

Practical Aspects in the Execution of Resolution Tools – a „Bridge Bank” case study in Poland

Session 4: Hoping for the best, preparing for the worst: Bank resolution.

Artur Radomski

17-18 May 2022

Financial Sector Advisory Center (FinSAC)
Annual International Conference



Resolution cases in Poland

Resolution cases in Poland:

- I. Cooperative Bank in Sanok
- II. Cooperative Bank in Przemków
- III. Idea Bank S.A.

Name of the Bank	Size of the bank	Tool used	Assets as at the resolution day (in total, in mln PLN)
Cooperative Bank in Sanok	Middle size	Bridge-bank	2 817
Cooperative Bank in Przemków	Small	P&A	75
Idea Bank S.A.	Systemic	P&A	14 006

FOLTF (1/2)

Entity is considered to be at risk of bankruptcy

(Art. 101 para. 3 of the BFG Act)



if at least one of the following circumstances occurs:

- 1) indications occur that it will fail to satisfy the operating business conditions to the extent justifying the repeal or revocation of a license to establish a bank or to pursue brokerage business by an investment firm;*
- 2) the assets of an entity are not sufficient to cover its liabilities or the indications occur that the assets of the entity are not sufficient to cover its liabilities;*
- 3) an entity fails to settle its due liabilities or indications occur that it will fail to do so;*
- 4) continuation of business of an entity requires involvement of extraordinary public funds.*

BFG's decision to initiate a resolution

(Art. 101 para. 7 of the BFG Act)



all of the following conditions has to be satisfied:

- 1) a domestic entity is at risk of bankruptcy,*
- 2) no indications occur that the feasible supervisory measures or the measures of a domestic entity will allow in due time to remove the threat of bankruptcy,*
- 3) measures towards a domestic entity are required in view of the public interest.*

Failing or likely to fail condition is included in art. 101(7) p. 1 of the BFG Act.

Potential resolution tools:

- ✓ Acquisition of the property rights
- ✓ Sale of the organized part of the enterprise
- ✓ Bridge bank
- ✓ Bail-in

Public Interest Assessment

BFG concluded that the resolution action was necessary in the public interest (as stipulated in art. 101 (7) point 3 of Act of 10 June 2016 on the Bank Guarantee Fund, Deposit Guarantee Scheme and Resolution („Act of BFG”).

Name of the bank	Threat to the implementation of the resolution objective (Article 66 of the Act on BFG)
PBS in Sanok	<ul style="list-style-type: none">ensuring the ongoing performance of the critical functions carried out by an Entity
BS in Przemków	<ul style="list-style-type: none">maintaining financial stability, in particular through the protection of confidence in the financial sector and ensuring market disciplineprotection of depositors and investors covered by the compensation Scheme
Idea Bank S.A.	<ul style="list-style-type: none">maintaining financial stability, in particular through limiting the spreading effect, including elimination of the negative impact of a potential liquidation of the Bank through standard insolvency proceedings on other entities in the financial sectorlimitation of public funds involvement or the likelihood of their exposure to the financial sector or its individual entities to achieve the objectives referred to in art. 66 point 1 and 3-5 of the Act on BFG.

Description of transaction:

1. Contribution of the initial capital into the bridge bank (Bank Nowy BFG S.A.) by the Bank Guarantee Fund amounting to PLN 100 million.
2. Write-off of the equity instruments (including subordinated bonds) PLN 170.8 million.
3. Transfer of the certain property rights and liabilities to the bridge bank, after granting a subsidy ensuring the level of net assets equal to 0.

Transfer to Bank Nowy S.A. (Bridge Bank) a separated part of PBS embracing all property rights with the exclusion of:

- ✓ Most of stock and shares owned by PBS in commercial companies,
- ✓ Financial means amounting to PLN 5 million in the amount corresponding to PBS obligations towards tax authorities and liabilities under social insurance.

Transfer of all liabilities related to the bank activity, with exclusion, amongst others, the following obligations:

- a) those for which pursuant to the art. 123 (second sentence and art. 191 para. 2 of the Act on BFG) PBS is responsible,
- b) those resulting from the administrative penalties imposed in connection with the PBS activities;
- c) arising from interest: (i) on cash liabilities other than guaranteed funds stipulated in art.2 point 65 of BFG Act; (ii) arising from electronic money within the meaning of the provisions of the Payment Services Act of 19 August 2011 (Journal of Law of 2019, position 730, as amended) as well as pecuniary means received in exchange of electronic money, as stipulated in art.7 para.1 of this Act.

