

BANKING RESOLUTION: A SHORT INTRODUCTION

NOVEMBER 2024 | LISBOA



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BANKING RESOLUTION: ORIGINS AND MOTIVATIONS

01

BANKING RESOLUTION: WHY?

THE WALL STREET JOURNAL.

TUESDAY, SEPTEMBER 16, 2008 • VOL. CCLII NO. 37

Bailout Plan Rejected, Markets Plunge, Forcing New Scramble to Solve Crisis

By Susan Kania, Richard Patten, and Alan Green Wolf

Down 777.68 points The tale of the Dow's largest point loss on record

FINANCIAL TIMES

Wednesday, September 10, 2008

Meltdown Monday

Investors ... S&P 500's worst day since 1929 ... Banks used on bail-out rejection

THE WALL STREET JOURNAL.

WEDNESDAY, SEPTEMBER 10, 2008 • VOL. CCLII NO. 40

U.S. to Take Over AIG in \$85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up

Emergency Loan Effectively Gives Government Control of Insurer; Historic Move Would Cap 30 Days That Reshaped U.S. Finance

Urgent Mission The U.S. government's rescue of American International Group Inc. is the most dramatic and costly of the rescue efforts. The U.S. government's rescue of American International Group Inc. is the most dramatic and costly of the rescue efforts.

Lending Among Banks Freezes The U.S. government's rescue of American International Group Inc. is the most dramatic and costly of the rescue efforts.

THE WALL STREET JOURNAL.

TUESDAY, SEPT 16, 2008 • VOL. CCLII NO. 37

Maior quebra da história causa pior dia nas Bolsas desde o 11/9

Mercado despista com crise em dois dos maiores bancos dos EUA; Dólar sobe e aquece mais café

THE WALL STREET JOURNAL.

WEDNESDAY, SEPTEMBER 10, 2008 • VOL. CCLII NO. 40

AIG, Lehman Shock Hits World Markets

Focus Moves to Fate of Giant Insurer After U.S. Allows Investment Bank to Pull Bailouts in Talks to Buy Core Lehman Unit

AIG Faces Cash Crisis As Stock Dives 61% The U.S. government's rescue of American International Group Inc. is the most dramatic and costly of the rescue efforts.

THE WALL STREET JOURNAL.

WEDNESDAY, SEPTEMBER 10, 2008 • VOL. CCLII NO. 40

U.S. Drafts Sweeping Plan to Fight Crisis As Turmoil Worsens in Credit Markets

House and Senate Move to Buy Bank Assets From Banks, Jettison Money Market Funds; Stocks Rebound Sharply

SEC Is Set To Issue Temporary Ban Against Short Selling The U.S. government's rescue of American International Group Inc. is the most dramatic and costly of the rescue efforts.

YOUR LOCAL NEWS EXTRA SCHOOLS • COMMUNITY EVENTS • HOME SALES • CRIME WATCH • INSIDE THE HOME MARKET

The Washington Post

Thursday, September 11, 2008

Markets in Disarray as Lending Locks Up

Federal Intervention Fails to Stem Crisis of Confidence on Wall St.

By Susan Kania, Richard Patten, and Alan Green Wolf

The U.S. government's rescue of American International Group Inc. is the most dramatic and costly of the rescue efforts.

Público

Scrambling to Clean Up After A Category 4 Financial Storm

The U.S. government's rescue of American International Group Inc. is the most dramatic and costly of the rescue efforts.

Bancos privados não quiseram salvar BPN e o Governo optou por a nacionalização

Problemas do Banco Português de Negócios eram anteriores à actual crise financeira

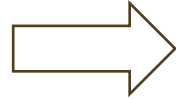
O Governo anunciou ontem a nacionalização do Banco Português de Negócios, que, segundo o ministro da Economia, António Costa, se encontra em "situação de insolvência". O anúncio foi feito no âmbito de uma reunião do Conselho de Ministros que se realizou no dia 10 de Setembro. O anúncio foi feito no âmbito de uma reunião do Conselho de Ministros que se realizou no dia 10 de Setembro.

BANKING RESOLUTION: A SHORT INTRODUCTION 4

THE EARLY DAYS OF THE RESOLUTION FRAMEWORK IN EUROPE



2008 financial crisis



Insufficient crisis management arrangements worldwide and, more particularly, in Europe.



Need to create a framework that would allow authorities to intervene swiftly and timely in a distressed institution, minimizing the impact of its failure in the economy.



Publication of the «**Key Attributes of Effective Resolution Regimes for Financial Institutions**», the international standard for best practices in resolution, by the Financial Stability Board.



Banking Recovery and Resolution Directive (Directive 2014/59/UE)



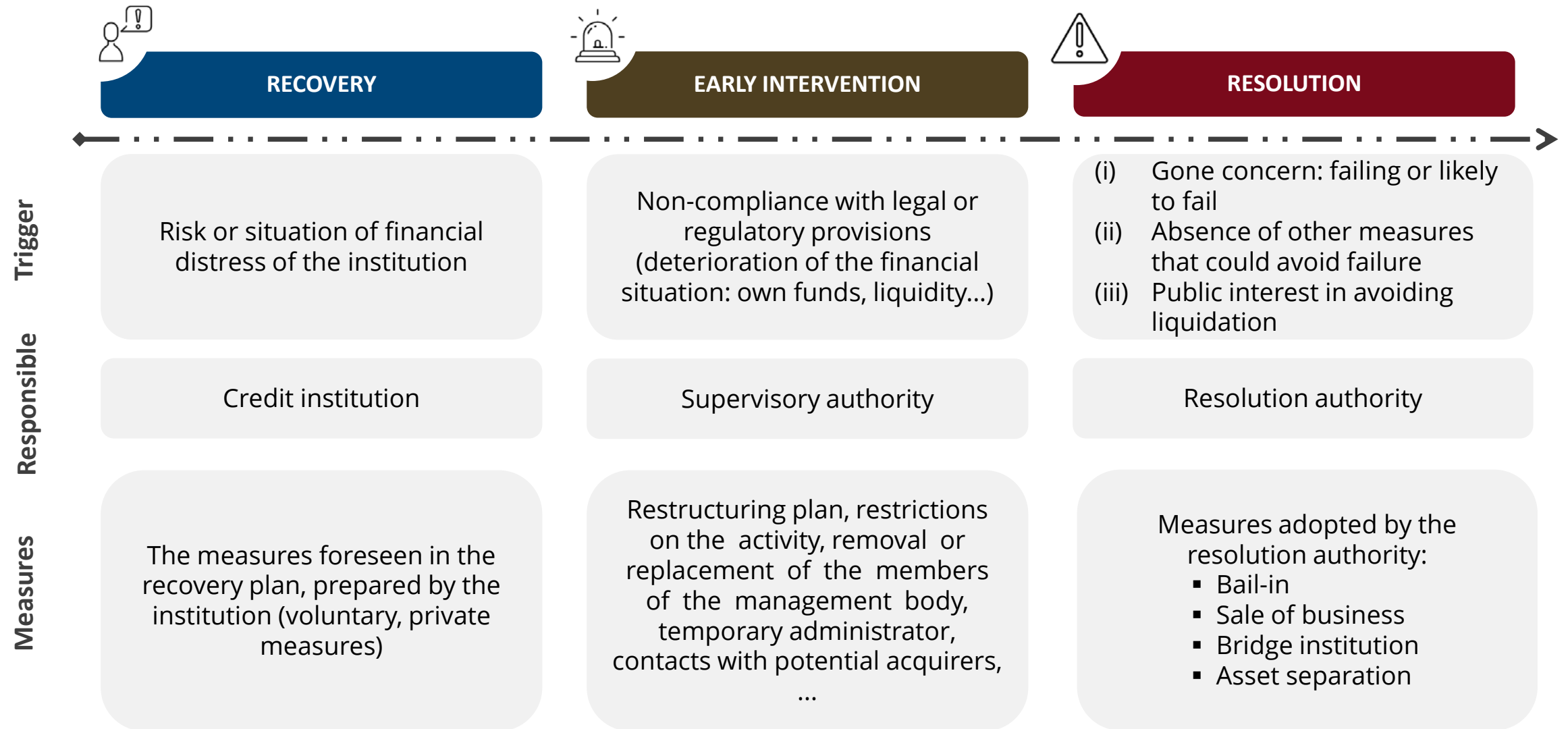
Three main blocks:

- Provides for, and regulates, **recovery and resolution planning**;
- Empowers authorities with **new powers and tools** to deal with crisis situations;
- Creates **resolution financing mechanisms** (the Resolution Funds).

