Making Retail Banks Resolvable

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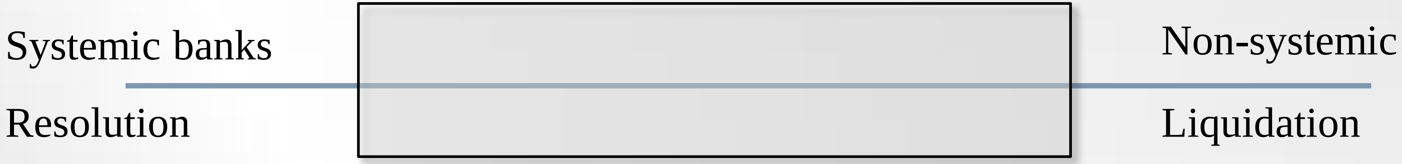
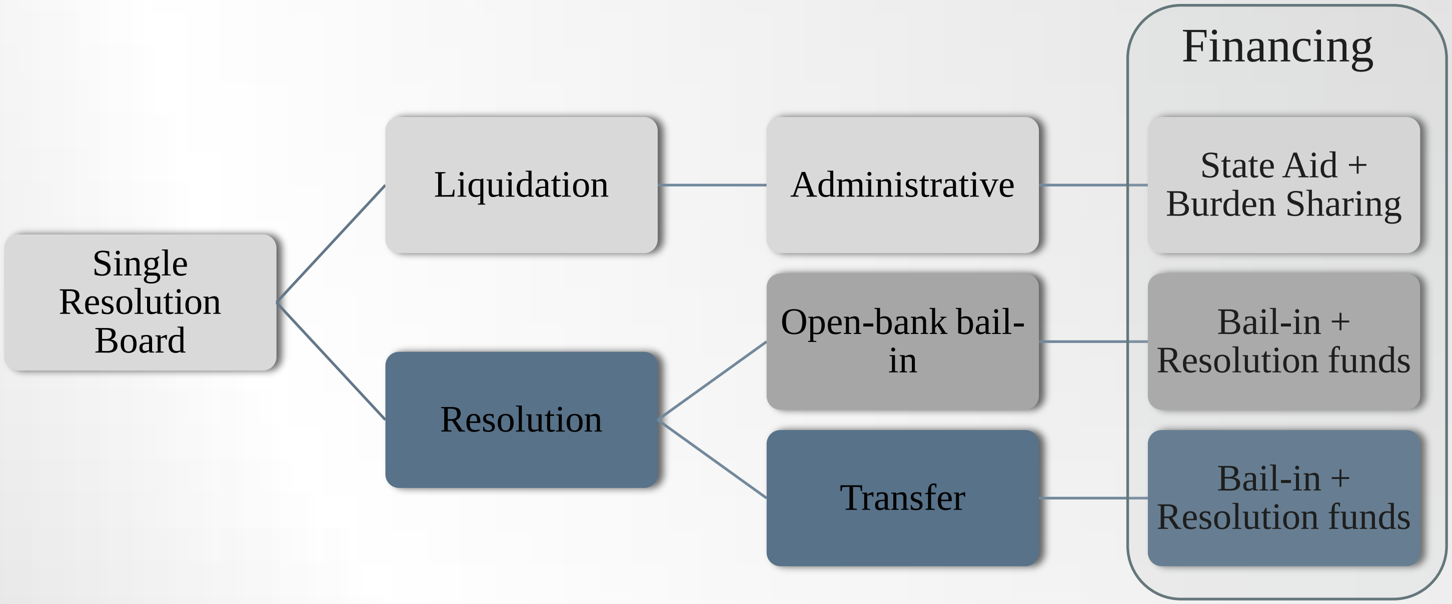
1. Research question

- **Scope**: (i) Retail banks – deposits/liabilities < 40%; (ii) both significant & less significant; (iii) that meet the public interest test.
- **Trade-off:** resolvability v viability
- **EU Problem:** diverse banking sector
  - **Significant banks:** 70% not listed, 60% never issued convertible bonds (CoCos), and 25% never issued subordinated debt [Restoy, 2018].
  - **Less significant banks:** Approximately 70 banks are domestically significant.



- How do we deal with this grey zone?

2. Strategies: overview



2. Strategies: (i) open-bank bail-in

- Financing: **min. 8%** bail-in + **max. 5%** SRF.
- Max. 5% SRF:
  - Resolution financing is limited→ pressure for more bail-in.
- Min. 8% bail-in:
  - Requires liability buffers (MREL) for loss-absorption and recapitalization.
  - BUT losses > minimum capital = need for higher MREL and bail-in?
  - high cost of MREL liabilities.
- What value and what business model left?

