

Course title: International financial regulation

Lesson 6. National and Cross-border Resolution of Failing
Banks

Lecturer: PhD. Nargiza Dalmuradova

PRESENTATION OUTLINE

- I. Background and objectives: Core Principles and Key Attributes
- II. Key comparisons**
- III. Special considerations**
 - I. Moral hazard and bail-in
 - II. Depositor preference
- IV. Next steps**

I. Background and objectives: iadi core principles

- The *Core Principles for Effective Deposit Insurance Systems* were approved by IADI and the BCBS in June 2009 and *Methodology* completed in December 2010.
- IADI and its international partners have prepared a set of revised Core Principles (issued for public consultation on Sept 1st 2014).
- **Key objectives:**
 - » *improve the effectiveness of deposit insurance systems in protecting depositors and contributing to financial system stability...*
 - » *ensure the CPs are adaptable to a wide range of country circumstances, settings and structures...*
 - » *mitigate moral hazard.*

Revising the core principles: key objectives

- Strengthen the CPs (e.g. governance, depositor reimbursements, coverage, funding) and improve safeguards for the use of deposit insurance funds.
- Incorporate IADI-FSB enhanced guidance on reimbursements, public awareness, coverage, moral hazard, and funding.
- Update to reflect the greater role played by deposit insurers in resolution regimes and ensure consistency with the FSB Key Attributes.
- Address moral hazard concerns within all relevant CPs instead of restricting moral hazard guidance to a single principle.
- Add more guidance on deposit insurer's role in crisis preparedness and management as well as cross-border issues.

Background and objectives: fsb key attributes

- The Financial Stability Board *Key Attributes of Effective Resolution Regimes (Key Attributes)* were approved in November 2011 and their supporting Methodology under development.
 - **Key Attributes** a new umbrella standard designed to strengthen resolution regimes.
 - **Key Attributes** influenced the development of the revised **Core Principles** (e.g. resolution powers, funding, crisis preparedness).
- Main objectives:
 - ...to resolve financial institutions in an orderly manner
 - ...without taxpayer exposure to loss from solvency support
 - ...while maintaining continuity of their vital economic functions

II. Topic Comparisons

Core Principles

1. Public policy objectives
2. Mitigating and powers
3. Governance
4. Relationships
5. Cross-border issues
6. Crisis preparedness & management
7. Membership
8. Coverage
9. Funding
10. Public awareness
11. Legal protection
12. Dealing with parties at fault
13. Early detection and timely intervention
14. Effective resolution processes
15. Reimbursing depositors
16. Recoveries

Key Attributes

1. Scope
2. Resolution authority
3. Resolution powers
4. Set-off/netting, collateralization...
5. Safeguards
6. Funding
7. Cross-border cooperation
8. Crisis management groups
9. Institution-specific cross-border COAGs
10. Recovery and resolution planning
11. Resolvability assessments
12. Access to information and info sharing

Connecting the Key attributes & core principles

KA1. Scope

- Regime for any financial institution that could be systemic – main focus G-SIFIs.

KA2. Resolution authority (RA)

- Single or multiple RAs.
- Operationally independent, accountable authority with a mandate to pursue financial stability.

KA3. Resolution powers

- Broad range of powers to intervene and resolve institutions, including through transfers of business, bridge bank and bail-in within resolution and timely payout or transfer of insured deposits.

Scope and operating environment

- Adaptable to a wide range of circumstances, settings and systems.

CP2/3. Mandates , Powers and Governance

- DI mandates vary from “paybox” to “risk minimizers”. Many insurers have resolution powers and are RAs.
- Mandate clarifies roles and responsibilities of deposit insurer and is aligned with the mandates of the other safety-net participants.
- Deposit insurer is operationally independent and accountable.
- Powers support its mandate.

Connecting the Key attributes & core principles

KA4 /5. Set-off, netting... Safeguards

- Legal certainty, effectiveness & enforceability.
- No creditor worse off than in liquidation principle.