Transfer of all liabilities related to the bank activity, with exclusion, amongst others, the following obligations:

- d) Resulting from means other than those indicated in letters *a-c* and other than:
 - Guaranteed funds as stipulated in art. 2 point 65 of the BFG Act,
 - Funds constituting the liabilities referred to in art. 440 para.2 point 2 of the Bankruptcy Law of 28 February 2003,
 - Fund referred to in art. 206 para. 1 points 2-10 of the Act on BFG.

However, liabilities referred to above in letter *d* are not transferred to the Bridge Bank only in the part being the product of their value and the percentage resulting from the ratio of the absolute value of the amounts:

- Negative amounts equity amounting to PLN 182.9 million resulting from the estimated loss (Valuation 2) reduced by the amount resulting from redemption of the subordinated bonds as well as liabilities indicated in letter *c* as above,
- Up to the amount of liabilities indicated in letter *d*

Advantage of Bridge Bank:

- ✓ Possibility to introduce relatively quickly BB without the necessity to have an acquiring entity (autonomy in the decision by the resolution authority).

Disadvantages of Bridge Bank:

- ✓ **Inability to keep financial stability** due to its short-term nature (according to the EC's decision maximum 2 years, we have 1 year).
- ✓ Effective in case of lack of sale of BB in this time, **start of liquidation will cause the bank run**, which will cause the fulfilment of the guarantee condition and pay-out – which encumbers the guarantee fund.
- ✓ **A significant decrease in the value of the enterprise** due to significant restrictions - on the possibility of conducting business - required by the European Commission (no new sales to new customers)

Disadvantages of Bridge Bank:

- ✓ **Significant liquidity risk** right after the resolution (particularly in the case of the redemption of deposits) which cannot be addressed with the own sales action due to the lack of possibility to place the deposits above the market (EC requirement) and lack of possibility to advertise.
- ✓ The potential cost of the emergency financing is **extremely high** and the loan from the resolution fund burdens it increasing the contributory need of the sector.

Disadvantages of Bridge Bank:

- ✓ **Higher levels of the required redemption** in comparison to SoB due to the need of equipping with the capital. In the case of institutional problems in the Bank, BB does not resolve them as there is lack of possibility to introduce new procedures by the interim management from the resolution entity. It causes the risk of continuation of bad practices for which the Resolution Entity is already responsible.
- ✓ Effective shutting down of the enterprise **increases the level of losses** of the entity liquidating in practice the franchise value and any new business. At the same time, the best employees and customers will leave the Bank having a short perspective of its existence.

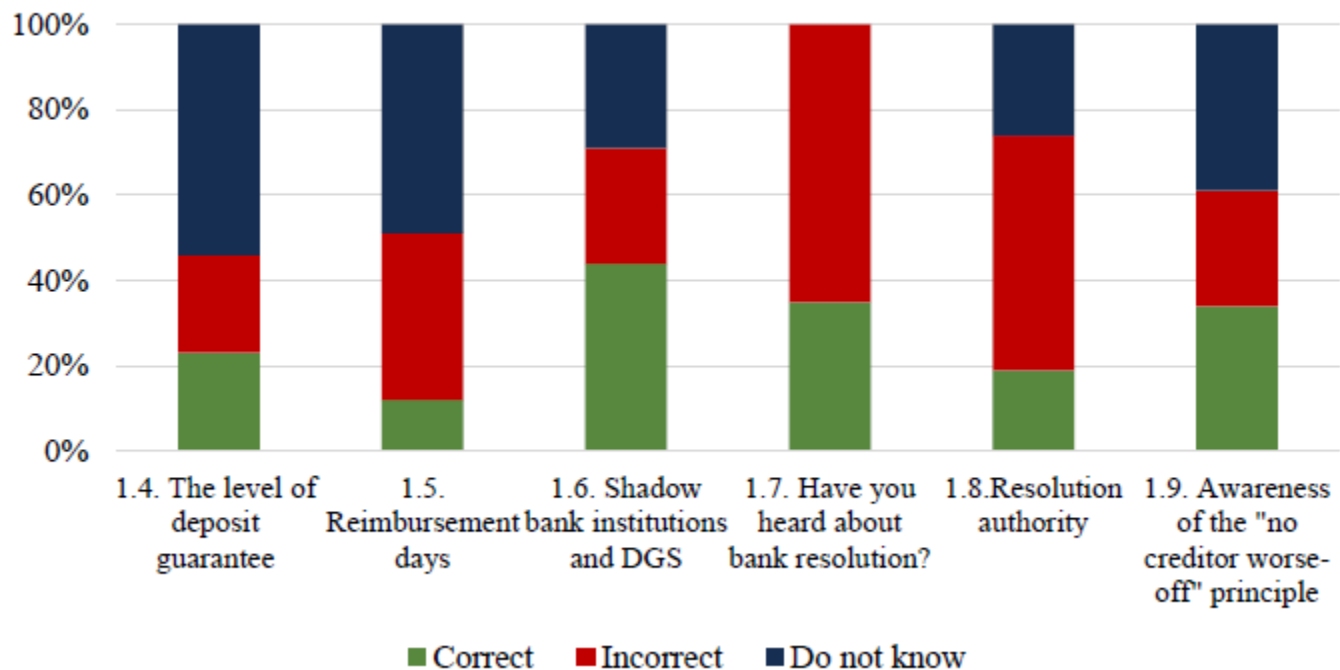
Summary of the Bridge Bank as a Resolution Tool

