BANCO DE ESPAÑA
Eurosistema

Departamento de Comunicación

13 de septiembre de 2019

Resolution of mid-sized European banks

Publicado en The EUROFI Magazine. September 2019

Pablo Hernández de Cos, gobernador del Banco de España

The global financial crisis required significant public-sector intervention to bail out banks in order to prevent financial instability and the subsequent deep and negative impact on the real economy. After the crisis, the authorities, through the work of the Financial Stability Board, reviewed the resolution framework and shifted the paradigm, moving from bail-out to bail-in. Additionally, for global systemically important banks (GSIBs) it was agreed to ask for minimum total loss absorption capital (TLAC) that should cover both potential losses and the funds needed to recapitalise the bank.

Europe has also developed a new resolution framework with three particular features. First of all, the creation of the Single Resolution Board (SRB) as a key pillar of the Banking Union. Secondly, the adoption of the new paradigm centred on the bail-in, but also including other resolution tools (sale of business, bridge institution and asset segregation). Thirdly, the new resolution framework and the accompanying MREL (minimum requirements of own funds and eligible liabilities) requirements apply to all banks, not only to GSIBs. This may pose some challenges for mid-sized European banks with a retail business model and almost no tradition or practice to tap wholesale markets for capital or debt that absorbs losses.

The BRRD clearly states which are the objectives to be protected in resolution: continuity of critical functions, financial stability, minimising the use of public funds, protecting the guaranteed depositors and the assets and funds of bank customers. The authorities, in cooperation with banks, develop a resolution plan that also includes a minimum MREL requirement, precisely to protect those objectives and minimise the use of tax-payers money. Therefore, if a bank of any size performs critical functions and its liquidation may threaten financial stability, it needs to have enough MREL for its orderly resolution.

The level of MREL a bank needs is calibrated depending on the resolution tool to be used. The resolution tool needs to be credible and feasible. As such, only bail-in seems credible and feasible for large and complex banks since it appears to be almost impossible to find a buyer for a large and complex bank when resolving it. The past crisis provides support for this hypothesis. However, for mid-sized and small banks, sale of business and the bridge bank seem reasonably credible and feasible resolution tools. The successful resolution of a Spanish bank two years ago by the SRB is an example of how a domestically systemic bank with 150 billion euros of total assets can find a buyer in resolution.

Which is the level of MREL needed for a sale of business tool? In this case, it should be taken into account that the buyer will probably recapitalise the bank, as it will also provide the liquidity the bank may need when opening after resolution. The MREL requirement should cover the loss absorption amount but it also seems reasonable for coverage of the recapitalisation amount to be partially fulfilled by the buyer. However, as it is not fully certain that a buyer will appear in resolution, a safe margin for the recapitalisation amount should be covered by each bank with a transfer strategy. In any case, the resolution plan must develop a credible strategy for sale of business, in particular, the creation of vendor data rooms that would allow a third party to run an efficient due diligence process in the event of resolution.

Last but not least, the BRRD2 will allow for a longer period to fulfill the MREL requirements (1st January 2024 in most circumstances). Small and medium-sized banks may need this longer period of time to build up the required MREL, without threatening their business model and profit generation. Given their smaller size, MREL issuance liquidity might also be a matter of concern. In any case, there are windows of opportunity for these banks to start to tap wholesale markets. It will be challenging but not impossible.

The combination of a longer period of time and the use of the whole array of tools provided by the resolution framework in Europe should allow mid-sized banks, with critical functions to protect and with a potential impact on financial stability in case of liquidation, to build the needed MREL that will insulate tax-payers from jumping in again to rescue failing banks.