



10 Years Financial Crisis: A European Perspective

Or: Complex Solutions to Complex Problems?

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Jens-Hinrich Binder



The Financial Crisis in Europe: A timeline

- **Germany**

- **July 2007:** IKB failure and private rescue package
- **August 2007:** emergency sale of SachsenLB
- **February 2008:** rescue of WestLB (later liquidated)
- **October 2008 – April 2009:** emergency legislation (provision of state aid to financial sector, nationalisation of banks, emergency powers to resolve failing banking institutions)
- **October 2008:** rescue of HSH Nordbank (now privatised)
- **January 2009:** nationalisation of part of Commerzbank
- **Sep- 2008 – Feb. 2009:** nationalisation of HypoRealEstate



The Financial Crisis in Europe: A timeline

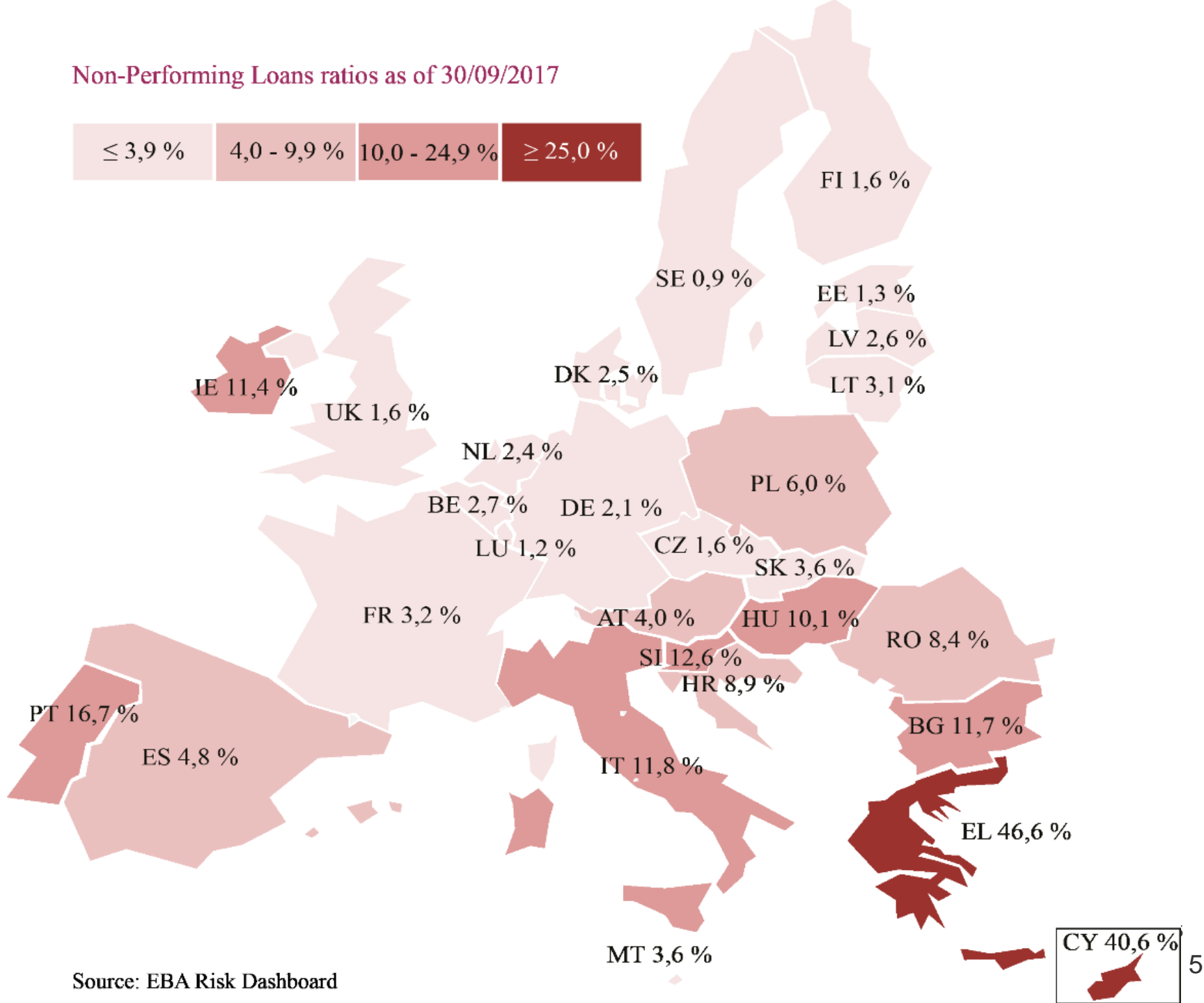
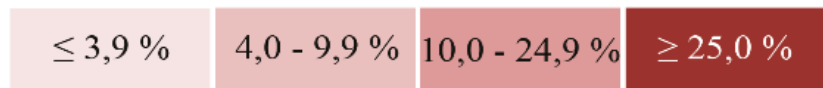
- **United Kingdom**
 - **September 2007:** Northern Rock bank run (and subsequent nationalisation)
 - Banking (Special Provisions) Act 2008
 - Banking Act 2008
 - **October 2008:** Royal Bank of Scotland, Lloyds Bank
- **Others:**
 - **October 2008:** rescue of Dexia group by Belgium, France and Luxemburg
 - **October 2008:** rescue of Fortis (Netherlands)
 - **2012-2013:** Cyprus Bail-in
 - **2008-2013:** Greek Banking crisis