THE RESOLUTION FRAMEWORK IN A NUTSHELL

02

FROM RECOVERY TO RESOLUTION



THE RESOLUTION FRAMEWORK: OBJECTIVES, PRINCIPLES AND CONDITIONS



Conditions for resolution

The institution is **failing or likely to fail (FOLTF)**

There is no reasonable prospect that any **alternative measures** would prevent the failure of the institution, within a reasonable timeframe

The resolution action is necessary in the **public interest** (which is assessed in light of the resolution objectives)



Objectives

Ensure the continuity of **critical functions**

Safeguard **public funds** and **taxpayers'** interests

Avoid a significant adverse effect on the **financial stability**

Protect **deposits** covered by the DGS and investments covered by investors compensation schemes

Protect the **funds** and **assets** held by the institution on behalf of its **clients**



Guiding principles

Shareholders of the failed institution bear losses first

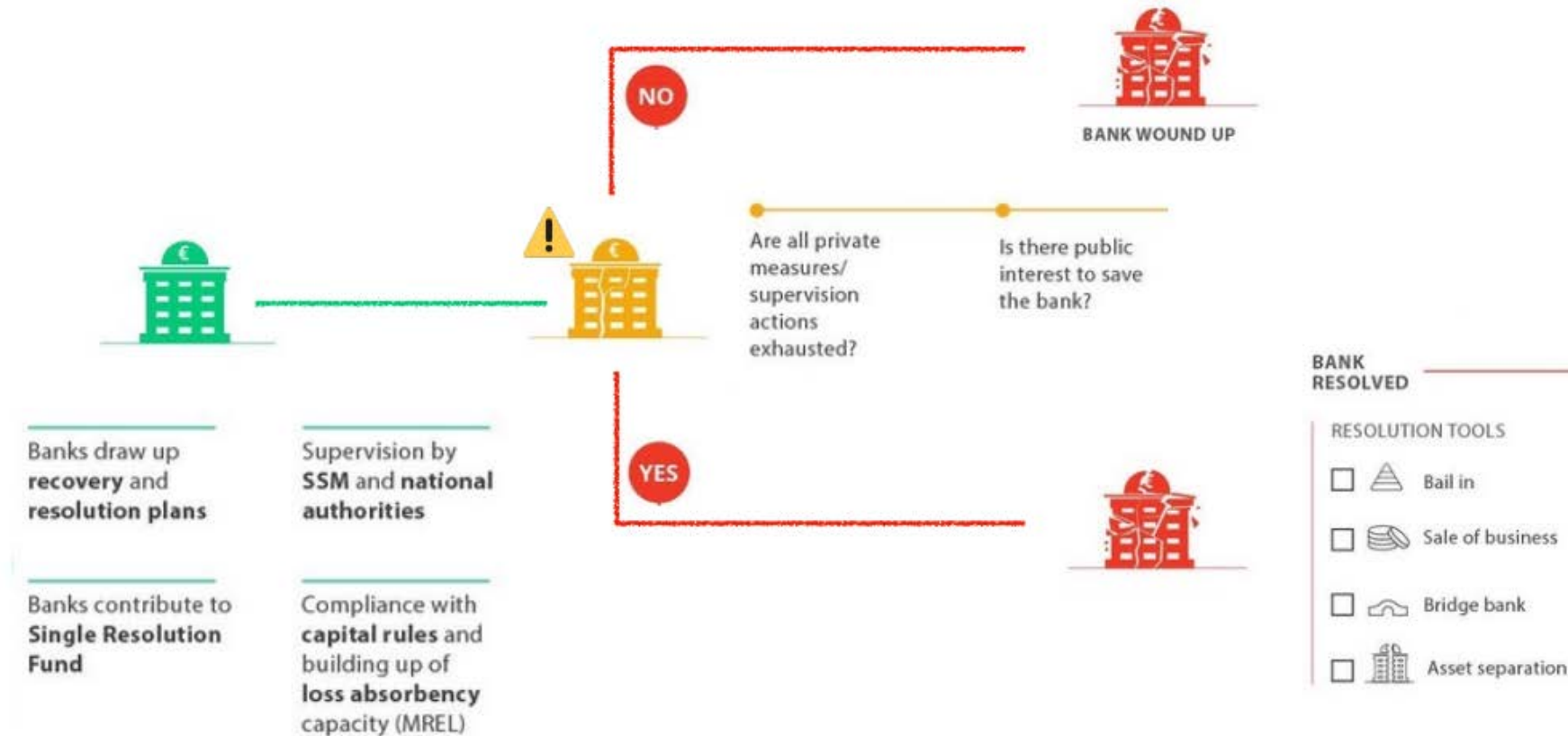
Creditors of the institution bear losses after the shareholders, in **equitable conditions**, in accordance with the order of priority of their claims under normal insolvency proceedings.

No creditor shall incur greater losses than would have been incurred had the institution entered into liquidation (**no creditor worse off**)

The **depositors** do not bear any losses on the amount of deposits covered by the DGS

THE RESOLUTION FRAMEWORK: OBJECTIVES, PRINCIPLES AND CONDITIONS

The entry into resolution only occurs if a set of requirements and circumstances materialize cummulative.