To sum up:

- ✓ Bridge bank perceptively it is an instrument not providing long-term stability, **the cost** of which compared to other tools is **relatively high** and the chance of **resolution failure**, when using it, **is very high** (e.g. in the case of liquidity problems).

Resolution And Depositors' Trust* (1)

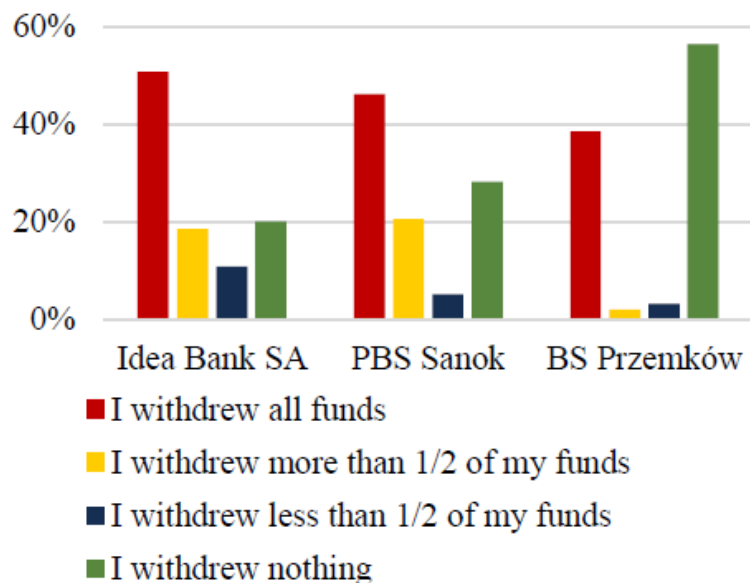
Chart 1. Knowledge of Polish society about DGS and resolution—test results.



*Source: Resolution And Depositors' trust: An Empirical Analysis Of Three Resolution Cases In Poland M. Iwanicz-Drozdowska, Łukasz Kurowski And Bartosz Witkowski

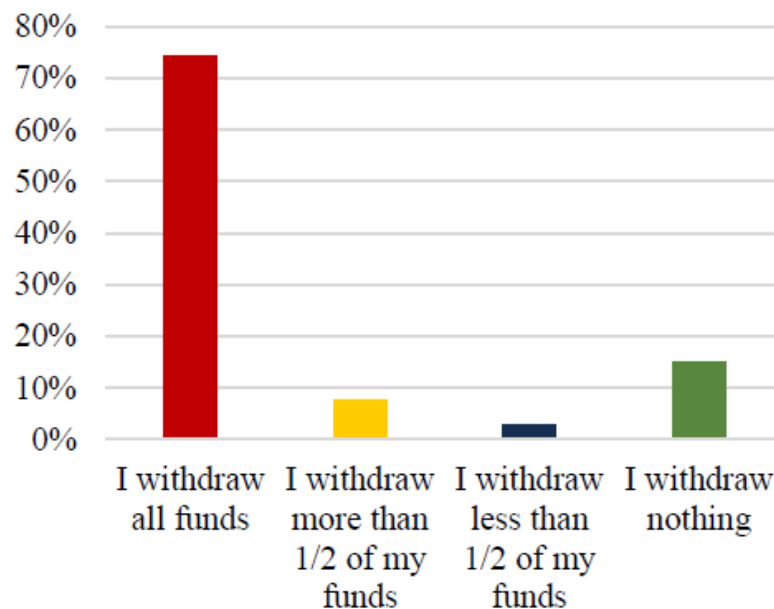
Resolution And Depositors' Trust (2)