Insolvency of Banks: What is Different?



Non-Performing Loans ratios as of 30/09/2017



Source: EBA Risk Dashboard



The European Response: Institutional Aspects

- **A new architecture in response to the global financial crisis**
 - **Background:**
 - proposals of a **High Level Group on Financial Supervision** in the EU (2009) for closer **co-operation** and **centralisation** of supervisory and rule-making powers within EU
 - **scope:** banking, securities, insurance/occupational pensions markets
 - **substitution** of former system of (sub)delegated rule-making through committees within the comitology framework
 - **New agencies and bodies (overview):**
 - European Systemic Risk Board (ESRB)
 - European System of Financial Supervision (ESFR), consisting of
 - European Banking Authority (EBA) in London
 - European Securities and Markets Authority (ESMA) in Paris
 - Eur. Insurance and Occ. Pensions Authority (EIOPA) in Frankfurt



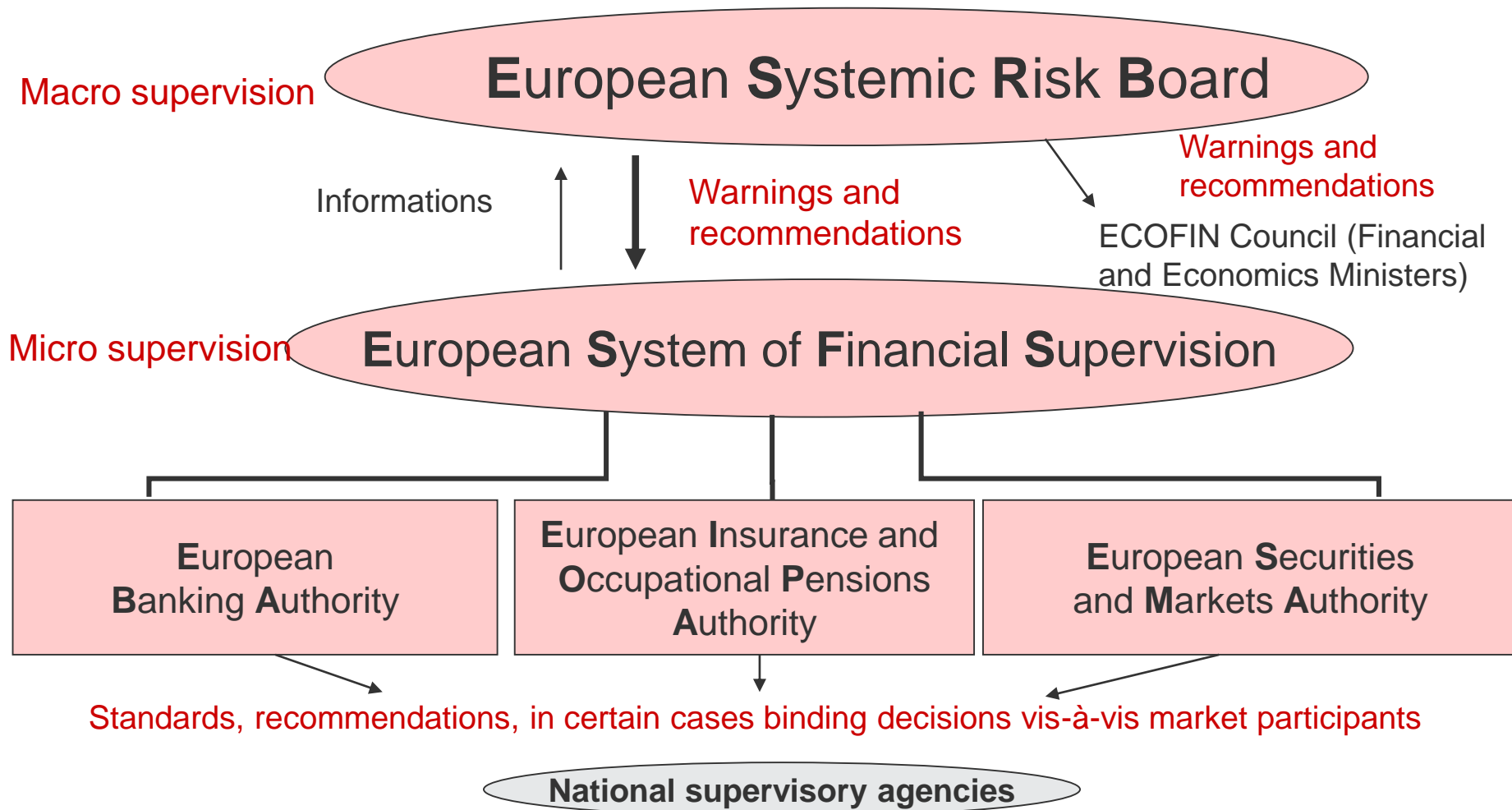
The EU Response: Institutional Aspects (cont'd)

- **The European Systemic Risk Board**
 - a co-operative body without legal personality
 - consisting of representatives of national central banks, the European Commission, and European Supervisory Agencies
 - functions:
 - to conduct ‘macro-prudential’ analyses of market developments and risks, including contagion risk arising from interbank relationships
 - to develop a sound information base and risk assessment
 - to issue warnings and recommendations, when appropriate



The EU Response: Institutional Aspects (cont'd)

- **The European System of Financial Supervision**
 - consisting of representatives of
 - European Supervisory Agencies,
 - the European Commission, and
 - national supervisory agencies
 - function: to co-ordinate supervisory policies and activities
- **The European Banking Authority (as an example for a European Financial Supervisor) – functions:**
 - co-ordination and harmonisation of national supervisory activities and policies, e.g. by way of 'Peer Reviews'
 - promulgation of guidance and recommendations
 - promulgation of technical standards as sub-delegated legislation (contributes to "Single Rulebook" for financial services in EU)
 - in certain (rare) cases decisions directed to individual market participants