THE RESOLUTION FRAMEWORK: TOOLS AND POWERS

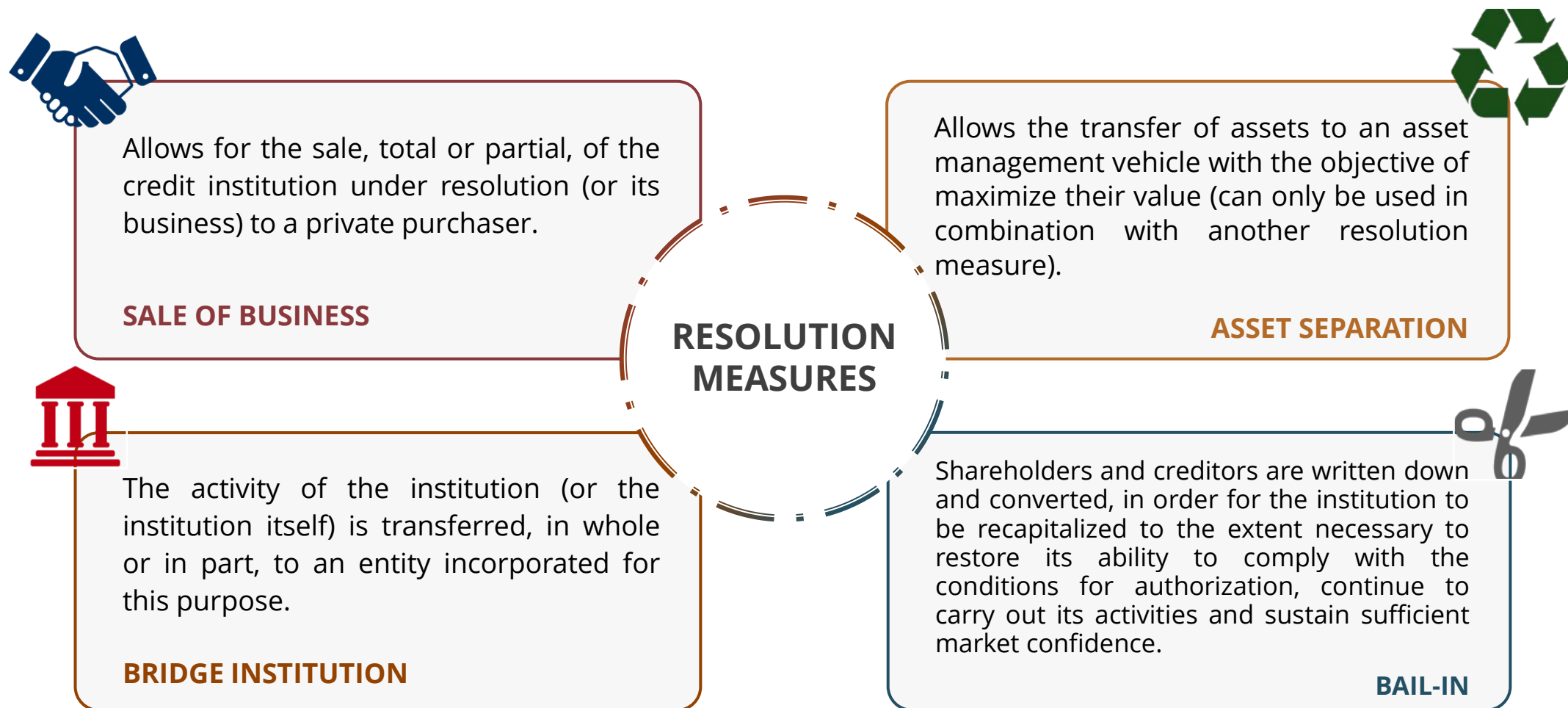
The resolution authority has at its disposal a set of **resolution measures and powers** that enable it to address the credit institution's weaknesses and the circumstances of the particular case.



The application of resolution measures:

- Entails, as a rule, the **replacement** of the management body and senior management of the institution under resolution;
- Does not depend on the **consent** of the shareholders, nor of the parties to contracts related to assets, liabilities, off-balance sheet items, or assets under management;
- **Does not constitute grounds** for the exercise of the rights of close-out netting agreements, resolution, termination, opposition to the renewal or amendment of conditions, or for the execution of collaterals;
- **Takes effect** regardless of any legal or contractual provision to the contrary.

THE RESOLUTION FRAMEWORK: TOOLS AND POWERS

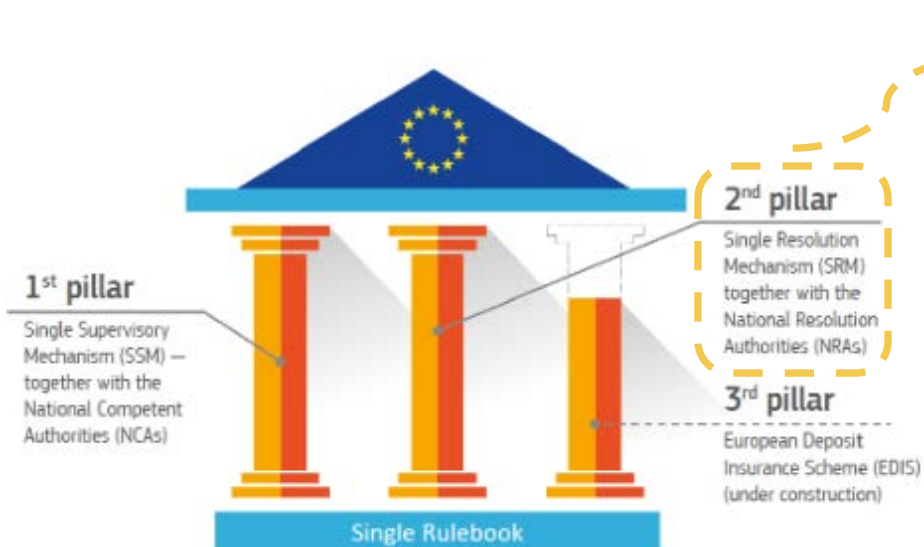


THE INSTITUTIONAL SET-UP IN THE BANKING UNION

03

THE RESOLUTION FRAMEWORK: THE INSTITUTIONAL MODEL IN THE BU

The creation of the resolution regime by the BRRD was also accompanied by the constitution of the **2nd Pillar of the Banking Union**, with the creation of the Single Resolution Board, in which Banco de Portugal participates as the Portuguese National Resolution Authority.



July

2014

Single Resolution Mechanism Regulation (SRMR)

Single Resolution Board (SRB) – entity responsible for the effective and consistent functioning of the SRM from 2016 onwards

Single Resolution Fund (SRF) – responsible for the provision of financial support for resolution in the Banking Union.



Responsible for **(i)** resolution plans, **(ii)** resolution decisions and **(iii)** monitoring the execution of resolution decisions for significant institutions (SIs) under the ECB's direct supervision and less significant institutions (LSIs) with cross-border activity.



Responsible for **(i)** resolution plans, **(ii)** resolution decisions and **(iii)** monitoring the execution of resolution decisions for LSIs without cross-border activity.
Responsible for the execution and implementation of SRB's decisions in its respective jurisdictions.

Division of competences between the SRB and the NRAs:

THE RESOLUTION FRAMEWORK: THE RESOLUTION FINANCING ARRANGEMENTS



- The SRF is financed by **annual contributions from the financial system** (credit institutions and some investment firms).
- The Fund was built up during the first eight years (2016-2023) with the goal of reaching at least 1% of covered deposits in the Banking Union (today, ≈ €78bn).
- During that transitional period, the contributions were allocated to different **national compartments** corresponding to each participating Member State. The compartments have now been merged and there is full mutualisation in the use of the Fund.