Chart 2. Deposit withdrawals by respondents who are clients of banks that have undergone resolution (n = 301).



Note: Based on interviews.

Chart 3. Possible deposit withdrawals by respondents who are clients of banks with no resolution experience (n = 699).

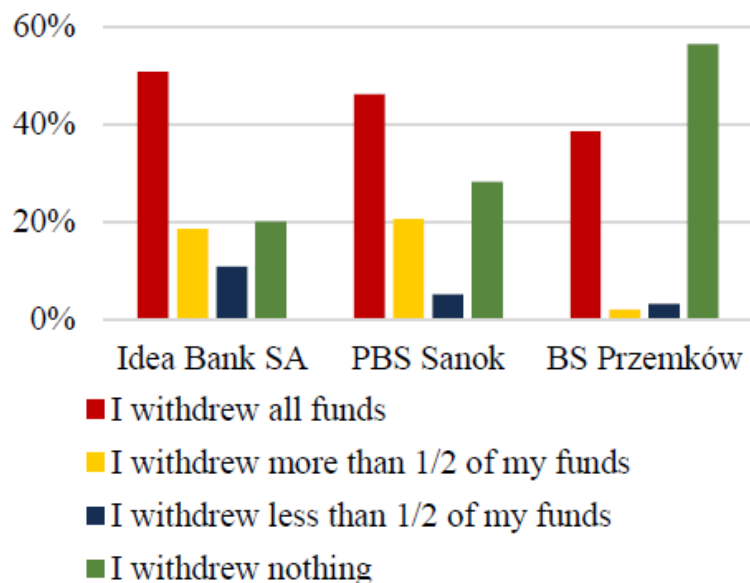


Note: Based on interviews.

*Source: Resolution And Depositors' trustan Empirical Analysis Of Three Resolution Cases In Poland M. Iwanicz-Drozdowska, Łukasz Kurowski And Bartosz Witkowski

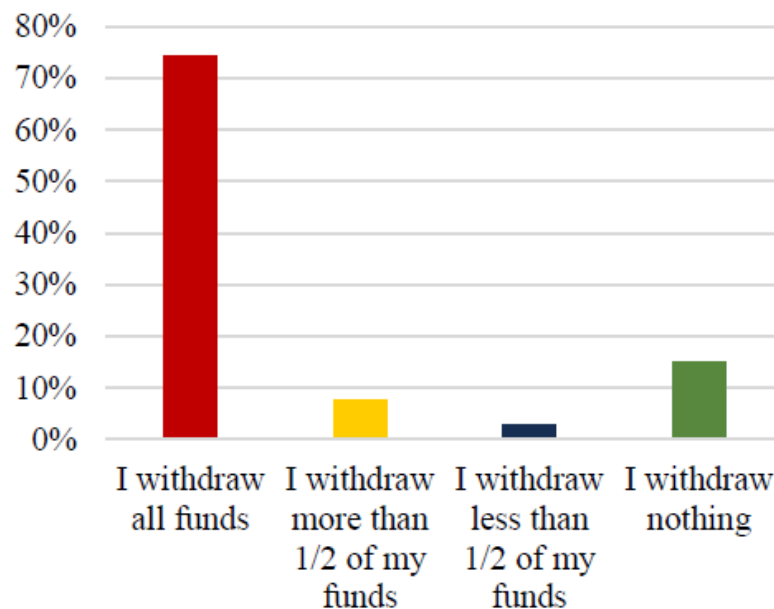
Resolution And Depositors' Trust (3)

Chart 2. Deposit withdrawals by respondents who are clients of banks that have undergone resolution (n = 301).



