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Finance & Markets

Bank Recovery and Resolution Stakeholders' Event Kiev, 15 May 2019

Key Elements of Proposed Legal Alignment with the Bank Recovery & Resolution Directive



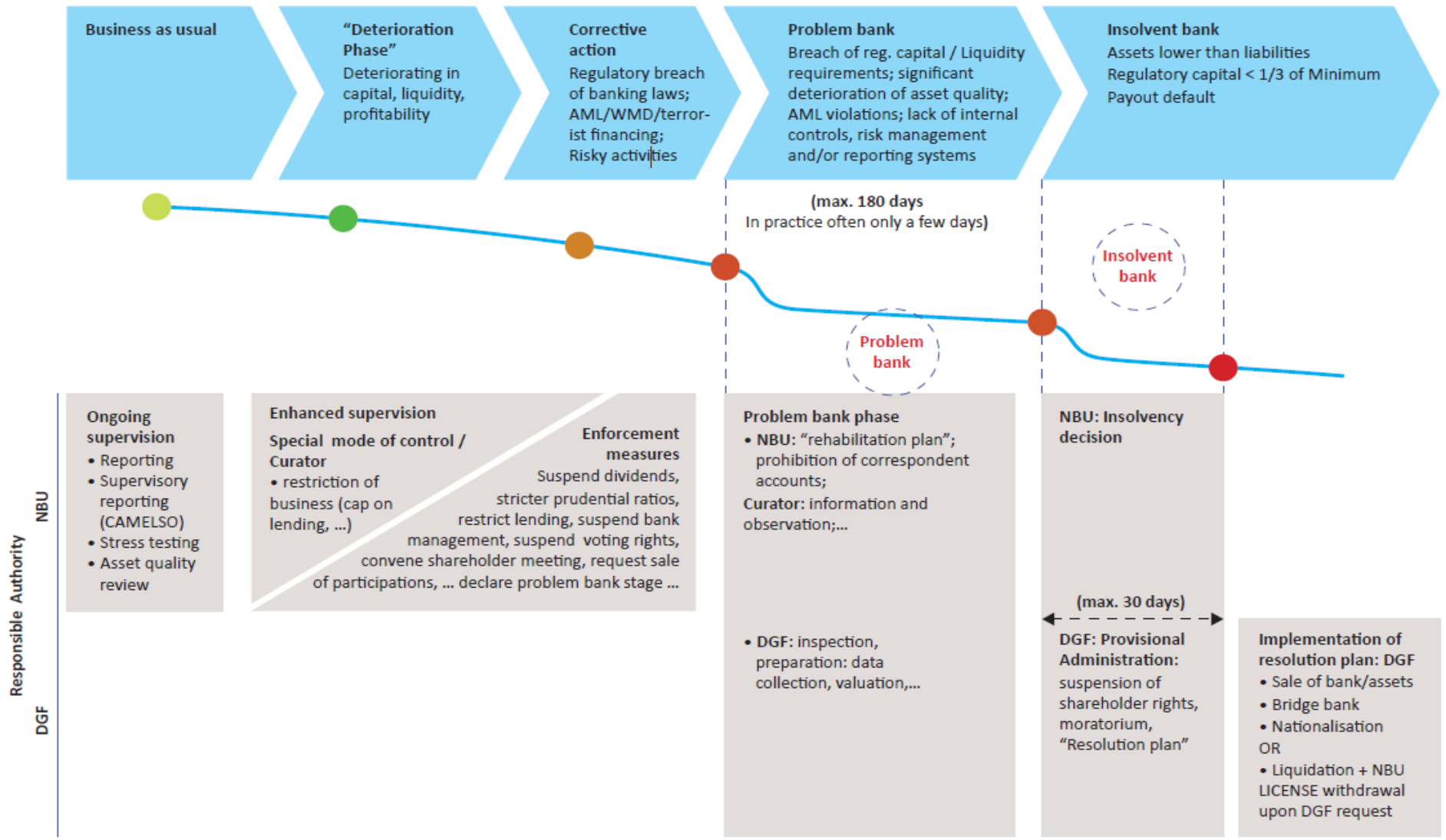
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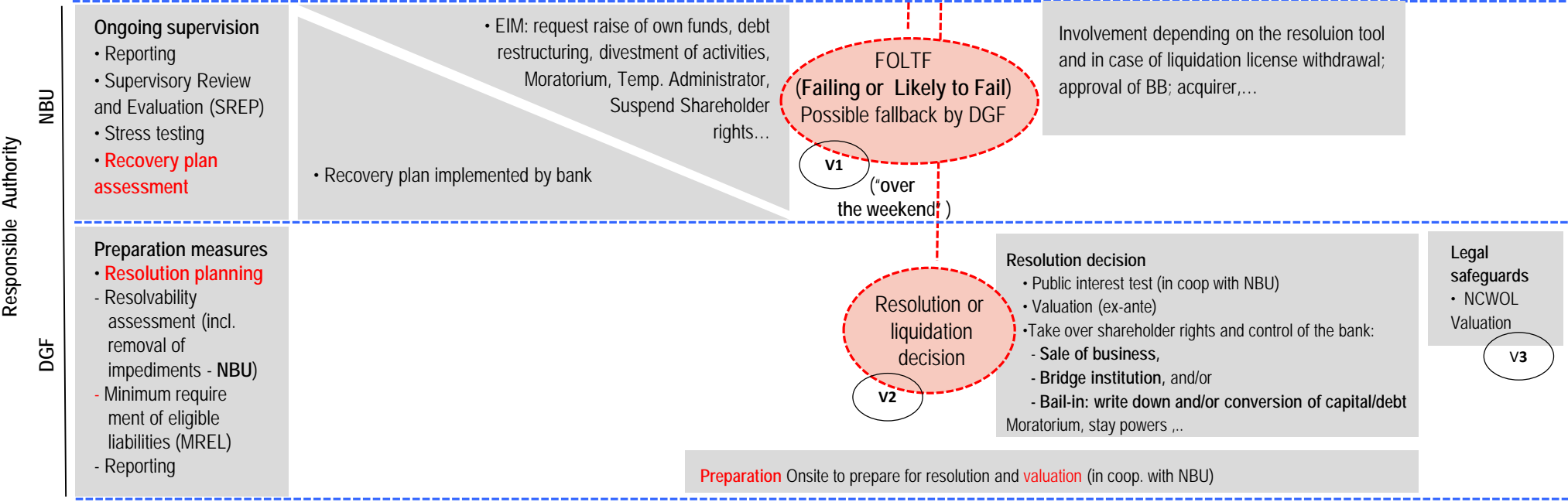
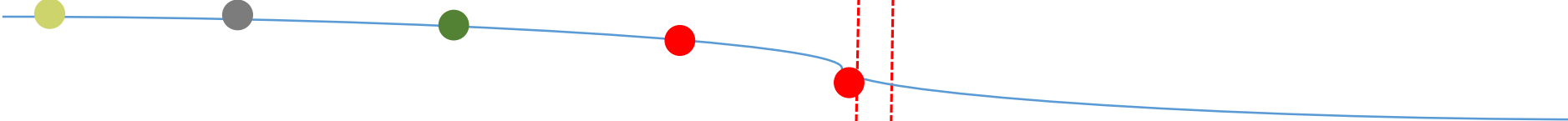
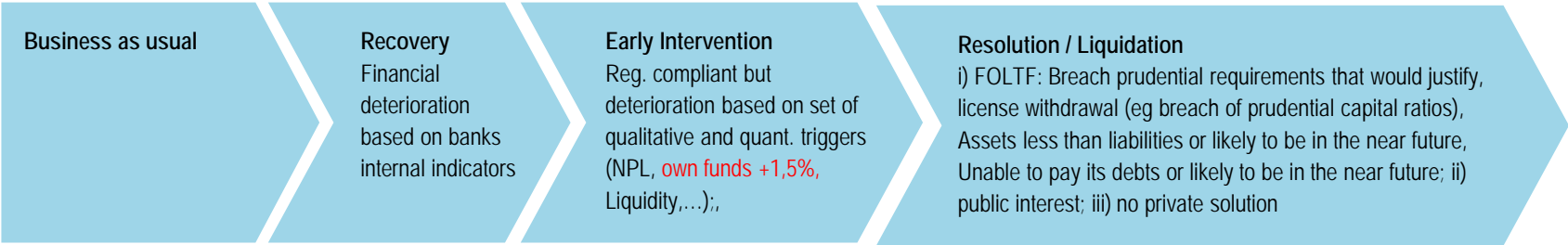
The BRRD as a starting point for reform in Ukraine