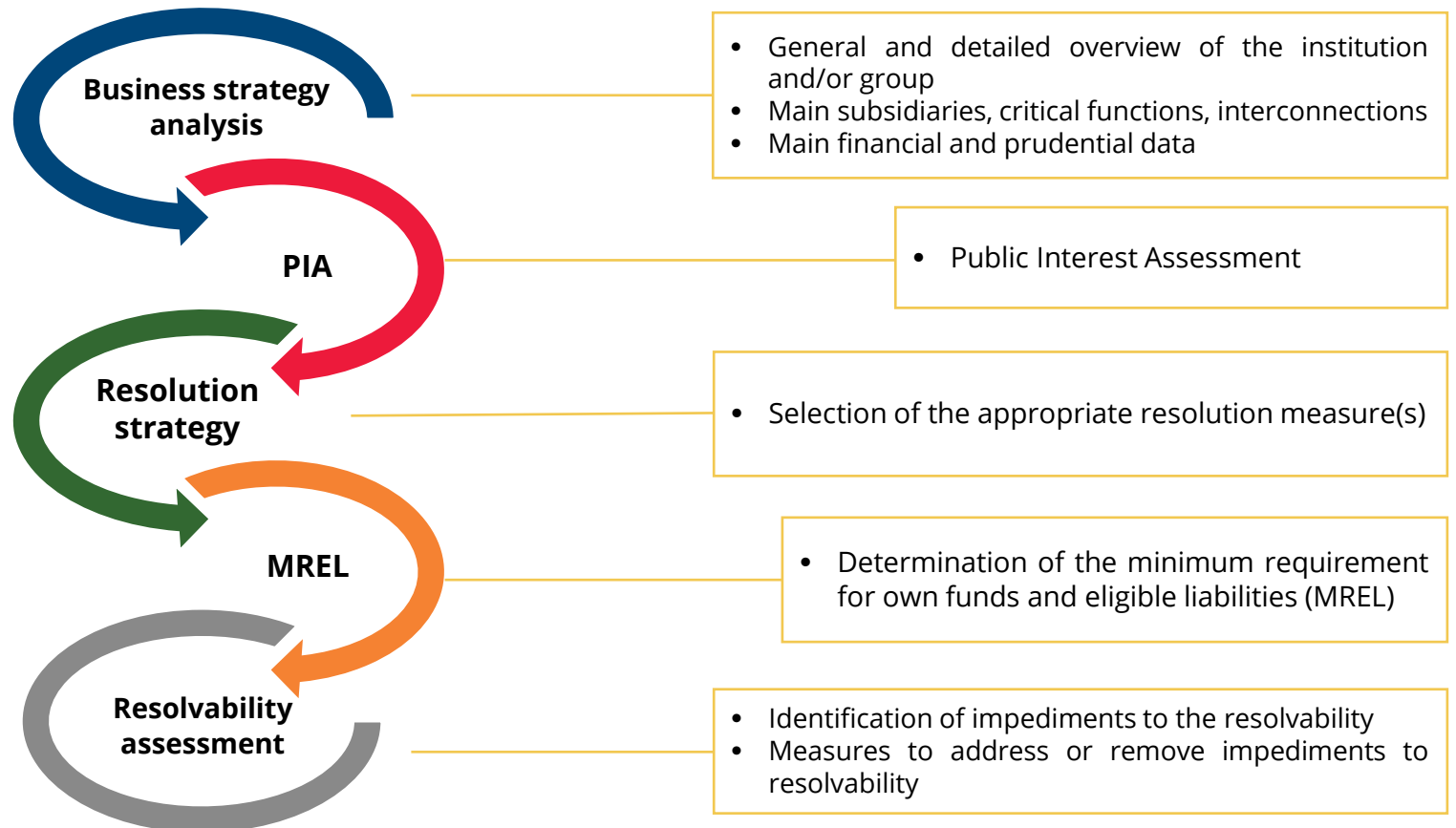
THE IMPORTANCE OF PLANNING AND ENSURING RESOLVABILITY

04

THE RESOLUTION FRAMEWORK: THE IMPORTANCE OF PLANNING





The resolution regime provided by the BRRD has created an **extensive, complex, and very demanding** framework for resolution authorities, particularly with regard to resolution **planning**.

Main phases and tasks of the resolution planning



THE RESOLUTION FRAMEWORK: THE IMPORTANCE OF PLANNING

In planning for resolution, authorities select the preferred resolution strategy and follow two main approaches.

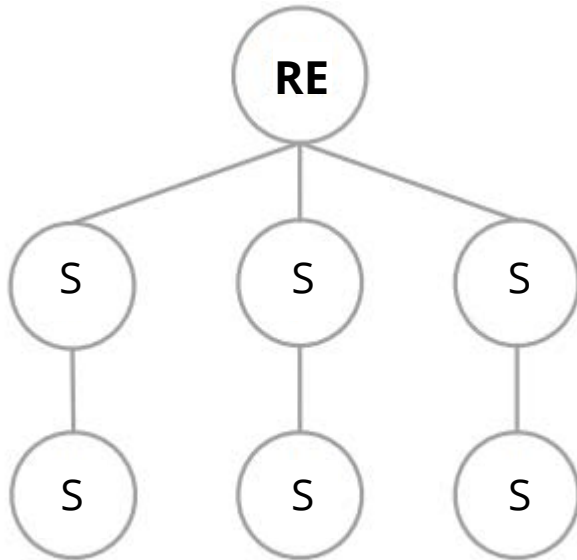
Single Point of Entry (SPE)		Multiple Points of Entry (MPE)	
 Characteristics	<ul style="list-style-type: none">✓ Resolution measures are applied at the level of the parent-undertaking/holding company;✓ The resolution process is conducted by the resolution authority of the parent-undertaking;✓ The losses of the subsidiaries are transferred to the parent-undertaking.		<ul style="list-style-type: none">✓ Resolution measures are applied to more than one resolution entity (parent-undertaking and selected subsidiaries);✓ The resolution process is conducted by two or more resolution authorities;✓ Losses are absorbed by each resolution entity.
	 Requirements Conditions		 Requirements Conditions
	<ul style="list-style-type: none">✓ Groups with centralized structure and operating model;✓ Financing and loss absorption capacity of the group centralized in the parent-undertaking;✓ Upstreaming of losses and downstreaming of capital and liquidity;✓ Agreement between home and host resolution authorities on the resolution strategy;✓ Acceptance of the decisions taken by the home authorities by the host authorities.		<ul style="list-style-type: none">✓ Groups entities operate and obtain financing in an independent manner;✓ Sufficient loss absorption capacity at the level of the resolution entities;✓ In resolution, the parent-undertaking does not support the subsidiary that is a resolution entity;✓ Possible group separation, in case of resolution;✓ Decentralized and independent internal processes.

THE RESOLUTION FRAMEWORK: THE IMPORTANCE OF PLANNING

The use of an SPE or an MPE strategy is closely related to the group structure.

Single Point of Entry (SPE)

RG 1

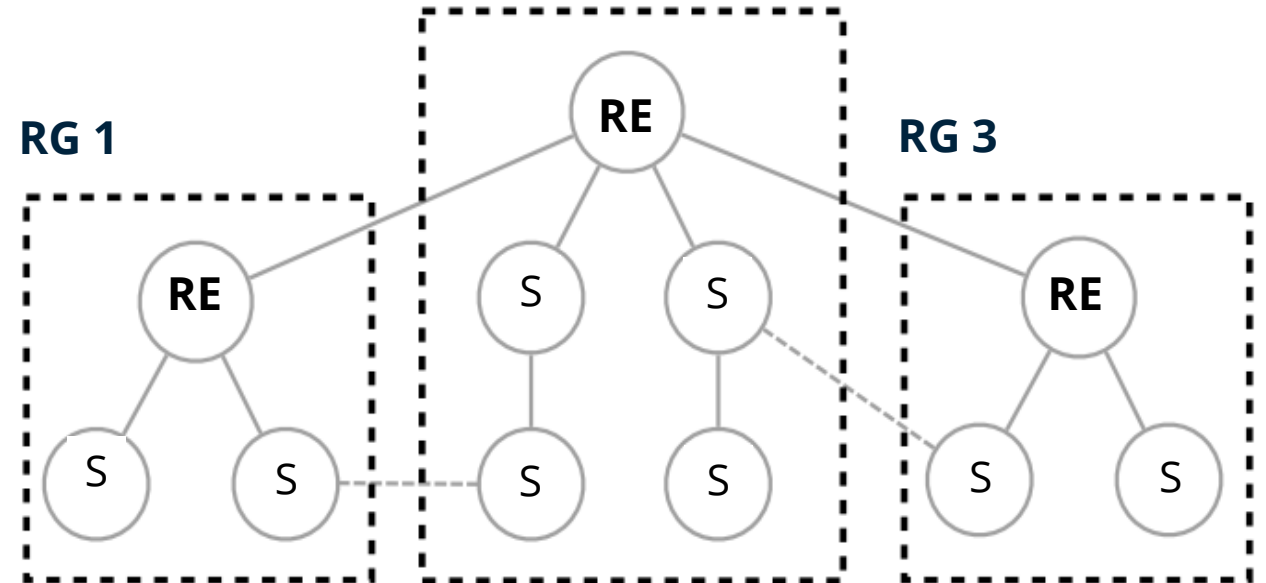


Multiple Points of Entry (MPE)

RG 2

RG 1

RG 3



THE RESOLUTION FRAMEWORK: WHY IS THE INTERNAL LOSS-ABSORBING CAPACITY SO IMPORTANT?