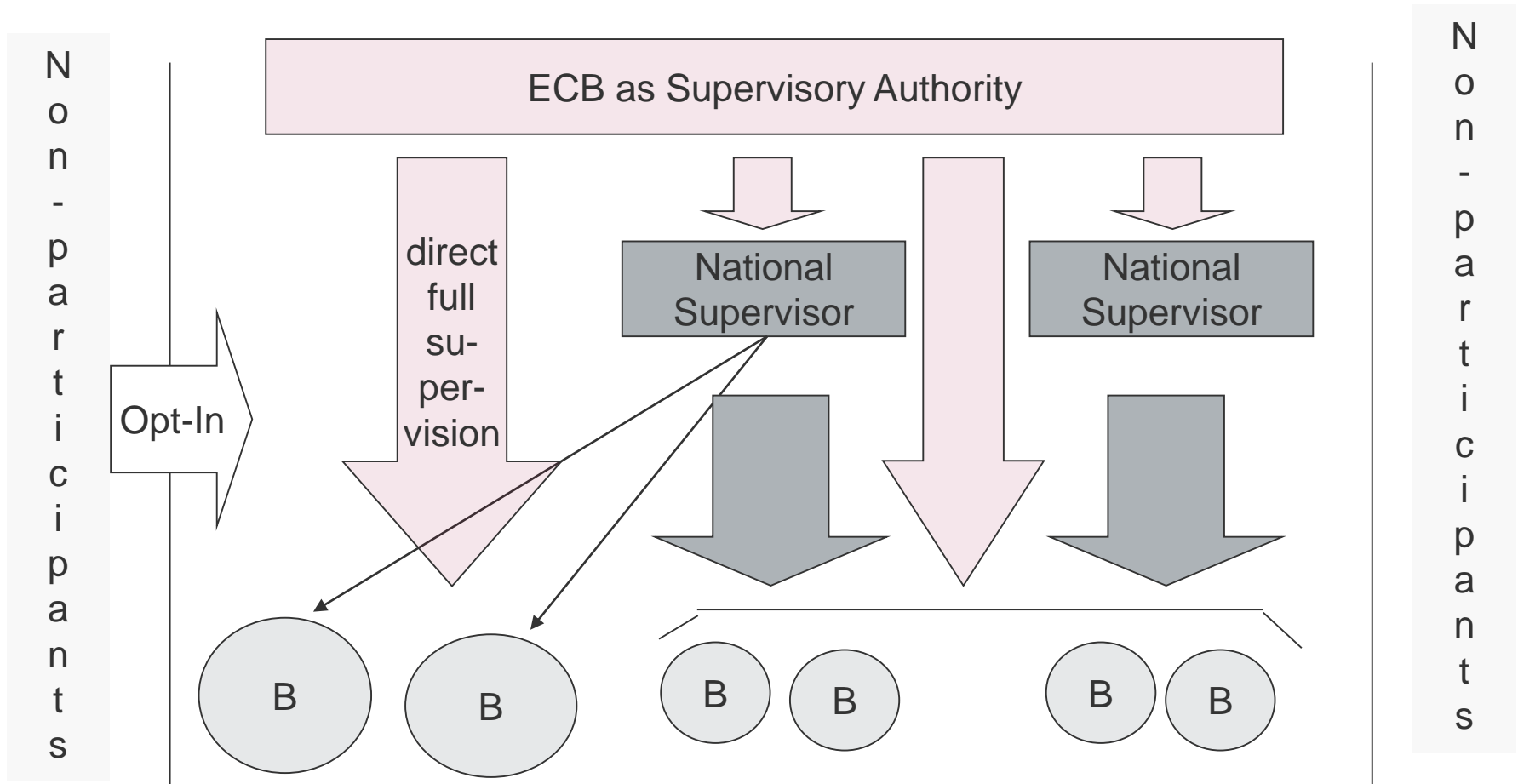
The EU Response: Institutional Aspects (cont'd)

• The “Banking Union”

