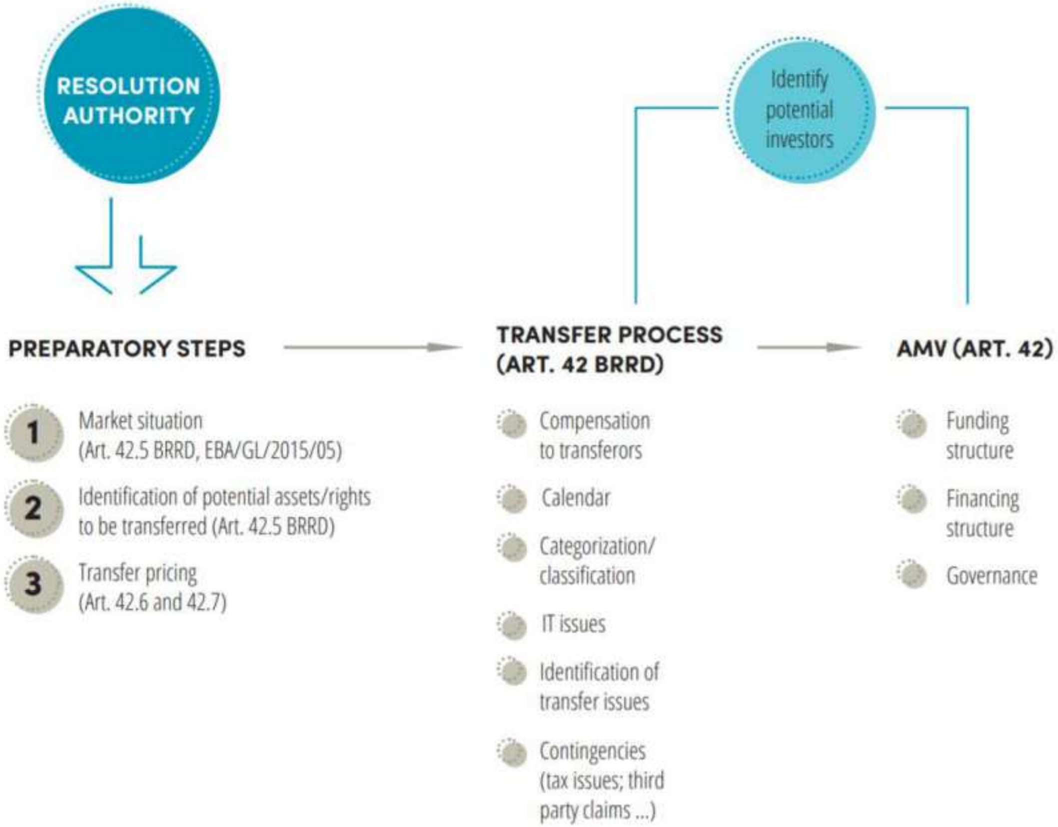
Terminating the Bridge Institution

If no private sector solution can be found within two years (with a possible extension), the bridge bank, or its residual parts of assets, rights and liabilities, should be wound down under normal insolvency proceedings ("**run-off**"; "**mandatory liquidation**").

Source: The World Bank Group

4.3.3. Asset Separation – Asset Management Vehicle

Art. 42 BRRD



Improper valuation of impaired assets was the cause of many financial institutions' problems during and since the most recent global financial crisis. In response, **<u>some authorities established asset separation schemes ("bad banks") to relieve distressed bank's balance sheet of "bad" assets and their associated risks.</u>** The BRRD asset separation tool aims to assist in a similar way. **<u>It allows for parts of a distressed bank that do not need to be maintained permanently to be wound down in an organized and measured way</u>**. The asset separation tool is used to transfer assets and liabilities to a separate **asset management vehicle (AMV)**. The AMV **<u>is wholly or partially owned by one or more public authorities including the resolution authority, or the resolution financing arrangements</u>.**

Source: The World Bank Group

4.3.3. Asset Separation – Asset Management Vehicle

Art. 42 BRRD

The AMV must **always** be applied **together** with another resolution tool (sale of business, the bridge institution tool and/or the bail-in tool) **and** it is **only justified if** immediate liquidation would be **disadvantageous** at that point in time.

The Transfer Process and Assets to be Transferred

The **identification** of assets for transfer is of particular importance. The focus should be on assets of no further strategic value; that are related to a specific impaired market; that contain risks considered to be no longer acceptable; that are too capital-intensive; and/or that may be unsuitable for obtaining future long-term funding.