Resolution guiding principles: losses incurred by the failing institution should be first borne by its shareholders and then by its creditors. To ensure this, the resolution regime has created the **Minimum Requirement for Own Funds and Eligible Liabilities (MREL)**



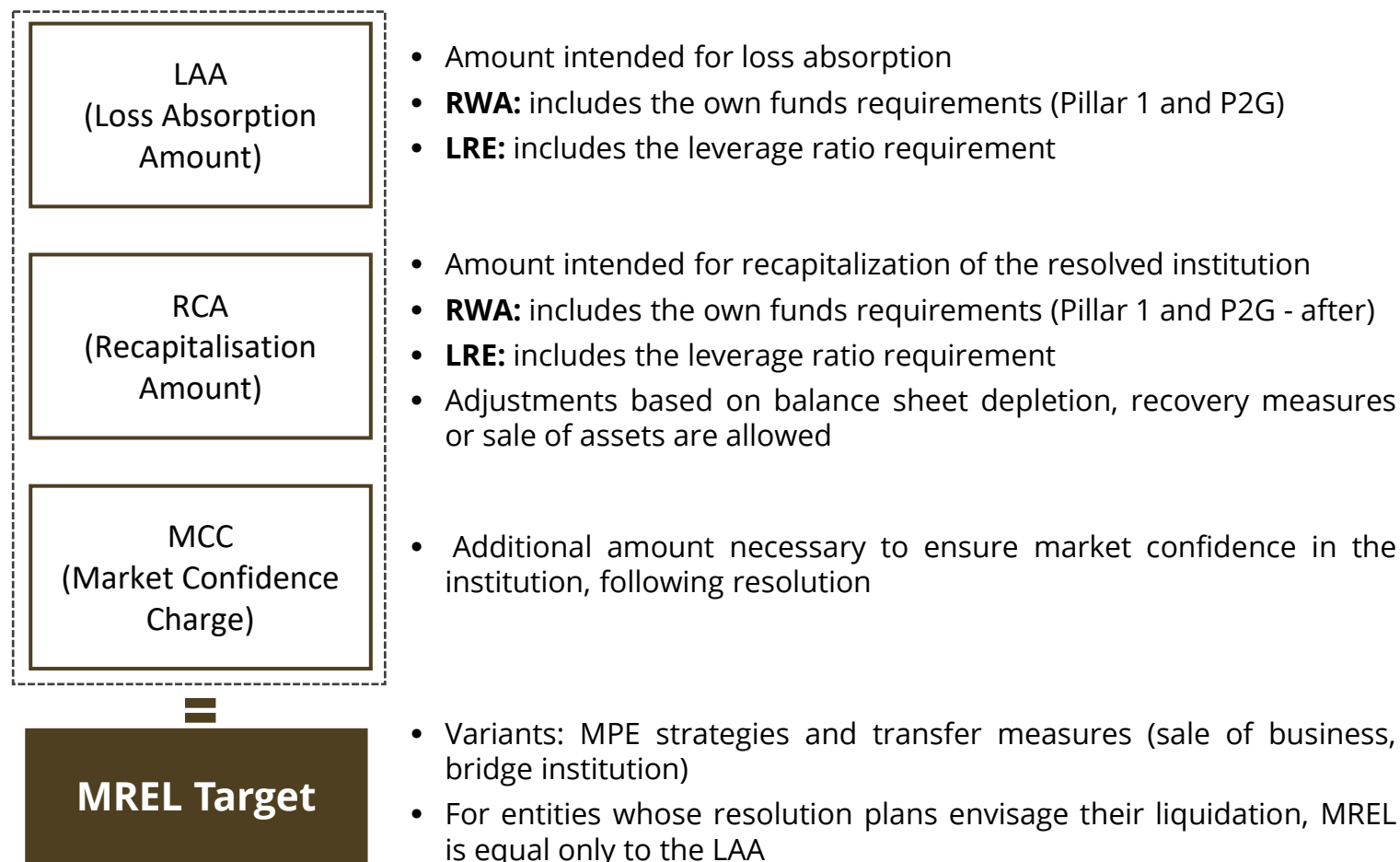
MREL is a requirement for banks to hold a certain level of **own funds** and **debt instruments**, as set in resolution planning, to ensure the **resolvability of the credit institution**.



Objective:

Ensure that, in resolution, the institution has sufficient liabilities to absorb its losses and recapitalize itself, so that the cost of resolution does not fall on creditors such as depositors or on the resolution financing mechanisms (which should only intervene after losses are absorbed internally to the maximum extent possible, without infringing the resolution objectives).

THE RESOLUTION FRAMEWORK: WHY IS THE INTERNAL LOSS-ABSORBING CAPACITY SO IMPORTANT?



Subordination

The SRB may determine that part of the MREL is to be complied with subordinated instruments, to address eventual risks arising from the NCWO principle and other impediments to resolvability.

Transitional period

- Until 1 January 2024
- Extension of the transitional period in very specific cases

For further information: https://www.srb.europa.eu/system/files/media/document/MREL%20Policy%202024_clean%20version_web.pdf

THE RESOLUTION FRAMEWORK: WHY IS THE INTERNAL LOSS-ABSORBING CAPACITY SO IMPORTANT?

The eligibility of an instrument for MREL purposes depends on the fulfillment of a wide range of requirements, such as permanence, maturity, collateralization, among others.

✓ **Own funds requirements;**

✓ **Liabilities eligible for bail-in**, provided that they additionally meet the following requirements:

- The contractual instruments constituting the claim are valid and effective;
- The claim is not held or guaranteed by the credit institution itself;
- The contractual instruments constituting the claim were not funded directly or indirectly by the credit institution;
- The claim has a maturity of at least one year; where the contractual instruments constituting the claim confer upon its owner a right to early reimbursement, the maturity of that claim shall be the first date where such right arises;
- The claim does not arise from derivatives;
- The claim does not arise from a deposit which benefits from preference provided under BRRD.