- an integrated framework for the oversight of financial institutions...
- ... for the Euro zone...
- ... operational from 2014 / 15
- **Stage 1: The “Single Supervisory Mechanism” (SSM)**
 - ECB as sole supervisor for “significant” institutions
 - national supervisory agencies under the control of ECB retain responsibility for less relevant institutions
 - legal basis: Regulations (EU) nos. 1024/2013 and 468/2014
- **Stage 2: The “Single Resolution Mechanism” (SRM)**
 - Single Resolution Board as central decision-maker
 - legal basis: Regulation (EU) no. 806/2014
- **Stage 3: A Unified Deposit Insurance System for the Eurozone?**

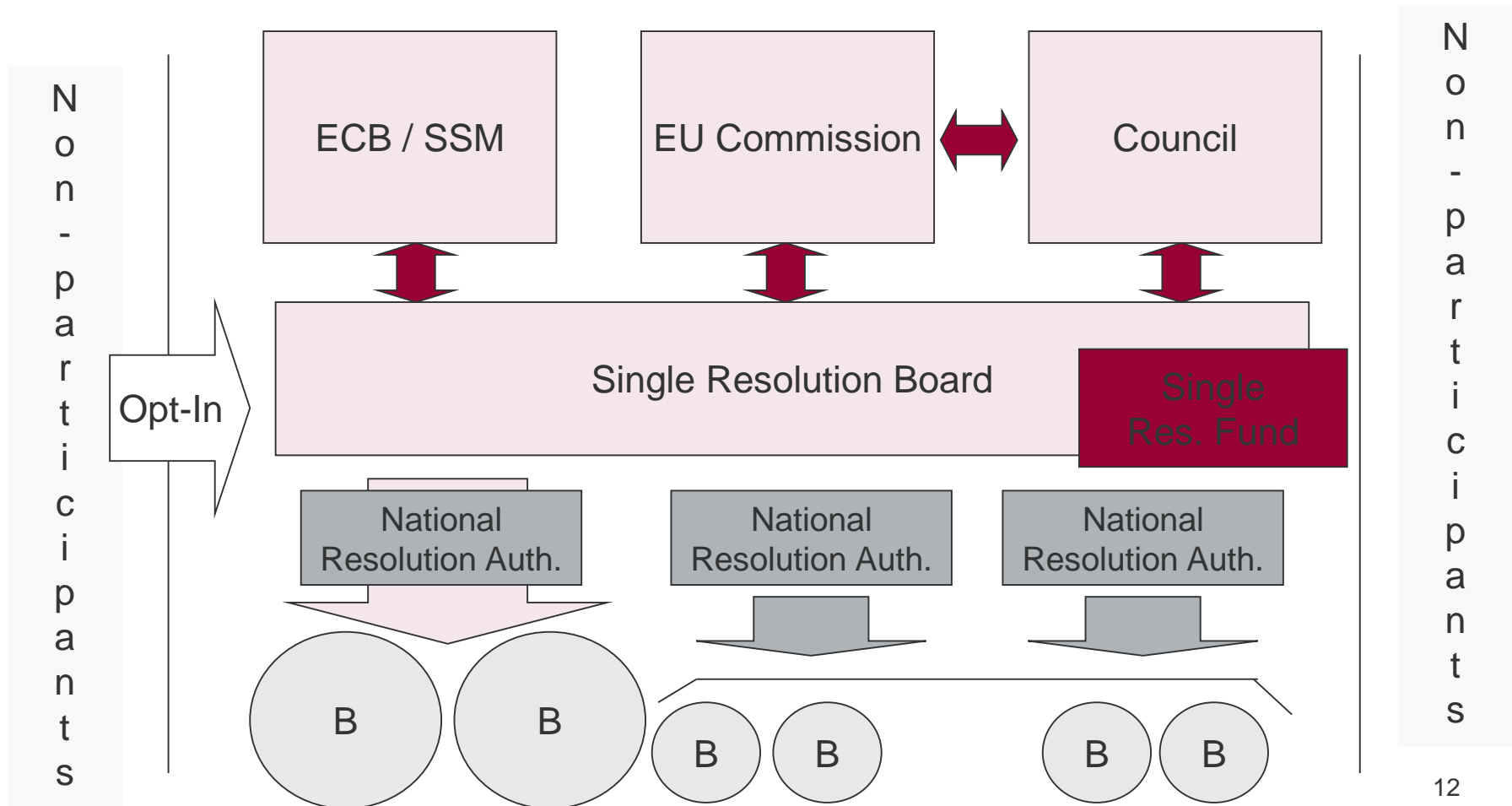


The Single Supervisory Mechanism (as of 2014)