Three scenarios provided by BRRD for using the Asset separation tool:

1. The market for those assets is such that their liquidation under normal insolvency proceedings could have an **adverse effect** on one or more financial markets and impact financial stability. European Banking Authority Guidelines sets out three specific categories of elements that should be considered: a) **whether the market for these assets is impaired**; b) the **impact of the disposal of these assets on the markets where they are traded**; c) the **situation of the financial markets and the direct and indirect effects of an impairment of the markets for these assets**;
2. The **transfer is necessary to ensure the proper functioning of the institution under resolution or bridge institution**; or
3. The **transfer is necessary to maximize the liquidation proceeds and preserve the value of the assets**.

Source: The World Bank Group

4.3.4. Bail-in

Art. 43-55 BRRD

Bail-in is the **most innovative** of the tools given to resolution authorities by the BRRD in the context of bank resolution.

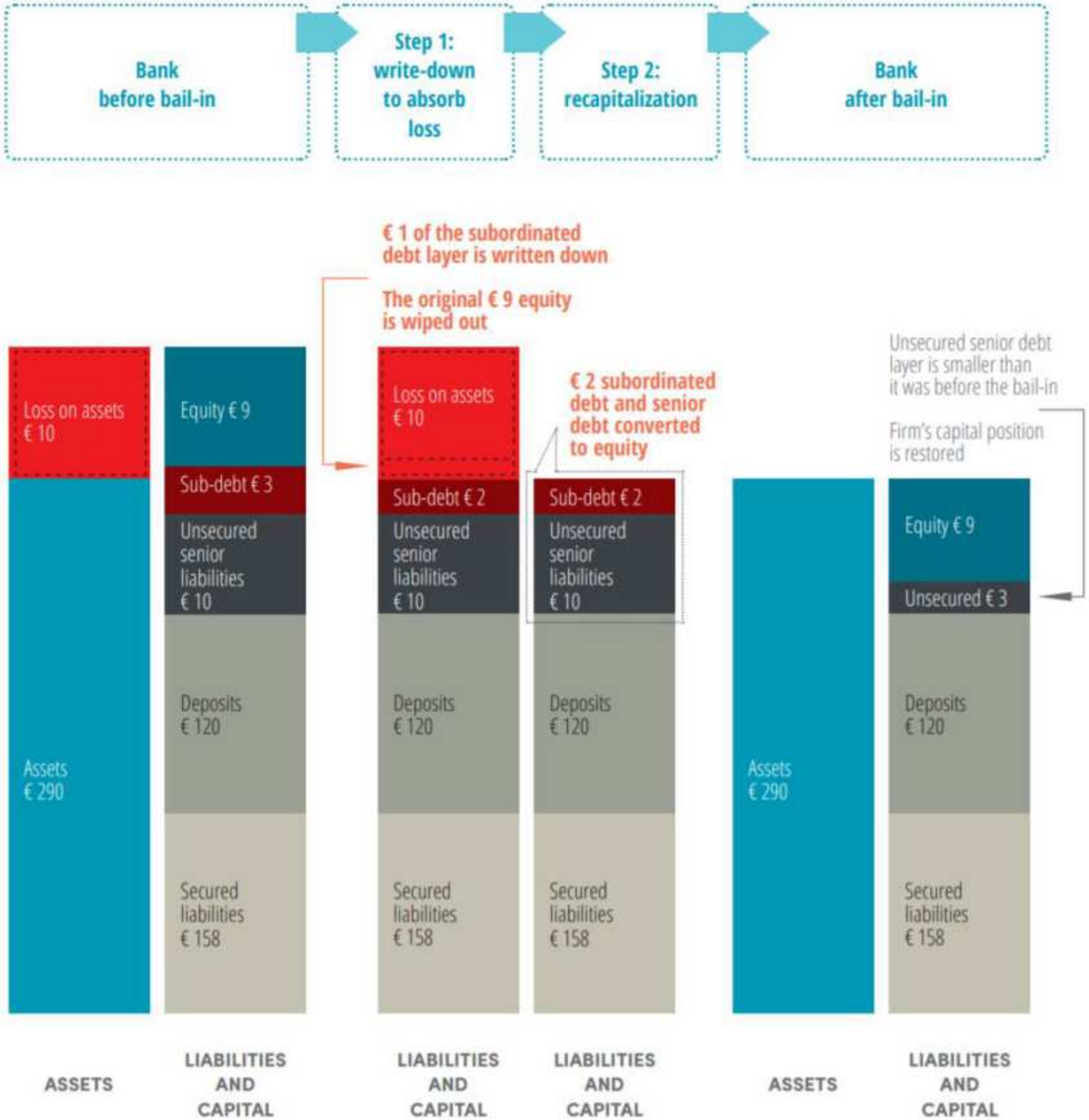
Under bail-in, **losses are imposed on owners and creditors of a failing bank**, rather than on taxpayers under a "public bail-out". The bail-in tool achieves **loss absorption** by either converting the liability into a common equity instrument, such as a share, or by writing down or writing off the principal amount of the liability (both are a form of a "bail-in").