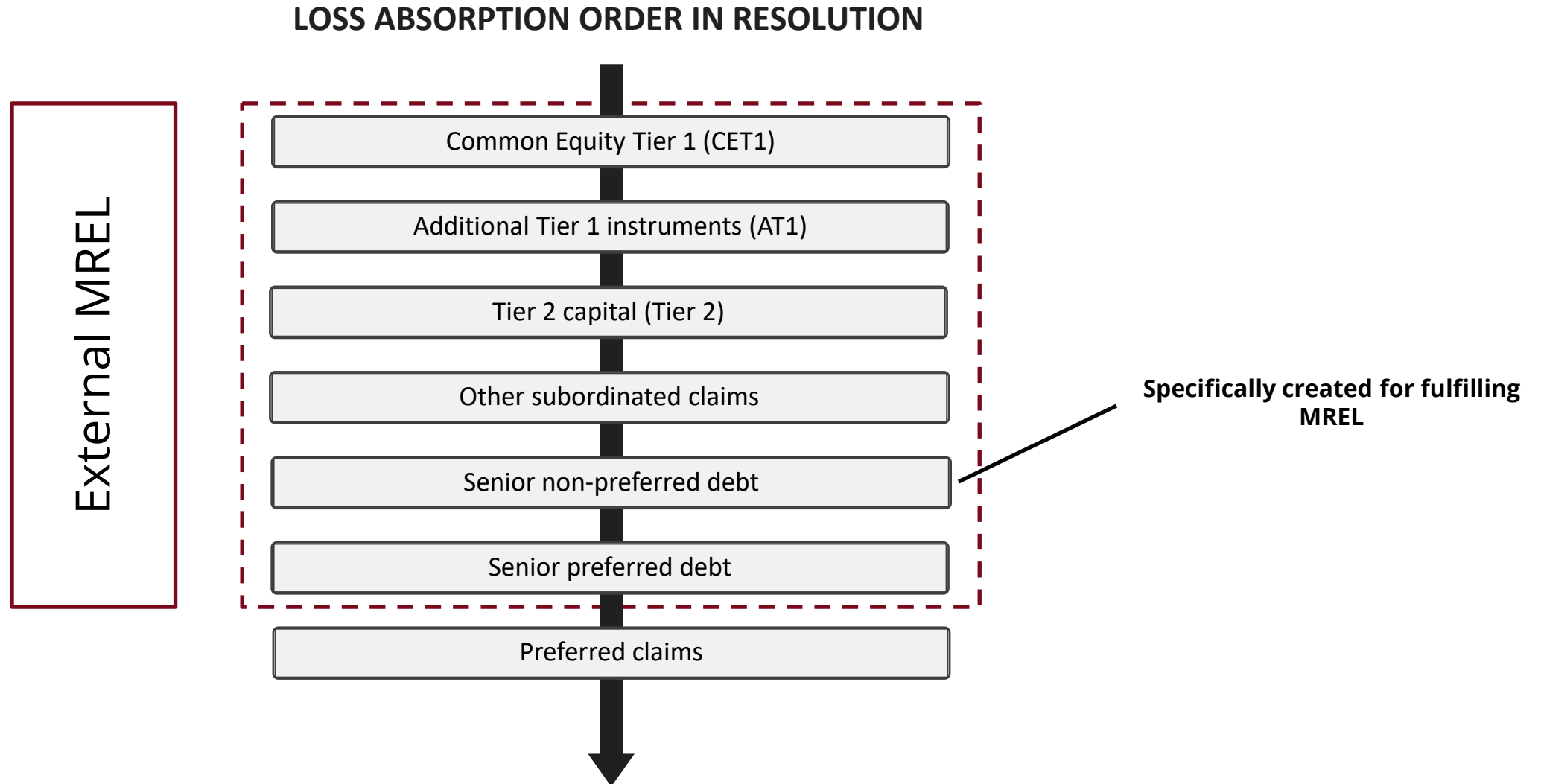
⊕ A claim subject to third country law may not be eligible for MREL if the institution cannot demonstrate that it will be possible bail-in that claim.



All claims of the institution are eligible for bail-in, **with the exception** of :

- Deposits that are guaranteed by the Deposit Guarantee Fund, within the limits of such guarantee;
- Claims for which there is collateral;
- Claims on credit institutions and some investment firms, with an original maturity of less than seven days, excluding entities that are part of the same group;
- Claims with a maturity of less than seven days on payment and securities settlement systems, their operators or their participants and arising from the participation in such a system;
- Claims on employees in relation to accrued salary, pension benefits or other fixed remuneration, except for the variable component of remuneration that is not regulated by a collective bargaining agreement and except for the variable component of the remuneration of material risktakers;
- Claims on the provision of goods and services that are critical to the daily functioning of the credit institution;
- Claims on tax and local authorities, provided that those liabilities are preferred under the applicable law;
- Claims on the Deposit Guarantee Fund arising from contributions due.

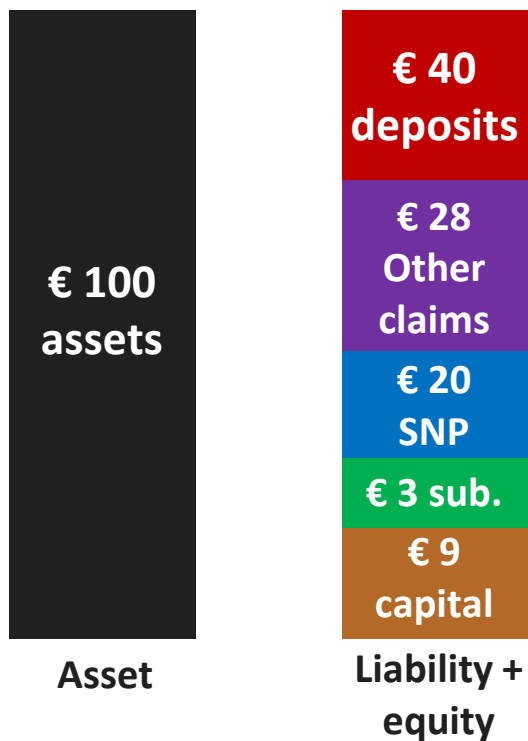
THE RESOLUTION FRAMEWORK: WHY IS THE INTERNAL LOSS-ABSORBING CAPACITY SO IMPORTANT?



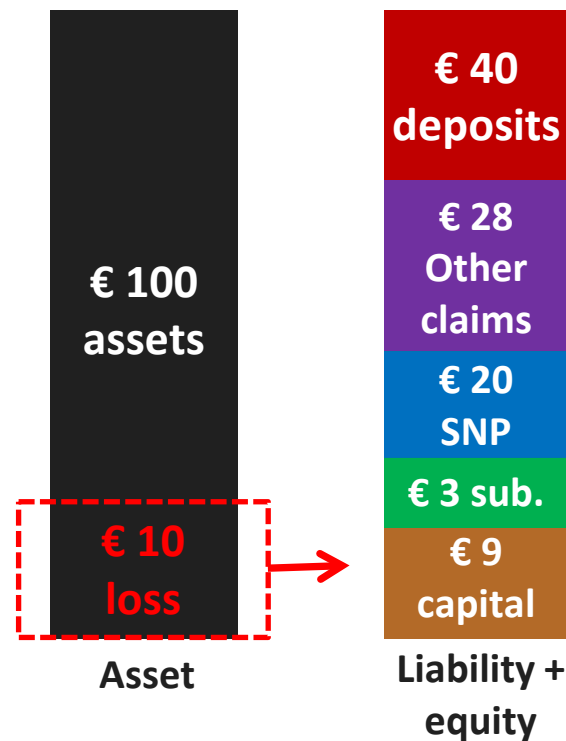
THE RESOLUTION FRAMEWORK: WHY IS THE INTERNAL LOSS-ABSORBING CAPACITY SO IMPORTANT?