KA6. Funding

- Privately financed sources of funds in resolution (e.g. DI or resolution funds).
- Ex post recoveries from industry, if necessary.
- Reference to IADI CPs on deposit insurer funds & safeguards

CP9: Funding

- Banks pay for deposit insurance.
- Deposit insurer must have ex-ante funding and assured access to emergency liquidity.
- Sound fund investment and management.
- Start-up funding from government or international donors permitted under conditions.
- Deposit insurer must authorize use of its funds.
- Taxation and remittance limits.

safeguards in more detail

IADI funding Safeguards

- **Decision-making:** the deposit insurer is informed and involved in the decision-making process.
- **Transparency:** the use of the deposit insurer's funds is transparent and documented and is clearly and formally specified.
- **Exposure limits:** where a bank is resolved through a resolution process other than liquidation, the resolution results in a viable, solvent and restructured bank, which limits the exposure of the deposit insurer to contribute additional funding in respect of the same obligation.
- **Contributions are restricted:** to the costs the deposit insurer would otherwise have incurred in a payout/liquidation net of expected recoveries.

Continued...

- **No recapitalization:** Contributions are not used for the recapitalisation of resolved institutions unless shareholder's interests are reduced to zero and uninsured, unsecured creditors are subject to parri passu losses in accordance with the legal claim priority.
- **Independent audit:** the use of the deposit insurer's funds is subject to an independent audit and the results reported back to the deposit insurer.
- **Ex-post review:** all resolution actions and decisions using the deposit insurer's funds are subject to ex-post review.

KA7. Cross-border Cooperation

- Statutory mandate to cooperate and legal capacity to share information and to give effect to foreign resolution measures.
- No discrimination against creditors based on nationality.

KA8-10. Crisis Management Groups, Resolvability Assessment & COAGs

- Home, key hosts, central banks, supervisors, resolution authorities and finance ministries of GSIFs to maintain CMGs.
- Information sharing among home & key host authorities in recovery and resolution planning as well as in crisis.
- Resolvability assessments for all G-SIFs to evaluate feasibility/credibility of RRP.
- Institution-specific cross-border cooperation agreements.

CP5. Cross-border issues

- Formal information sharing and coordination in place among deposit insurers.
- No discrimination against depositors based on nationality.

CP6 . Crisis preparedness & management

- The deposit insurer has effective contingency planning/crisis management policies/procedures.
- The insurer should be a member of any institutional framework for coordination involving system-wide crisis preparedness & management.

CP14. Failure resolution

- Resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability.
- Legal framework includes special resolution regime.

KA11. Recovery and resolution planning (RRPs)

- Set out recovery and resolution plans to be undertaken by all G-SIFIs.
- To be informed by resolvability assessments.
- Regularly updated and reviewed.

12. Access to information and information sharing

- Robust management information systems
- No impediments to cross-border sharing of information among authorities subject to confidentiality.

CP14. Failure Resolution

- Resolution regime enables the deposit insurer to provide for the protection of depositors and contribute to financial stability.
- All banks resolvable through a broad range of powers and tools which include: powers to preserve critical bank functions (bridge bank), transfers of deposits and assets, write-down and/or debt to equity conversion.

CP15. Reimbursing depositors

- Most insured depositors to be reimbursed within seven working days utilizing a variety of reimbursement options.
- Provisions to be made for making advance, interim or partial payments.
- Access to depositor records at all times; authority to undertake advance or preparatory exams.
- Scenario planning and simulations mandated.

III. Special considerations

» **Moral hazard/ and bail-in issues**

- FSB discussions indicate covered (insured) deposits to be excluded from the scope of bail-inable liabilities.
- Some jurisdictions intend to exclude all uninsured depositors from bail-in.
- G-SIB resolution would likely also involve use of funding from resolution funds and possibly deposit insurers.

» **No depositor preference in KAs or CPs**

- But, various forms of depositor preference being increasingly adopted in many jurisdictions.

IV. Next steps

- » **IADI:** Finalization of revised CPs and development of assessment framework tools (e.g. Handbook for Assessors).

- » Key areas many jurisdictions will need to focus on:
 - Governance;
 - Coverage;
 - Fund adequacy and safeguards;
 - Crisis preparedness/management ;
 - Cross-border agreements; and
 - Payout timeliness.

Next steps

- » **FSB:** Emphasizing the acceleration of reform initiatives to ensure progress in adopting resolution regimes consistent with the KAs because:
 - Few resolution regimes are fully aligned with the KAs.
 - Many barriers to resolvability remain (e.g. operational, structural and financial).
 - Need to build-up adequate loss absorbency across G-SIBs.
 - Address cross-border close-out-risks and cross-border resolution cooperation.