The **recapitalization** amount would equal the aggregate amount according to the resolution valuation necessary to absorb all losses and also restore and maintain the institution's compliance with its authorization conditions for at least one year, as well as sustain market confidence in the institution.

Source: The World Bank Group

4.3.4. Bail-in

Art. 43-55 BRRD



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Source: The World Bank Group

4.3.4. Bail-in

Art. 43-55 BRRD

Liabilities **excluded from the bail-in**:

- **covered deposits**, i.e. deposits up to the amount covered by a deposit guarantee scheme (DGS) (the DGS pays in lieu, on use of a DGS)
- **liabilities in respect of holding client assets or client money**, where the client is protected under applicable insolvency law;
- **liabilities resulting from a fiduciary relationship**, where the beneficiary is protected under applicable law;
- **liabilities to other financial institutions** (outside the group of the institution in resolution) with an original maturity of less than seven days;
- **liabilities with a remaining maturity of less than seven days, owed to payment or securities settlement systems or their participants**;
- **employee remuneration or benefits** (other than variable remuneration);
- **liabilities to commercial or trade creditors** relating to the provision of critical goods or services;
- **liabilities to tax and social security authorities** that are preferred by law;
- **liabilities for contributions to deposit guarantee schemes**; and
- **liabilities to the extent they are secured**, including covered bonds and hedging instrument liabilities of the covered bond issuer.

Deposits are excluded only to the extent that they are covered by a DGS. Any amount of the deposit liability in excess of the amount covered by the scheme could, therefore, potentially be bailed-in. **Secured liabilities** are only excluded from bail-in to the extent of the value of the collateral securing the liability.

Source: The World Bank Group

4.3.4. Bail-in

Art. 43-55 BRRD

In addition to the above list of excluded liabilities, the **BRRD provides that, in exceptional circumstances, the resolution authority may wholly or partially exclude certain liabilities from bail-in**, where:

– it is not possible to bail-in the liability within a reasonable timeframe (this could potentially apply to derivatives liabilities, which can be very difficult to value in a short space of time); or
– the exclusion is necessary and proportionate to achieve continuity of critical functions and core business lines; or
– the exclusion is necessary and proportionate to avoid widespread contagion that would disrupt the functioning of financial markets, in particular as regards deposits held by individuals and micro, small and medium size enterprises; or
– bailing-in the liability would cause higher losses to other creditors than not bailing it in.