EXAMPLE OF USING MREL – BAIL-IN (1/2)

Original balance sheet of the institution



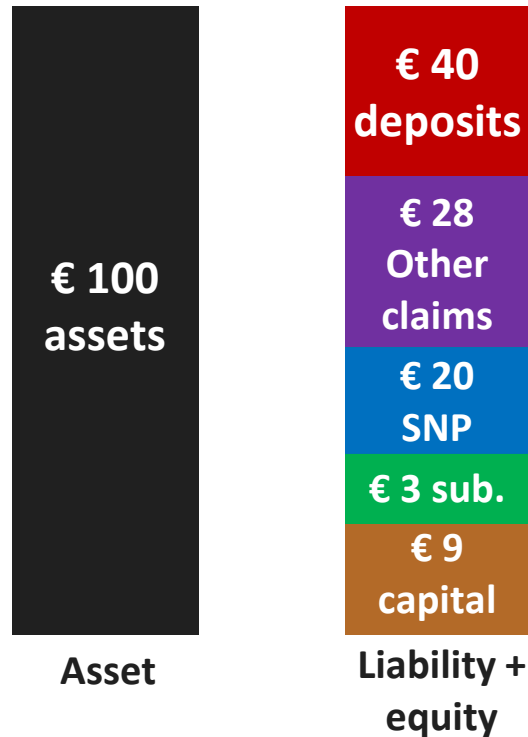
1st step
Assets reevaluation



THE RESOLUTION FRAMEWORK: WHY IS THE INTERNAL LOSS-ABSORBING CAPACITY SO IMPORTANT?

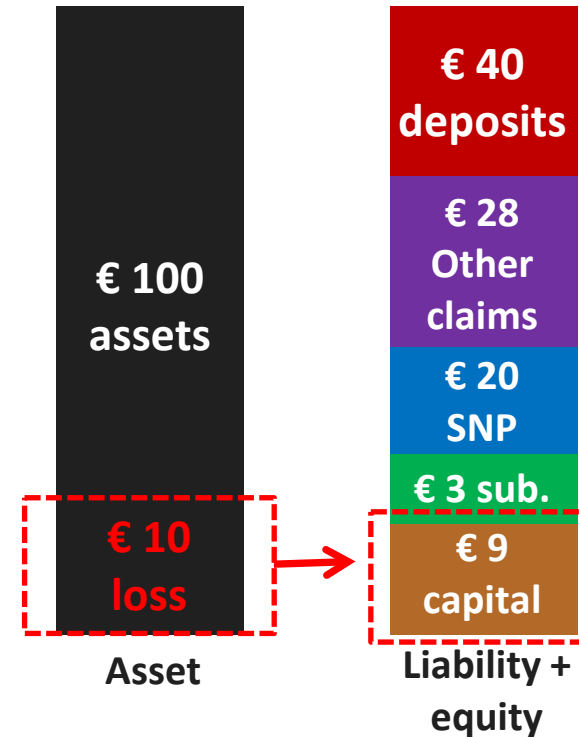
EXAMPLE OF USING MREL – BAIL-IN (1/2)

Original balance sheet of the institution



CET1, AT1 e Tier 2

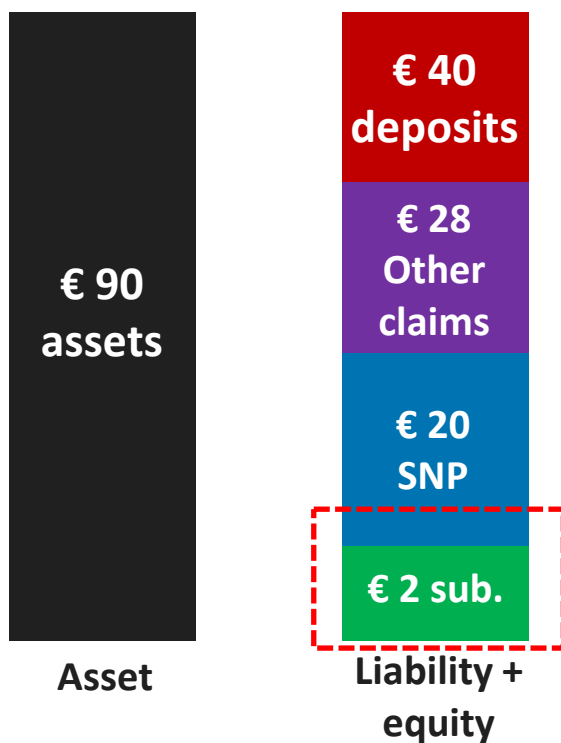
1st step
Assets reevaluation and loss absorption



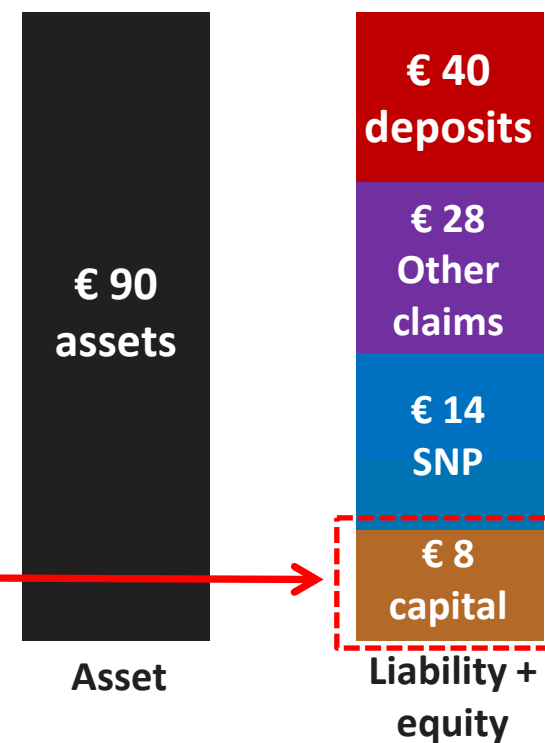
THE RESOLUTION FRAMEWORK: WHY IS THE INTERNAL LOSS-ABSORBING CAPACITY SO IMPORTANT?

EXAMPLE OF USING MREL – BAIL-IN (2/2)

2nd step
Balance sheet after loss absorption



3rd step
Balance sheet after recapitalization



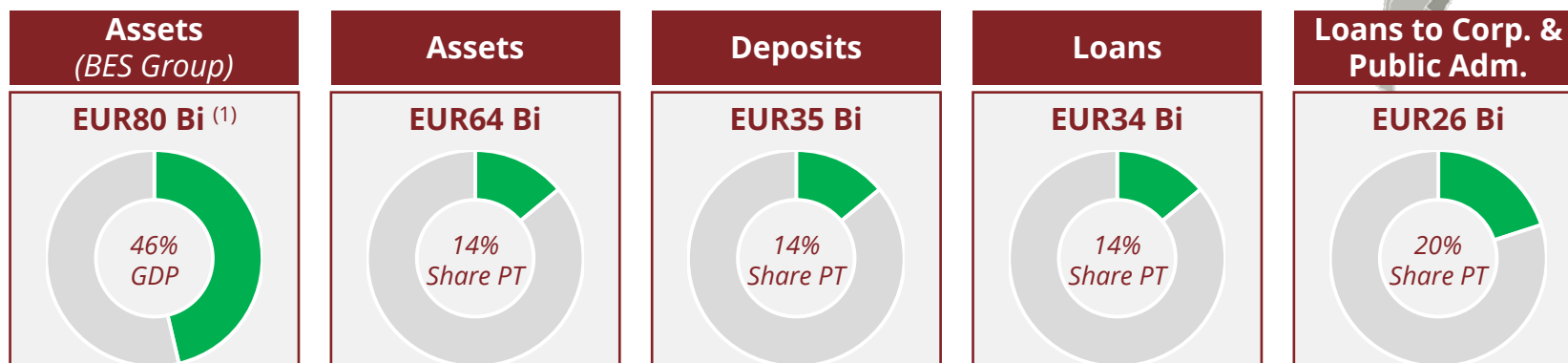
THE PORTUGUESE EXPERIENCE: THE CASES OF BES AND BANIF

05

THE PORTUGUESE EXPERIENCE – THE RESOLUTION OF BES

Banco Espírito Santo (BES) was the 3rd largest banking group in PT and had a leading role in SME lending.