BRRD	Ukrainian bank resolution
BRRD entered into force in 2015/ obligatory bail-in in 2016	DGFL
Main objectives <ul style="list-style-type: none">• Maintain financial stability by preventing contagion, ensuring continuity of critical functions if required in the public interest	Liquidation or P&A or BB under least cost for all banks
Main elements <ul style="list-style-type: none">• Administrative based resolution• better preparedness via Recovery and Resolution Plans• Strong powers and tools to take fast action at an early stage (“Likely to fail”)• Allocation of losses on owners and creditors also outside liquidation (without closing the bank) via Bail-in• Ex-ante resolution fund to support resolution (instead of public support) after prior 8% bail-in	Good starting point: <ul style="list-style-type: none">• administrative based bank resolution and liquidation system• Tools and powers to build upon• additional skills and powers required with a focus on EX-ante preparation (RRP) and enhanced legal safeguards

Resolution Framework in Ukraine: status Quo



Possible revised BRRD aligned resolution framework for Ukraine



Preparation Onsite to prepare for resolution and **valuation** (in coop. with NBU)

Key issues for reform

	Current Ukrainian framework	BRRD
Recovery planning	-	All banks – proportionality Assessment by NBU – opinion from DGF
EIM	Deterioration and corrective action phase	Enhanced qualitative and quantitative set of triggers e.g. 1,5% own funds
Problem bank stage	Maximum 180 days	-
Resolution planning	After declaring a bank failing during 30 day management	Ex-ante For all banks: resolvability assessment (liquidation or simple SoB/BB) For Public interest banks: preferred resolution strategy , MREL,...
Resolution trigger	Insolvent, Reg. capital <1/3, ...	FOLTF e.g. regulatory breach e.g. below regulatory capital requirement (8-10.5% of RWA, 3% LR)
Resolution decision	Handover to DGF - manages up to 30 days	over the weekend (48 hours);



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Resolution tools: Overview

- **Sale of business**
 - Sale of assets/liabilities or shares via privately negotiated deal or auction
 - **Bridge institution**
 - Transfer of shares and/or (performing) assets/liabilities of one or more failing banks to a NewCo (bridge institution)
 - **Bail-in**
 - Write-down/conversion of capital instruments and certain liabilities to recapitalise failing bank; losses imposed on shareholders and creditors (stand-alone or in combination with Sale of business or Bridge institution)
 - **Asset separation**
 - Transfer of (doubtful/non-performing) assets of one or more failing banks to a NewCo (asset management vehicle); in exceptional circumstances only
 - **Public financial support**
 - Limited financial support by DGF, capped at level of hypothetical pay-out
 - Additional financial support from public funds only under strict conditions
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Resolution tools: Key issues for reform

Sale of business

- Share sale: limited private auction as default option (instead of open tender)
- Tight limits on DGF contribution to funding: **may not exceed hypothetical loss incurred by DGF in liquidation if guaranteed deposits had been bailed in**)
- Assuming bank to comply with regulatory requirements immediately after transfer

Bridge institution

- “Long-term” bridge institution only (**short-term bridge replaced with other tools**)
- Public ownership: no minimum level, no direct holding by DGF
- **Initial term under BRRD 2 years, no fixed limit on extensions**
- Bridge bk. to **fully** comply with regulatory requirements after establishment

State intervention

- **Strict formal preconditions (“last resort”):**
 - **public interest in preventing disorderly failure (“systemically important”);**
 - **resolution tools not sufficient to prevent severe negative effects;**
 - **no private sector solution and internal bail-in capacity exhausted**

Asset separation

- Only available in exceptional circumstances (market for relevant assets demonstrably impaired)

Bail-in

- **New tool to force all shareholders/creditors to contribute to the recapitalisation of the bank (currently limited to related parties only)**

Bail-in: Mechanics

- **Scope of the bail-in instrument**

- Bail-inable liabilities: a priori all liabilities that are not excluded
- Excluded liabilities: liabilities that cannot be bailed in in order to
 - a) protect employees, guaranteed depositors and other privileged creditors
 - b) maintain financial stability and prevent contagion

- **Write-down and conversion of capital instruments**

- Write down/conversion of ordinary and preferred equity (CET1), conditional convertible debt (AT 1), other hybrid debt and certain subordinated debt (T2)
- In accordance with respective priority in liquidation (insolvency ranking)

- **Write-down and conversion of bail-inable liabilities**

- All bail-inable liabilities, in accordance with their priority in liquidation
 - Includes, **a priori**, uninsured part of depositors and most unsecured creditors
 - Differentiation between financial investors and others (e.g. depositors, trade), e.g. by way of (statutory/contractual) subordination
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Bail-in: MREL