The Single Resolution Mechanism (as of 2015/16)





Insolvency of Banks: Relevant Problems

- **In search for solutions**
 - so why not simply bail out?
 - Government-funded assistance as wide-spread approach during global financial crisis
 - but consider the consequences
 - for national budgets (note EU State Aid restrictions)
 - for market participants
 - the basic objectives of bank resolution
 - to act swiftly and effectively
 - to safeguard important business activities
 - and to avoid moral hazard
 - ➔ to “simulate” traditional forms of insolvency management while avoiding their systemic impact



Bank Resolution: EU Developments

- COM Communication 20 October 2009 COM(2009) 561/4
- Consultation Paper 6 January 2011
- Informal early drafts circulated in October / November 2011
- Additional consultation on the bail-in tool April 2012
- Mai 2012: first proposals for a Banking Union
- **12 June 2012: Commission Proposal for a “Directive ... establishing a framework for the recovery and resolution of credit institutions and investment firms“**
- October 2012: Consultation on a possible framework for the recovery and resolution of nonbank financial institutions
- **Summer 2013: Single Resolution Mechanism as part of Banking Union proposals released**



Bank Resolution: EU Developments (cont'd)

- September 2013: Commission proposal for a Regulation establishing a Single Resolution Mechanism as part of the Banking Union framework
- October 2013: formal acceptance of SSM arrangements, publication in OJ on 29 October 2013
- 15 April 2014: EU Parliament adopts BRRD
- 12 June 2014: publication of BRRD in OJ (Dir. 2014/59/EU)
- 30 July 2014: publication of SRM Regulation in OJ (Reg. (EU) no. 806/2014)
- 1 January 2016: SRM fully operational