- » **IADI and FSB:** Continue development of supporting guidance both individually and together where common areas of interest (e.g. funding).

February 1995

The Bank Guarantee Fund was established on the basis of the Act of 14 December 1994 on the Bank Guarantee Fund as a response to Directive 94/19/EC on deposit guarantee schemes of 30 May 1994.

Hybrid funding: mainly ex-ante with an ex-post component

From the very beginning the mandate of BFG wider than pure pay-box

Apart from reimbursement of covered deposits required by the directive BFG's powers included:

- **Collection and analysis of information on institutions covered by the guarantee system:** access to data collected by the Central Bank (assigned with supervisory functions),
- **Provision of assistance to entities covered by the guarantee system provided from the Assistance Fund:** loans, guarantees and endorsements for entities at risk or as support for acquirers in merger and acquisition processes;

January 2001

Enhanced powers to provide support to cooperative banks.

- Returnable financial assistance on preferential conditions,
- Addressed to entities in which the threat of insolvency is absent,
- To finance needs relating to mergers of cooperative banks,
- Granted from separate **Cooperative Bank Restructuring Fund**.

November 2008

- Coverage limit raised to 50 000 EUR,
- No 10% co-insurance.

December 2010

- Coverage limit raised to 100 000 EUR,
- Payout period reduced to 20 working days.

*Directive **2009/14/EU**
on deposit-guarantee
schemes as regards
the coverage level
and the
payout delay*



December 2010

Enhanced control powers in entities covered by the guarantee system.

- **BFG assigned with the power to carry out audits with respect to the accuracy of data contained in calculating systems of all banks covered by the system.**
- **On-site and off-site inspections.**
- **Accuracy data audits supplemented by the power of review with respect to entities receiving BFG financial assistance, assigned to BFG since its inception, where it:**
 - **verifies the correctness of assistance funds allocation,**
 - **audits the implementation of a reorganization program,**
 - **monitors the economic and financial situation of the bank as well as its management.**
- **Independently of its auditing powers, BFG may assume the role of a trustee, overseeing the implementation of a reorganization program with respect to a bank receiving BFG financial assistance.**

May 2013

BFG assigned with new powers in relation to credit unions, including some resolution tools (bridge bank, support to an acquirer in P&A) and providing financial assistance to entities at risk (guarantees, loans classified as own funds) from the [Cooperative Savings and Credit Union Guarantee Fund](#).

September 2013

New power to provide capital support to banks.

- **Guarantees to increase the bank's own funds level,**
- **Guarantee executed in the event of insufficient demand by purchase or assumption of stock, bonds or bank-issued securities,**
- **Provided upon a request submitted by the Minister of Finance,**
- **Financed from the newly created [Stabilization Fund](#).**

November 2013

Deposits collected by credit unions covered by BFG guarantee.

Ongoing developments

The following changes to BFG mandate and powers are a result of two EU regulations:

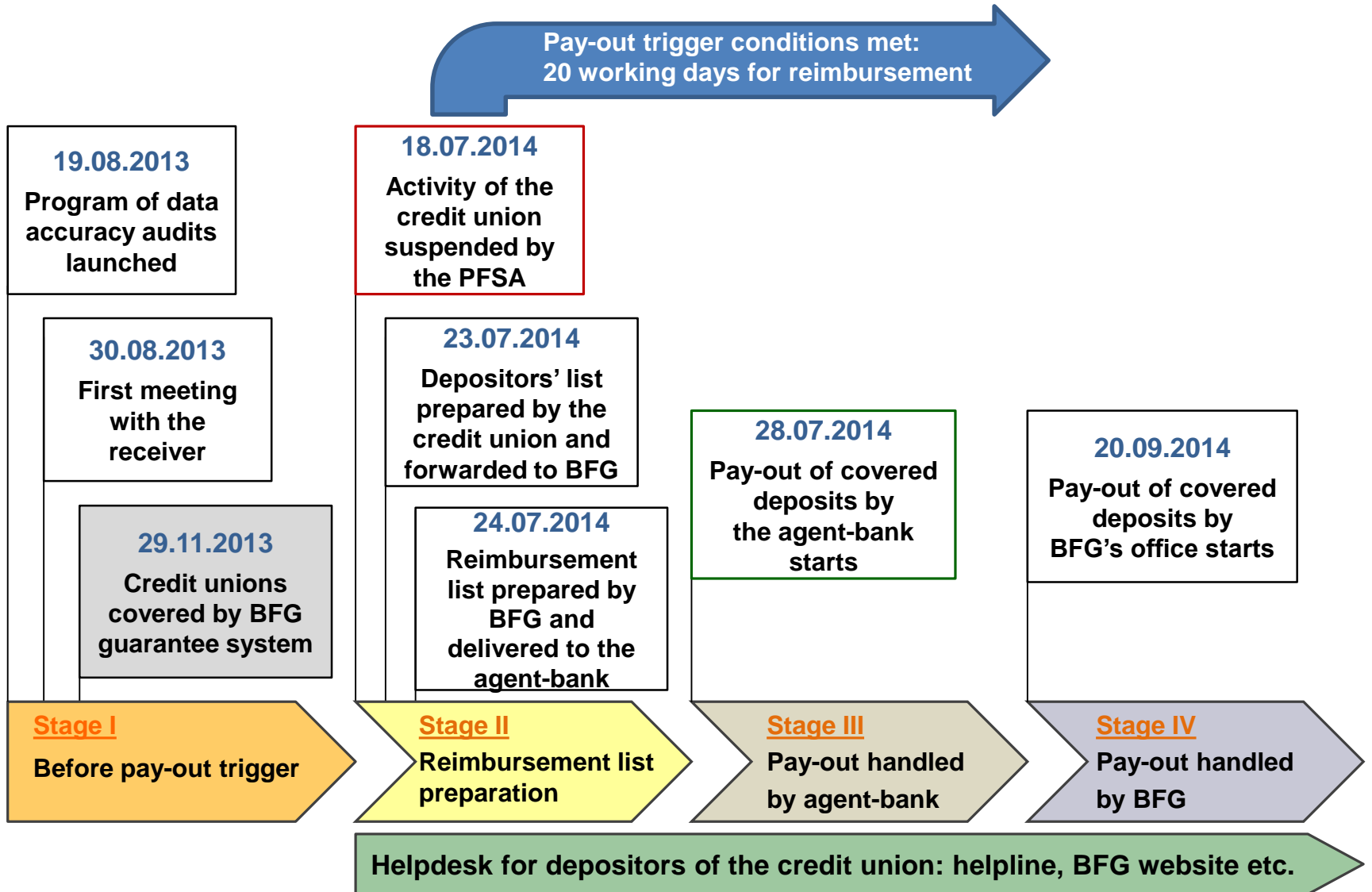
- [Directive 2014/49/EU](#) on deposit guarantee schemes (DGSD), and
- [Directive 2014/59/EU](#) establishing a framework for recovery and resolution (BRRD).



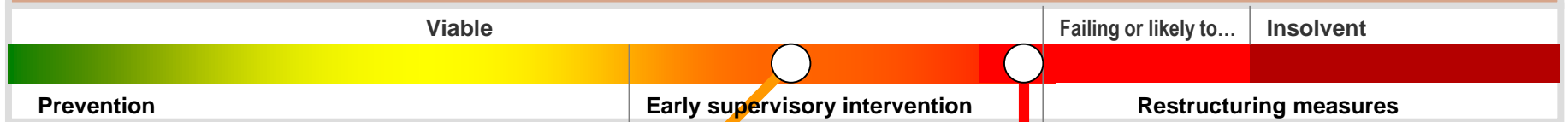
DGSD imposes obligations, inter alia, to:

- Reimburse covered deposits within 7 working days,
- Reach a minimum target level of 0.8% of covered deposits by 3rd July 2024,
- Ex-ante funding based on risk-based premiums,
- Use of DGS funds for resolution purposes.