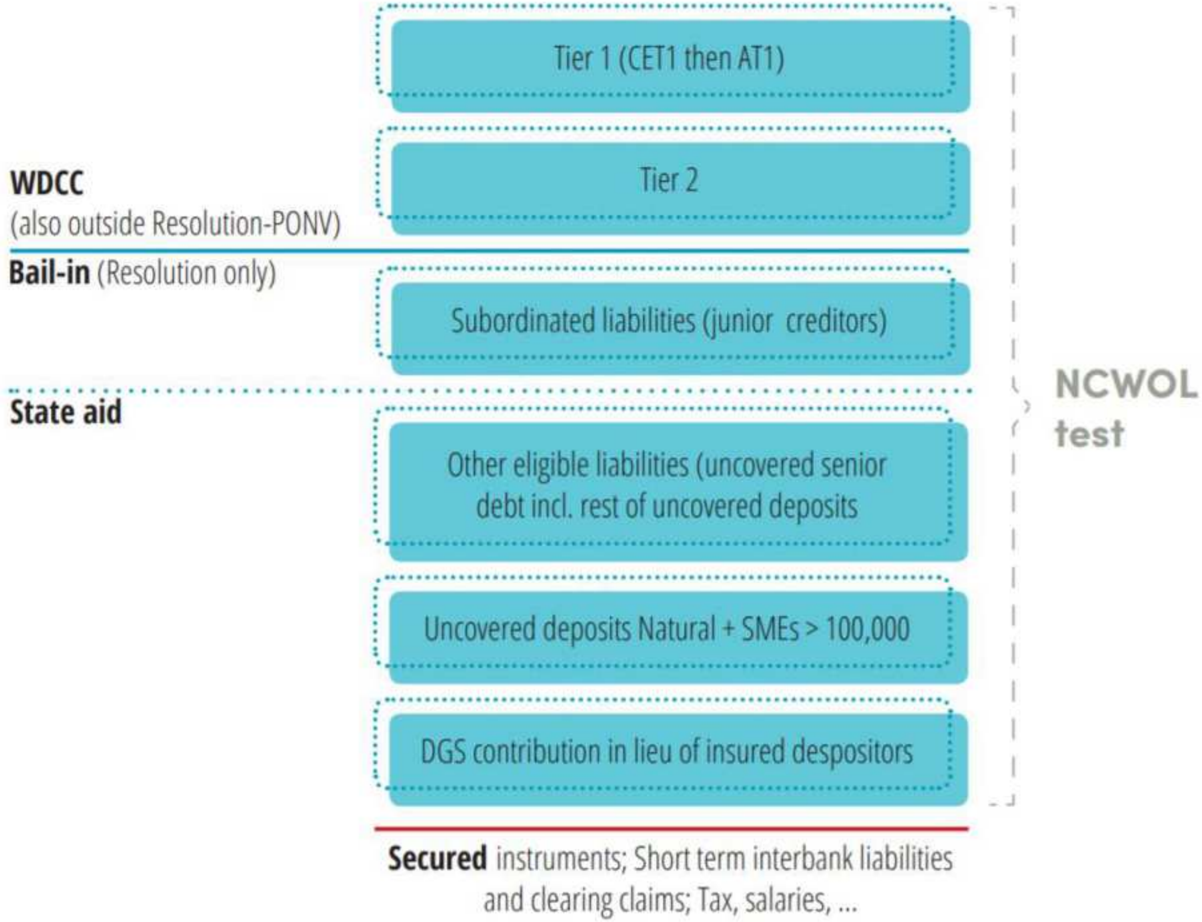
Where a resolution authority decides to exclude all or part of an eligible liability from bail-in, it may increase the level of write-down or conversion applied to other bail-inable liabilities to take account of such exclusion, provided that the other creditors would not suffer greater losses than they would have under normal insolvency proceedings. This provision (the no creditor worse off than under liquidation (NCWOL) principle) represents one of the key principles that must be observed by resolution authorities when applying resolution tools. **Following application of the bail-in tool and any other applicable resolution tools, a further valuation** (separate from the resolution valuation carried out for the purpose of determining the extent to which resolution tools should be applied) **will be carried out in order to determine whether any creditor has in fact suffered losses greater than they would have incurred in a normal insolvency proceeding**.

Source: The World Bank Group

4.3.4. Bail-in

Art. 43-55 BRRD

Bail-in is a **mandatory step** to access to other resolution tools. In fact, BRRD provides that <u>Government support</u> and the <u>use of the Resolution Fund</u> are conditional on prior 8% bail-in.
This means that the Government support or the use of the Resolution Fund can be activated when institution's own funds, capital instruments and eligible liabilities have together already absorbed losses of **at least 8 % of the institution's total liabilities** (including own funds).
Moreover, since an institution can have different instruments that can be used to absorb a losses, BRRD provides a hierarchy on imposing the losses. The loss absorption order is aligned with the priority applicable in normal insolvency proceedings, in order to adhere to the **NCWOL principle**.