- The **Minimum Requirement for Eligible Liabilities (MREL)** is a complement to regulatory capital and may consist of
 - Tier 1 and 2 capital instruments
 - subordinated debt, potentially senior unsecured debt (bonds, interbank loans); but: **MREL subordination** critical to preserving integrity and credibility of bail-in
 - MREL consists of
 - a “**loss absorption amount**” (usually the regulatory capital requirement); and
 - a “**recapitalisation amount**”, calibrated to refinance the entity and restore it to regulatory compliance (if required as per its resolution plan – “public interest”)
 - Capital and eligible liabilities are mobilised on at the “resolution entry point”:
 - “external MREL” is raised by the subsidiary (from external; investors);
 - “internal MREL” is “downstreamed” from the parent to subsidiaries to absorb losses and losses are “upstreamed” to the parent co. from the entity where they arise.
 - Target level for large banks to enable “seamless” public support/use of Resolution Fund, if needed (in EU: 8% of assets)
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Bail-in: Potential issues

- **Financial stability considerations**

- Reduction of potential public sector-exposure to bank failures
- mitigation of the “moral hazard” problem in the banking sector
- increase of internal loss-absorption capacity within financial sector; but
- contagion risk through cross-holdings of bail-inable debt within banking sector

- **Debt market capacity**

- Subordinated debt: UAH 20 bn (EUR 690 mn), thereof 50% state-owned banks
- Other (senior) debt securities: UAH 967 mn (EUR 33 mn); mostly by two banks
- Interbank lending (total): UAH 80 bn (EUR 2.7 bn), ca. 4% of bank sector assets

- **Debt market maturity**

- Potential to kick-start development of market, contributing depth and liquidity
 - Availability of domestic institutional investors capable of absorbing losses
 - Availability of sophisticated investors capable of accurately pricing risk
 - Appropriate **phase-in period** required to ensure effectiveness of MREL
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Resolution financing

- **Cost of bank resolution to be borne by private stakeholders**, instead of the public
 - Internal loss-absorption and recapitalisation capacity (MREL)
 - Public financial support only as “ultima ratio” to prevent systemic crisis
 - Creation of private-sector “backstop”, analogous to deposit insurance
 - Limited scope for DGF to contribute towards resolution funding
 - Dedicated **bank resolution fund** financed by industry contributions – administrated by DGF but separate from deposit guarantee scheme
 - Access to funding subject to minimum level of internal loss absorption (bail-in)
 - **Introduction to be delayed – reassessment e.g. by year-end 2022**
 - **Proactive vs. reactive** procedures for granting public financial support
 - Supervision: designation of “systemically important” banks; identification of “critical economic functions”; (ex-ante) recovery planning
 - Resolution: (ex-ante) resolution planning (“public interest”), loss absorption capacity (MREL), analysis of potential exposure and contingency budgeting
 - Formal procedure involving Ministry of Finance, Financial Stability Council
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Safeguards

Independent valuations

Authorities have to obtain valuations from independent experts at certain points

- before FOLTF decision is made (Valuation 01);
- when resolution decision is made and resolution strategy decided (Valuation 02 + estimate on V3);
- after resolution decision comparison with what would have happened under hypothetical liquidation (legal safeguard; Valuation 03).

External valuations provide objective points of reference for both authorities and stakeholders

Equal treatment

- Creditors who share the same ranking in liquidation are to be treated equally in resolution

No Creditor Worse Off than in Liquidation (NCWOL)

- Creditors are entitled to compensation if they could have recovered more of their respective claims in liquidation than they did in resolution
- Review of NCWOL claims (based on Valuation 03) required to conclude resolution proceedings

Legal remedies

Judicial review

It is critical that resolution can be implemented rapidly to preserve the value of the failing bank and to prevent systemic contagion.

Whereas stakeholders' rights to seize the courts should be protected, the review of authorities' **resolution decisions**, e.g. to declare a bank "Failing or Likely to Fail" and their application of resolution strategies, should be

- subject to **strict limits** on time and the nature of claims; and
- have **no suspensive effect** (presumption that suspension would be against the public interest).

Claims against authorities' resolution actions, including alleged infractions of property rights and/or legal principles or safeguards (e.g. NCWOL) should, if successful, as a rule result in **monetary compensation only**.

Annex 2: overview different types of Valuations for resolution purposes under BRRD

V1 before resolution	V2 before resolution	V3 after resolution
<ul style="list-style-type: none">• Inform if bank is FOLTF/WDCC• Accounting principles (+ supervisory adjustments)• Independent valuer for / Supervisor or RA / or authority itself	<ul style="list-style-type: none">• Inform resolution action; extent of write down and conversion of capital and debt• “economic value” incl. franchise value• Independent valuer for RA - or RA itself• provisional valuation	<ul style="list-style-type: none">• Determine NCWOL*• Gone concern• Independent valuer for RA

* whether shareholders and creditor would have received better treatment under hypothetical liquidation

<https://eba.europa.eu/-/eba-publishes-handbook-on-valuation-for-purposes-of-resolution>