General Preparedness



Deterioration of cooperative savings and credit unions' financial situation



Financial support granted by BFG to a credit union at risk of insolvency

- Upon application of a credit union at risk,
- Available only to entities being subject to reorganization proceedings conducted according to the requirements of the PFSA,
- Positive decision of the PFSA required,
- BFG's claims fully collateralized,
- Forms of support:
 - Guarantee,
 - Endorsement,
 - Loan (can be classified as own funds)

If the Polish National Association of Credit Unions refuses to grant support

Restructuring decisions



Purchase and assumption:

- partial or whole credit union
 - by other credit union or a bank
-
- BFG may acquire or assume shares of a bank to participate in credit union restructuring measures as an acquirer,
 - BFG may provide to the acquirer, financial assistance in the form of:
 - Purchase of shares,
 - Loan,
 - Guarantee,
 - Loss-sharing agreement,
 - Subsidy.

1. BFG may provide assistance in the form of:

- **total or partial guarantees to cover losses arising from risks associated with acquired property rights or liabilities**
- **subsidies to cover the difference between the value of acquired property rights and liabilities**
- **loans**
- **guarantees**
- **subscription of shares of the acquiring bank**

2. In providing support BFG has the right to participate in profits relating to acquired property rights

3. Detailed conditions for support are defined in individual agreements

Subsidy

1 A subsidy is granted to cover the difference between the value of acquired property rights and liabilities arising from guaranteed funds

2 The value of the acquired property rights arising from guaranteed funds is determined based on cash accounting records as at the date of acquisition

3 The subsidy is paid under the terms of an individual agreement

4 The obligations of the transferee are specified in the subsidy agreement

Guarantee of loss coverage

A guarantee of loss coverage may be given up to 100% of the balance sheet value of the acquired property rights or obligations, in particular:

- 1) loans to households for consumption;
- 2) mortgage loans to households;
- 3) shares
- 4) debt securities
- 5) units of investment funds on the money market
- 6) investment certificates of closed investment funds

Receiver

29.07.2013: PFSA established a receiver for the duration of the reorganization program to strengthen financial situation of the entity through increase of capital and operational efficiency

Tasks of the receiver:

- Draws up and agrees a reorganization program with the PFSA,
- Coordinates implementation of the program,
- Informs the PFSA, the Polish National Association of Credit Unions and supervisory board of the credit union about the effects of corrective measures.

Sequence of events

- Trigger condition met (ratio of own funds to total assets below 1%),
- Polish National Association of Credit Unions refused to provide assistance,
- Lack of potential acquirers among credit unions.

17.07.2014: PFSA designated 7-day period to submit offers by domestic banks interested in P&A transaction

14 August 2014: – decision of the PFSA to take over the credit union by the bank

Takeover of the credit union by the bank

- Credit union taken over by the bank on **01.09.2014**,
- Before that date asset management of the credit union goes to the bank-acquirer, credit union operates and provides services to its members on the current basis,
- Financial statements at the acquisition date should be issued by the acquirer within 15 days from the date of the acquisition,
- Acquirer will order the auditor to examine the financial statements of the credit union and shall provide a report and the auditor's opinion immediately after being prepared.

Initial work

Preparation of internal regulations in the field of providing financial support to credit unions or acquirers in P&A transactions

Audit on the accuracy of data contained in calculating systems of the credit union - value of covered deposits at the day of takeover

Draft standard form contracts on subsidy to acquirer and loss-sharing agreements

Operational preparations in the field of IT solutions

Conditions

The requirements to grant support:

1. Recognition by BFG of the results of an audit of the financial statements
2. Positive opinion of the PFSA and no risk to safety of depositors' funds
3. The amount of BFG funds granted for support must not be higher than the amount of a potential pay-out
4. Use of the equity of the entity for covering losses

Process within BFG

30 days

Financial Assistance Dept.