Source: The World Bank Group

4.3.4. Bail-in

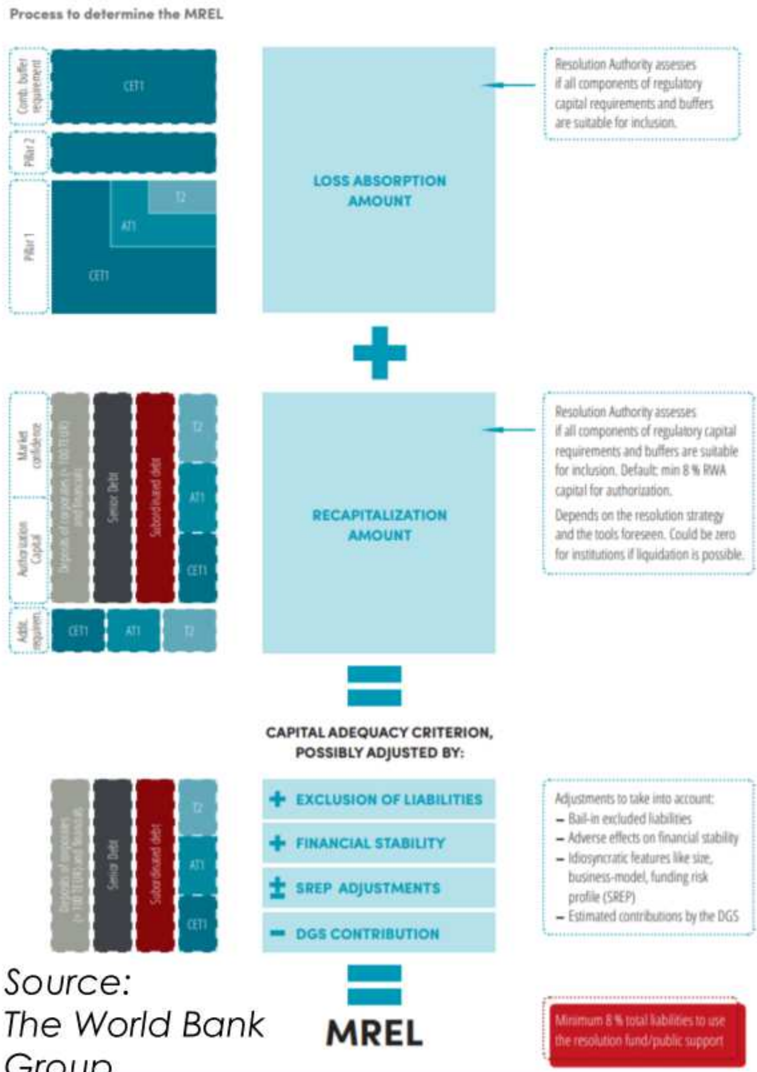
Art. 43-55 BRRD

Minimum Required Level of loss-absorbing liabilities (MREL)

To deter institutions from structuring their borrowings to be immune from the bail-in tool, the BRRD provides that resolution authorities must set a **Minimum Required Level of loss-absorbing liabilities (MREL)** to be held by each institution (in its jurisdiction), expressed as a percentage of the aggregate of an institution's own funds and total liabilities. **MREL will consist broadly of own funds** (i.e. regulatory capital) **and bail-inable liabilities.**

Equity and debt instruments have to fulfil the following criteria to qualify as MREL under the BRRD:

– Issued and fully paid-up;
– Liabilities with a remaining maturity of more than one year;
– Not a liability related to a derivative;
– Not a liability that arises from deposits that benefit from preference in the insolvency hierarchy;
– Not owed to, secured by, or guaranteed by, the institution itself.