International Best Practice and Standards

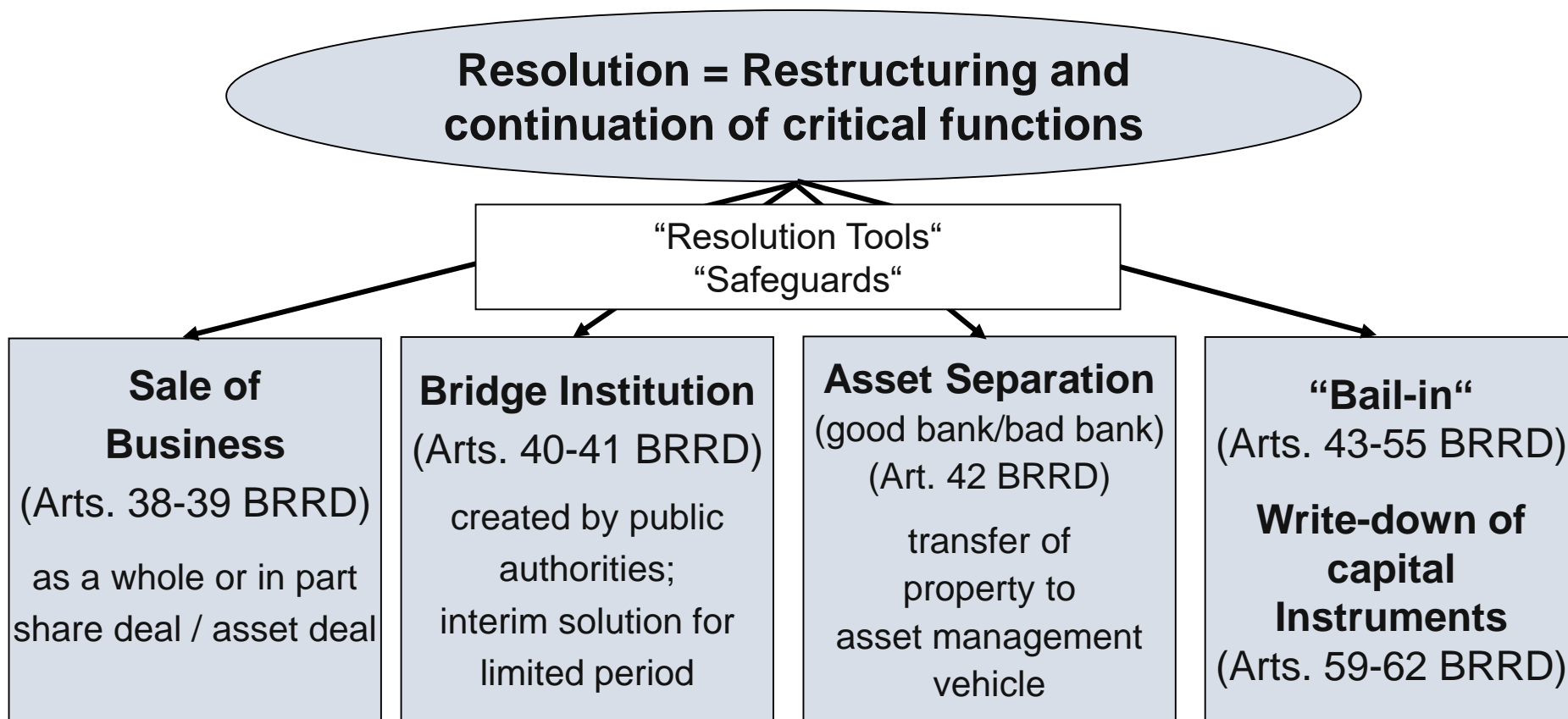
- **Basel Committee Recommendations**
 - Report and Recommendations of the Cross-border Bank Resolution Group (2010)
 - Resolution Policies and Frameworks – Progress so far (2011)
- **G-20 Resolutions and FSB Recommendations**
 - Effective Resolution of Systemically Important Financial Institutions – Consultative Document (2011)
 - Key Attributes of Effective Resolution Regimes for Financial Institutions (2011/2014), in particular:
 - transfer of assets and/or liabilities to private sector party acquirer or bridge bank
 - forced write-down of capital instruments and debt-to-equity conversion (“bail-in“)



Policy Objectives

- **Commission Draft, 6 June 2012, COM(2012) 280 final, p. 5**

“Resolution constitutes an **alternative** to normal insolvency procedures and provides a **means to restructure or wind down a bank that is failing** and whose failure would create concerns as regards the general public interest (threaten financial stability, the continuity of a bank's critical functions and/or the safety of deposits, client assets and public funds). (...) resolution **should achieve, for institutions, similar results to those of normal insolvency proceedings** (...), while safeguarding financial stability and limiting taxpayer exposure to loss from solvency support. In the process, it should also ensure legal certainty, transparency and predictability regarding the treatment of shareholders and bank creditors (...).”



- if:**
- institution has failed or is likely to fail (at least, proximity of insolvency)
 - no alternative measure, including bail-in, capable of preventing failure
 - resolution action is required to protect public interest (systemic stability)



Sale of Business and Bridge Institution

- sale of business: Arts. 38-39 BRRD / bridge institution: Arts. 40-41 BRRD (cf Arts. 24 and 25 SRM Reg, respectively)
- combination of powers that reflects growing international convergence (e.g., US, Canada, UK, Denmark, Germany...)
- emanation of the same principle:
 - transfer of entire business or parts thereof...
 - ... to private sector purchaser with bank license or (public) bridge institution
 - facilitates continuation of “critical functions”, but insolvent company liquidated
- BRRD in line with international best practice, but...
 - ... likely to be practicable only in the case of smaller or medium-sized banks (witness past experience), at least absent holding group structures
 - ... swift application dependent on substantial (interim) funding
 - an instrument for “Non-SIFIs”?