Liabilities
Covered depositors/ DGS
Senior unsecured creditors-Uncovered depositors
Senior non-preferred creditors
Junior unsecured creditors
Shareholders

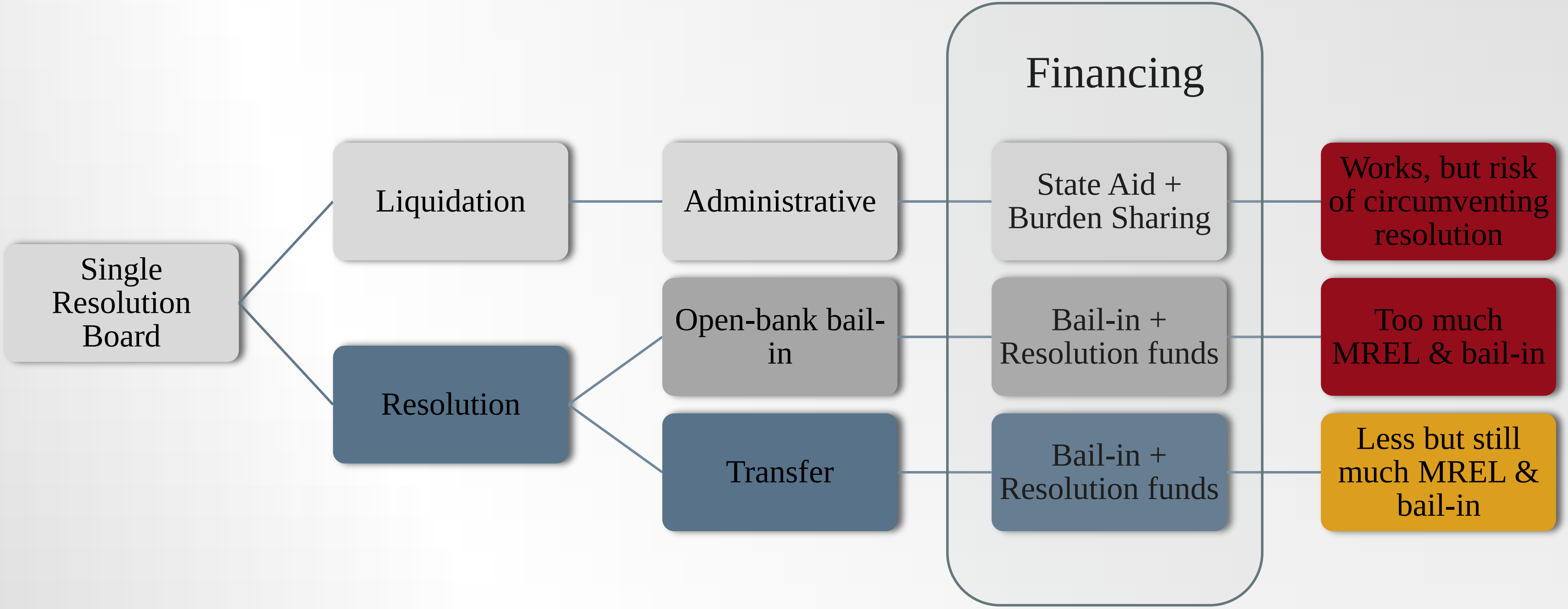
2. Strategies: (ii) transfer strategies

- Use of transfer tools: sale of business, asset separation, bridge institution.
- In principle, lower MREL requirements.
- 2 scenarios:
  - a buyer already exists → perfect
  - a buyer does not exist → bridge institution.
- Financing: **min. 8%** bail-in + **max. 5%** SRF.

2. Strategies:(iii) administrative liquidation

- Use of transfer tools + state aid + burden sharing.
- Comparison with resolution transfer strategy:
  - Toolkit: same;
  - Amount of bail-in/burden-sharing: lower requirements;
  - Financing: limited private/more flexible public;
  - Competent authority: European/national.
- Risk of de facto circumvention of resolution (Veneto banks).

2. Strategies: conclusions



3. Recommendations

- Enhancing resolution transfer strategies for retail banks since:
  - losses/ resolution costs still need to be covered, but no need for full recapitalization; thus, lower MREL levels;
  - there will always be bigger banks willing to buy;
  - however, when bail-in might go beyond junior creditors, need for collective funds:
    - Allow SRF use for higher than 5%;
    - Establish voluntary collective industry funds.

3. Recommendations

- ‘Base’ legal vehicle for such funds: institutional protection schemes (IPSs).
  - Successful in countries used, i.e. Germany;
  - Flexible trigger;
  - Incentive to join – lower MREL levels;
  - The SRB could incorporate such arrangements in its MREL policy – aligned with BRRD 2 on cooperative networks;
  - Moral hazard risks – contributions based on risk-weights/leverage ratios;
  - Liquidity risks.
- Could establish resolution-specific *financing arrangements*.

4. Conclusion

- From existing strategies, resolution transfer strategies may be the most suitable for many retail banks.
- Need for credible collective financing:
  - Higher limit to the use of SRF funds (5%<);
  - Establishment of voluntary industry funds in exchange for lower MREL levels.