Source: The World Bank Group

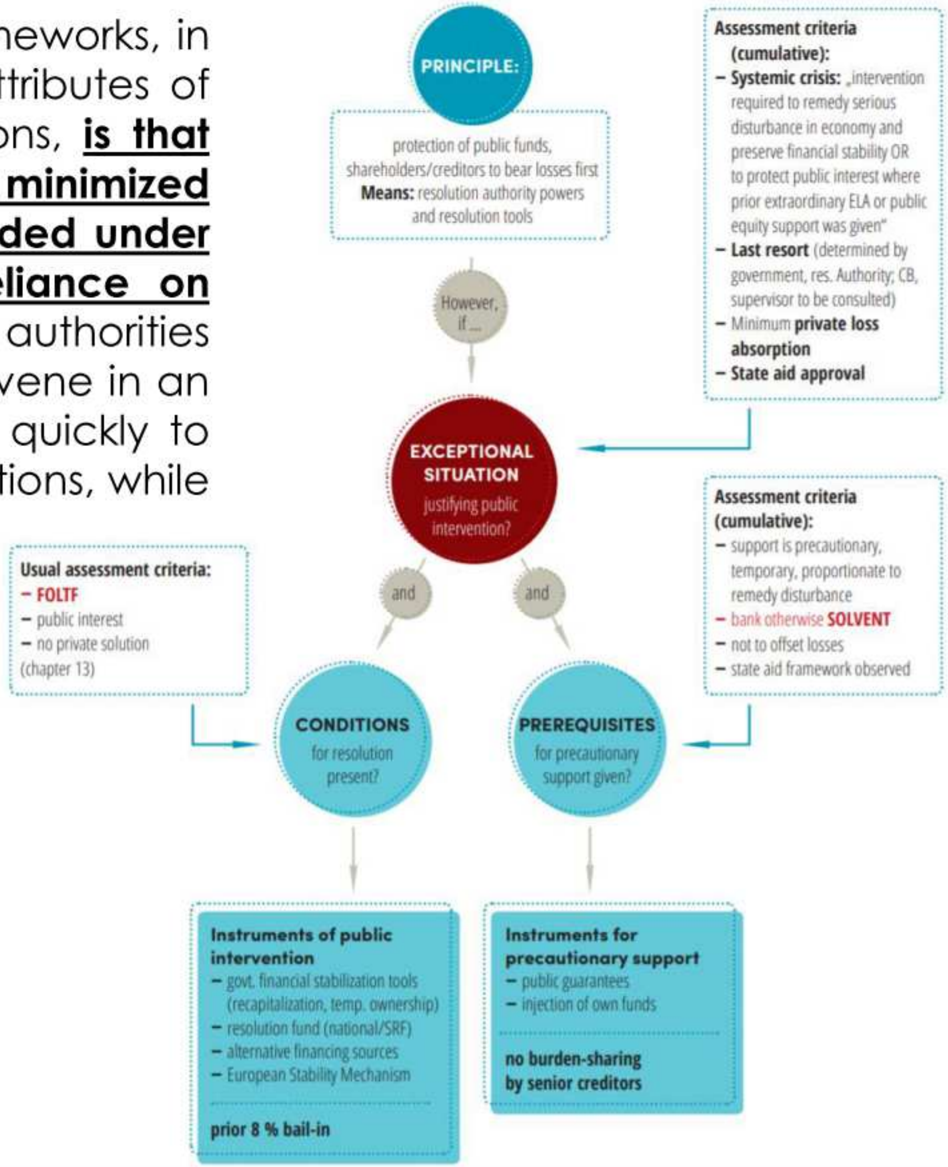
4.3.5. Government stabilization

Art. 56–58, 32(4)(d), 37(10) BRRD

A key principle underlying post-crisis resolution frameworks, in line with the Financial Stability Board (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions, **is that use of public funds should be avoided or at least minimized as far as possible. Use of public funds is not excluded under the BRRD but is strictly regulated to reduce reliance on extraordinary public financial support**. Resolution authorities should instead have a **credible set of tools** to intervene in an unsound or failing institution sufficiently early and quickly to ensure the continuity of the institution's critical functions, while minimizing the impact of an institution's failure on the economy and financial system. Shareholders should bear losses first, followed by creditors.

In exceptional circumstances, however, the greater good of financial and economic stability may require "amendments" to this general principle.

These amendments may apply in the process of resolution of a problem bank or for precautionary purposes



Source: The World Bank Group

4.3.5. Government stabilization

In the **exceptional situation** of a systemic crisis, **the government may**, subject to prior approval under the EU state aid framework, **provide funds** through the government stabilization tools of temporary public ownership and public equity support.
In these cases a **minimum loss absorption (bail-in) of not less than 8 % of total liabilities**, including own funds of the institution under resolution, is required from shareholders and creditors before government support is allowed.

Government support can take the form of:

– **participation in the recapitalization of a bank** in exchange for shares or other capital instruments (temporary public equity support); or

– **taking a bank into temporary public ownership** through the use of a transfer order (temporary public ownership).

In either case the bank must be managed on a commercial and professional basis and transferred to the private sector as soon as commercial and financial circumstances allow.

Source: The World Bank Group

References

1. "Understanding bank recovery and resolution in the EU: a guidebook to the BRRD", The World Bank Group, April 2017

2. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014

3. https://srb.europa.eu/

Readings

ABOUT THE LESSON

1. "**Understanding bank recovery and resolution in the EU: a guidebook to the BRRD**", The World Bank Group, April 2017

2. **Resolution Cases** https://srb.europa.eu/en/content/resolution-cases

OTHER

1. **Italian Assets Slump Again as Ripples Spread Across Europe** https://www.bloomberg.com/news/articles/2018-05-21/italian-bonds-extend-slide-amid-concern-over-increased-borrowing

2. **World's Top Market Survived Bailouts and Brexit Only to Face Italian Threat** https://www.bloomberg.com/news/articles/2018-05-22/top-market-endured-brexit-bailouts-only-to-face-italian-threat

3. **HSBC Completes World's First Blockchain Trade Finance Transaction** https://www.ccn.com/hsbc-completes-worlds-first-blockchain-finance-transaction/