Draws up an application for assistance for the acquirer

Committee for the Assessment of Requests for Assistance

Opinion

Council of the Bank Guarantee Fund

Opinion

Management Board

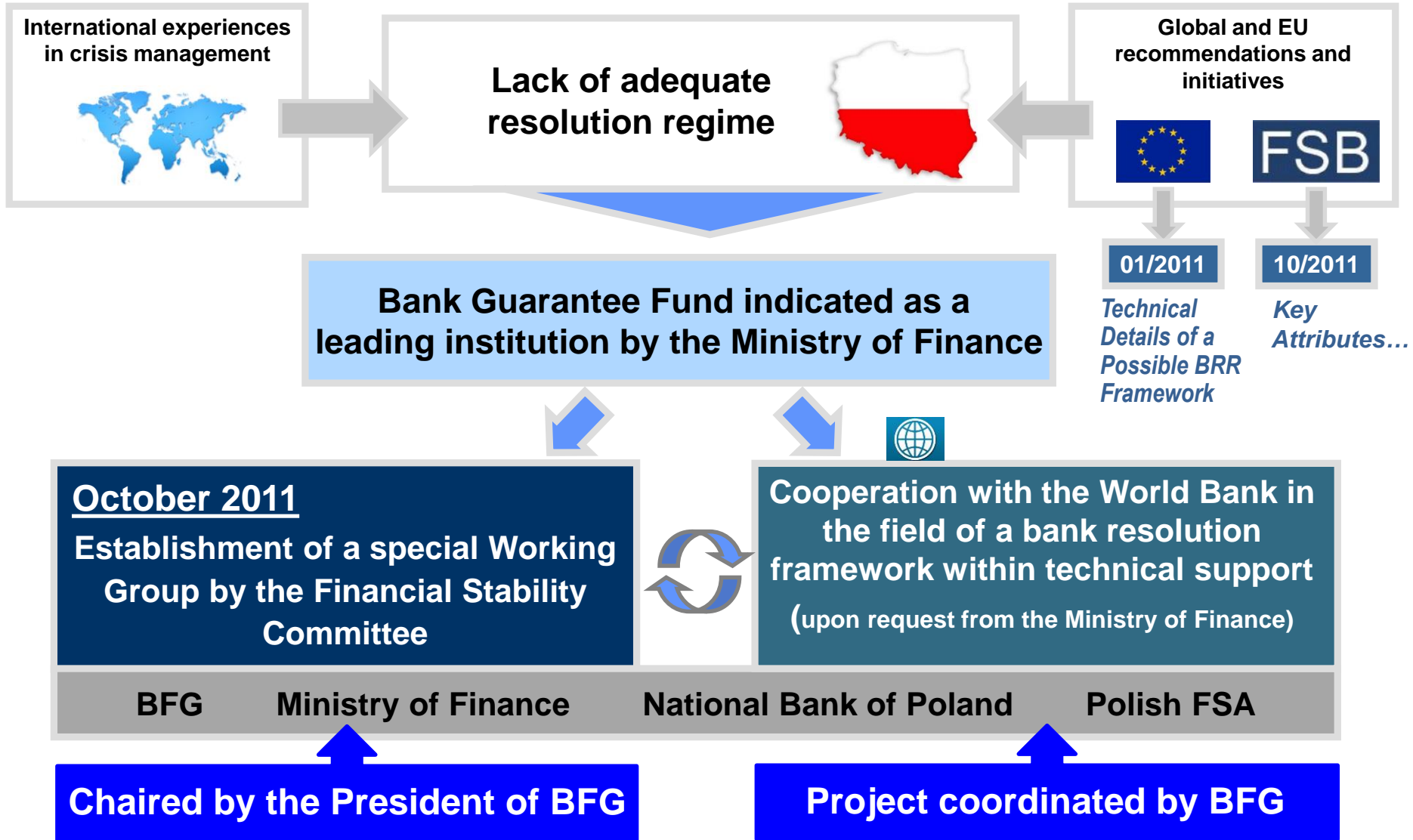
Decision on financial assistance

Agreement with the acquirer

Contract fulfillment

BFG monitors the fulfillment of obligations arising from contracts, especially contracts of loss coverage:

- settlement of the guarantee on a semiannual basis
- control of the exercise of the beneficiary obligations under the agreements



International experiences in crisis management



Lack of adequate resolution regime



Global and EU recommendations and initiatives



01/2011

Technical Details of a Possible BRR Framework

10/2011

Key Attributes...