Note: Based on interviews.

Chart 3. Possible deposit withdrawals by respondents who are clients of banks with no resolution experience (n = 699).

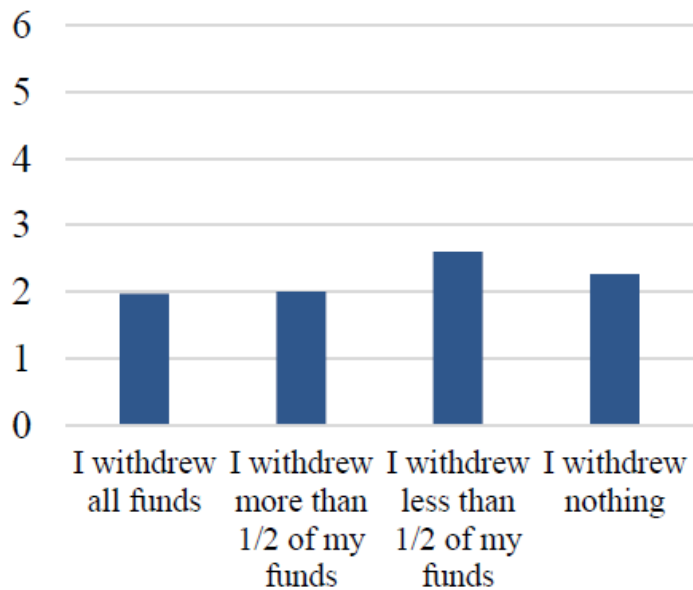


Note: Based on interviews.

*Source: Resolution And Depositors' trustan Empirical Analysis Of Three Resolution Cases In Poland M. Iwanicz-Drozdowska, Łukasz Kurowski And Bartosz Witkowski

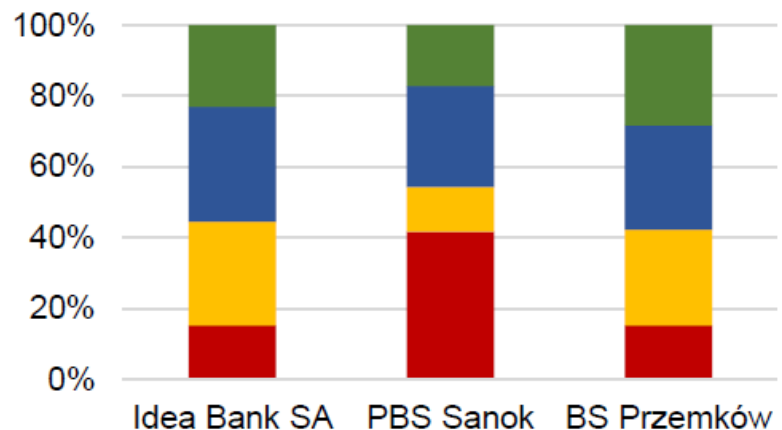
Resolution And Depositors' Trust (4)

Chart 4. Average number of correct answers (out of six possible) to questions about DGS and resolution by each respondent (vertical axis) and the decision to withdraw funds (horizontal axis)—clients of banks subject to resolution



Note: Based on interviews.

Chart 5. Clarity of information received by clients who experienced bank resolutions.



- The information I received was fully understandable to me
- The information was quite understandable to me
- The information was incomprehensible to me
- I have not received any information

Note: Based on interviews.

To sum up:

- ✓ **Continuous access to the banking services** by the clients is the key factor of the resolution process
- ✓ Sale of business is the **most effective resolution tool**
- ✓ Bail-in of not covered deposits or suspension of the bank's activities would result in **the market panic (run on a bank)**
- ✓ Sufficiently **high level of MREL** can expand potential resolution actions

To sum up:

- ✓ The effective process demand **the strong cooperation** (with: the bank in the potential resolution, the potential acquirers, financial and law advisors, Valuer, market infrastructure entities/institutions, other entities in the financial safety net especially supervisor, EC)
- ✓ **Identification of key employees** in the bank and their availability **is crucial**
- ✓ **Full confidentiality before** the resolution required
- ✓ The **best moment for the resolution** is „long-weekend” or public holiday

Thank you for your attention