Write Down of Capital Instruments and Bail-in

- Bail-in: Arts. 43-55 BRRD (Art. 27 SRM Reg) / Write down and conversion of capital instruments: Arts. 59-61 BRRD (Art. 21 SRM Reg)
- Bail-in:
 - functions (Art. 43(2) BRRD):
 - to **recapitalise institutions** (but only where there is reasonable prospect of recovery (cf. Art. 43(3) and Art. 52 BRRD) → note requirement to develop and execute a **business reorganisation plan**
 - to **convert to equity or reduce the principal amount of claims or debt instruments that are transferred**
 - to a bridge institution, with a view to providing capital for that bridge institution, or
 - under the sale of business tool or the asset separation tool



Write Down and Bail-in - Conclusions

- A magic solution to TBTF, if could be applied without contagion
 - in derivatives and CDS markets
 - in payment and securities settlement systems
 - in equity and debt markets
- But...
 - contingent on (highly complex) valuation of institution's financial position, which may be difficult to achieve within narrow timeframe
 - unclear, if details will be respected by Third Country jurisdictions
 - unclear repercussions on refinancing conditions
 - a highly complex task for Resolution Authorities...
 - ... that might be feasible in “single point of entry” resolutions but (too) complicated in “multiple point of entry” scenarios

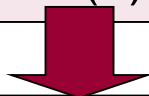


Resolution Action Within the SRM

Assessment of Conditions for Resolution
by SRB on own initiative or upon a communication
from ECB (Art. 18(1) SRM Reg)
(in coordination with national Res Auth)



Adoption of “Resolution Scheme”
to place institution under resolution and determine
the application of resolution tools and the use of the
Res Fund (Art. 18(1) and (6) and Art. 23 SRM Reg)



Transmission of Res Scheme to Commission
(Art. 18(7)(1) SRM Reg)



Commission:

within 24 hrs from transmission (Art. 18(7)(2) SRM Reg)

endorse
the
Resolution Scheme

object to the
discretionary
aspects

within 12 hrs: proposal to
amend with regard to
- public interest aspects
- amount of Fund contrib.
(Art. 18(7)(3) SRM Reg)

referral to Council,
Council decision

Commission
decision

Amendment of Res Scheme / Entry into force
Execution by national Res Authorities
(Art. 18(7)(5) and (7) and Art. 29 SRM Reg)



Bank Resolution Within the SRM: First cases

- **Precautionary recapitalisation of Monte dei Paschi di Siena S.p.A. (February 2018)**
 - application of Art. 18(4), subpara. (1), (d)(iii) SRMR – no resolution, but a bail-out
 - bespoke legislation facilitating the recapitalisation under Italian law
 - relevance for viability of SRM?
- **Resolution of Banco Popular Español (June 2017)**
 - sale of business to Banco Santander S.A.
 - write-down and conversion of capital instruments prior to the transfer



Bank Resolution Within the SRM: First cases

- **Banca Popolare di Vicenza and Veneto Banca (June 2017)**
 - decision **not to** take resolution action, as ‘public interest’ test had not been met
 - resolution to be carried out in accordance with national law
 - approval of State Aid granted to facilitate liquidation under Italian law, conditional on bail-in of shareholders and subordinated debtholders
- **ABLV Bank, AS and ABLIS Bank Luxembourg, S.A. (Feb. 2018)**
 - decision **not to** take resolution action, as ‘public interest’ test had not been met
 - referred to for liquidation under the laws of Latvia and Luxembourg, respectively
 - lessons learnt?



So – where do we stand?