Bank Guarantee Fund indicated as a leading institution by the Ministry of Finance

October 2011

Establishment of a special Working Group by the Financial Stability Committee



Cooperation with the World Bank in the field of a bank resolution framework within technical support (upon request from the Ministry of Finance)

BFG

Ministry of Finance

National Bank of Poland

Polish FSA

Chaired by the President of BFG

Project coordinated by BFG

Adopted work plan

FSC Working Group on Bank Resolution

Ministry of Finance

Establishment of an FSC special Working Group

Stage I

Conceptual work



Stage II

Study visits



Stage III

Design of draft legislation

Legislative process

Schedule built in compliance with FSB recommendations

FSB FINANCIAL STABILITY BOARD

Know the practice, benefit from experience



External legal experts support in terms of congruence with internal and European law

 Lex

April 2012

- **Financial Stability Committee approved technical details for bank resolution framework in Poland proposed by the Working Group,**
- **Bank Guarantee Fund as a resolution authority with full scope of resolution powers.**

December 2012

- **Draft legislation forwarded to the Minister of Finance for further legislative process.**

2013 / 2014

Legislative process:

- **Impact assessment,**
- **Intradepartmental consultations,**
- **Public consultations (including consensus conferences).**

2014

Full adjustment to the final BRRD provisions.

BFG as a resolution authority

- **Strong position in the financial safety net and active role in crisis management,**
- **Appropriate ex-ante funds available,**
- **Advanced analysis including *Early Warning System*,**
- **Experience in restructuring measures,**
- **Governance in line with international standards → *Core Principles*.**

The Financial Stability Committee was established by force of law in 2008 and consists of four member entities, whose representatives meet on a regular basis



MINISTRY
OF FINANCE



NATIONAL
BANK
OF POLAND



FINANCIAL
SUPERVISION
AUTHORITY



BANK GUARANTEE
FUND*

* FROM OCTOBER 2013

THE FSC'S TASKS INCLUDE

Crisis management and coordinating the activities of members in situations that constitute a threat to the stability of the financial system

Ensuring a proper flow of information with respect to major events and trends that may pose a threat to financial stability

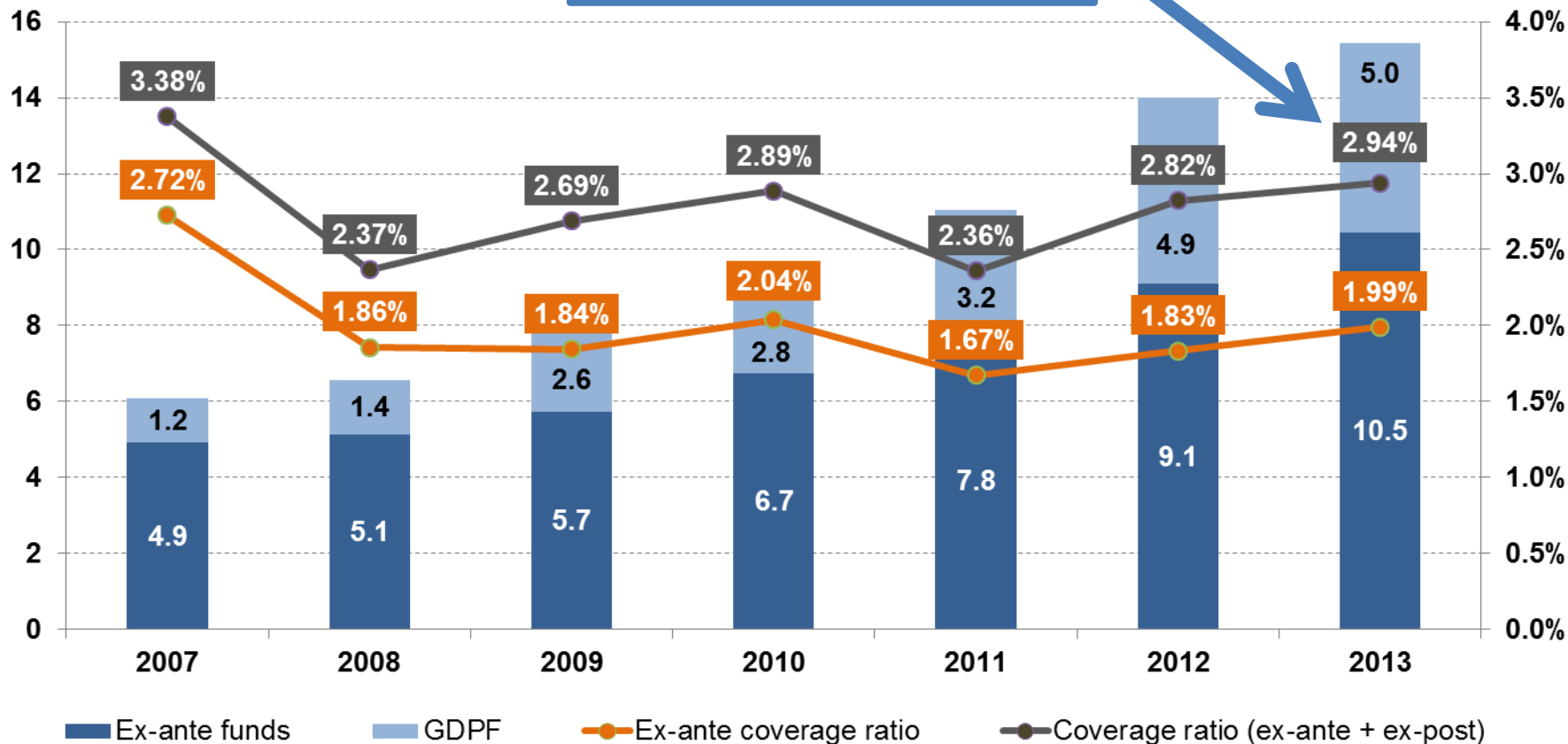
The development and adoption of procedures in case of the emergence of a threat to financial stability

On-going assessment of the situation in the domestic financial system

Preventing crisis escalation in the domestic financial system.

BFG is already compliant with the new European DGS directive and has one of the highest fund to deposit ratios in the EU

in billion PLN



Remarks: For the purpose of comparability between the year 2013 and previous years, the 2013 data does not consider funds collected for allocation to the Stabilization Fund and the Cooperative Savings and Credit Union Guarantee Fund.



Agreements with several banks

- BFG agreement with banks on transactions with debt securities on the secondary market. These transactions contain repo and sell-buy back transactions.

IN CASE OF A NEED FOR EMERGENCY FUNDING:



Agreement between the National Bank of Poland and the Bank Guarantee Fund

- Aim is to create an institutional framework which, in the case of pay-outs, would facilitate obtaining fast, short-term liquidity from NBP.
- The agreement is one of a number of actions taken to reinforce the stability of the financial system and safety-net in Poland.



Loans granted from the state budget

One of the statutory tasks assigned to BFG (from its establishment in 1995) is collecting and analyzing information on entities covered by the guarantee system.

2009/2010

Analytical toolkit supplemented by *Early Warning System*

Complex

Considers wide range of areas



Efficiency

+

Credit risk

+

Capital adequacy

Detailed

Sufficient set of indicators for each area



CI

×

SI₁

×

SI₂

×

SI₃

=

Credit Risk

Core indicator

Supplementary indicators

Dynamic

Considers changes in the financial and economic situation of banks in 3- and 6-month trends



Flexible

Qualitative indicators amended with qualitative assessments based on non-financial data

Reference and source

- Principles of Financial Regulation by John Armour , Dan Awrey, et al. | Sep 28, 2016
- The Financial Courts: Adjudicating Disputes in Derivatives Markets (International Corporate Law and Financial Market Regulation) Part of: International Corporate Law and Financial Market Regulation (20 Books) | by Jo Braithwaite | Jan 7, 2021
- The Foundations of Anglo-American Corporate Fiduciary Law (International Corporate Law and Financial Market Regulation) Part of: International Corporate Law and Financial Market Regulation (20 Books) | by David Kershaw | Aug 23, 2018
- Corporate Governance and Responsible Investment in Private Equity (International Corporate Law and Financial Market Regulation) by Simon Witney | Jan 7, 2021
- Venture Capital Law in China (International Corporate Law and Financial Market Regulation) by Lin Lin | Feb 28, 2021
- Transatlantic Financial Regulation: US-EU Cooperation During the 2008 Financial Crisis by Peter O'Shea | Jul 4, 2021
- The AIFMD: Understanding the framework and ensuring compliance (International Financial Markets Regulation) (Volume 1) by Heiko Timm | May 12, 2015
- Risks and Returns: Managing Financial Trade-Offs for Inclusive Growth in Europe and Central Asia (Europe and Central Asia Studies) by David Michael Gould and Martin Melecky | Dec 6, 2016

Thank you