- Universal financial institution covering all relevant financial services for retail, corporate and institutional clients;
- Long-standing institution and brand in Portugal (originated in 1869, became a bank in 1920);
- Part of Grupo Espírito Santo (operated in sectors as diversified as energy, real estate, healthcare, tourism and agriculture)
- Around 2 million depositors;
- Pivotal role in financing the Portuguese economy;
- ~ 700 agencies in Portugal alone.



⁽¹⁾ Consolidated data as of 30 Jun 2014; remaining data on an individual basis as of 30 Jun 2014

THE PORTUGUESE EXPERIENCE – THE RESOLUTION OF BES

Unexpected losses unveiled in late July 2014 triggered a breach in solvency ratios which further and irreparably aggravated the liquidity shortfall.

- Initial expectations of BES, of its external auditors and of Banco de Portugal were that, even in the worst-case scenario, exposures to GES could be absorbed by the existing capital buffer.
- However, on 30 July 2014 BES announced losses highly above the expected figures. Total losses for 1H14 amounted to € 3.6 bn, on a consolidated basis. The losses announced on 30 July brought the CET1 ratio (consolidated) down to 5.1%.
- Part of those losses reflected acts of willful mismanagement and the violation of previous determinations of Banco de Portugal. Acts committed when the replacement of the former management had already been announced led to an additional loss of around € 1.5 bn compared with the losses that were expected.
- Nature of losses and aggravated uncertainty made a private capitalization solution unfeasible in the short run and further deteriorated public perception.
- Access to Monetary Policy Operations was suspended and the ECB determined that existing Eurosystem funding (in the amount of € 10 bn) had to be reimbursed in the following Monday if a solution was not to be found.




As of 1 August, it was highly likely that BES would not be able to meet its obligations as they fell due and would not be able to open for business the following Monday.

THE PORTUGUESE EXPERIENCE – THE RESOLUTION OF BES

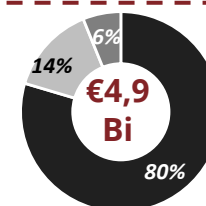
Creation of a bridge bank was the only feasible option in face of the bank's capital shortage, imminent default, liquidity needs and no appetite for an outright sale.

- On 3 August 2014, BdP created “Novo Banco”, a Bridge Bank with an initial term of 2 years, and transferred thereto most of the business of BES, which was left to be liquidated.

Objectives		Solution	
Overarching objectives	✓ Continuity of financial services provided by BES	<ul style="list-style-type: none"> Transfer of the business of BES to Novo Banco Capital was fully paid-in by the Resolution Fund (although the State provided a loan) 	NOVOBANCO
	✓ Safeguard financial stability		
	✓ Safeguard of taxpayers' money, as much as possible	<ul style="list-style-type: none"> Equity + subordinated debt + senior claims from related parties (shareholders > 2%, entities controlling BES in the past, board members) stayed in BES. Also, ~EUR 2bn of senior bonds were later retransferred to BES. Exposures to GES, equity holdings in Angola, Libya and USA (Miami) stayed in BES Legal and compliance risks stayed in BES, including any potential indirect exposures to GES 	
Specific objectives	✓ Loss absorption by shareholders and creditors		
	✓ Protection against risks stemming from exposure to GES and other specific exposures		
	✓ Minimize exposure to compliance risks from past management		

- Capital requirements of Novo Banco were estimated at **EUR 4.9 Bi**, targeting a **CET1 ratio of 8.5%** on a consolidated basis
- Independent valuation performed by PwC.

- Loan provided by the State
- Loan provided by 8 banks
- Own funds



THE PORTUGUESE EXPERIENCE – THE RESOLUTION OF BANIF

BANIF Group was the 7th largest Portuguese banking group in Portugal and was the lead bank in the Portuguese Islands (Azores and Madeira), with a market share of around 30%.



- BANIF was essentially focused on commercial banking activities in the domestic market (retail and corporate clients), with total assets of €12 Bn and €6 Bn in deposits.
- BANIF played a key role in the financing of the economy of the Portuguese Islands (Azores and Madeira).
- BANIF was classified as an Other Systemically Important Institution (O-SII); as such, a potential disruption in the provision of the critical activities provided by BANIF was considered likely to generate systemic risks and jeopardize the Portuguese financial stability.
- Despite BANIF's small balance sheet size, the bank had a strong international presence, namely close to Portuguese emigrant communities.

THE PORTUGUESE EXPERIENCE – THE RESOLUTION OF BANIF

BANIF's failure was the result of a set of factors that impaired the bank's recovery that had been expected following its recapitalization by the Portuguese State in 2013.

Absence of an approved
Restructuring Plan

BANIF's management inability to
implement corrective measures

Challenging economic
environment



BANIF suffered larger losses than those projected in the Recapitalisation Plan, leading to a significant deterioration of its solvency position, especially after 2014.



Several prudential adjustments were deemed necessary, which would reduce the consolidated total capital ratio to levels below the regulatory minimum.



A private sale procedure was launched but it failed to receive bids that did not require additional state aid.

BANIF's liquidity position rapidly deteriorated following the publication of news about the bank's future and in the week before resolution the bank face severe deposit outflows.

Serious risk of BANIF not being able to comply with its obligations towards customers and to maintain regular payment flows.



THE PORTUGUESE EXPERIENCE – THE RESOLUTION OF BANIF

On 20 December 2015, Banco de Portugal sold the majority of BANIF's activity to Banco Santander Totta and transferred a set of BANIF's assets to Oitante, an asset management vehicle created by Banco de Portugal.



- The assets and liabilities that were not transferred to Banco Santander Totta and Oitante were left behind at BANIF;
- Those assets and liabilities were managed by the members of the Board of Directors of BANIF, appointed by Banco de Portugal, and are now part of its insolvency estate in the respective judicial liquidation proceeding.

- Transfer of a set of assets to an **asset management vehicle** set up for this purpose;
- The consideration paid by Oitante for the transfer of the assets was made through a debt issued by the vehicle;
- Those bonds were guaranteed by the Resolution Fund and counter-guaranteed by the Portuguese State and were later transferred to Banco Santander Totta;
- The share capital of Oitante (€50.000) is 100% owned by the Portuguese Resolution Fund.

- **Sale of business** of BANIF and of the vast majority of its assets and liabilities to Banco Santander Totta;
- Payment of 150 M€;
- Ensuring full continuity of the institution's activity, with no impact on its customers, transferred employees or suppliers.

THE PORTUGUESE EXPERIENCE

Weight in PT banking system
(% total assets, Dec-2013)

21%

Relevance in the PT economy
(total assets in % of GDP, Dec-2013)

55%



GUIDING PRINCIPLES

Shareholders lost 100%

Subordinated creditors lost 100%

Remaining creditors absorbed losses in accordance with their ranking and in equitable terms

No creditor suffered or will suffer losses higher than it would have suffered in case of liquidation
(*no creditor worse off*)

Deposits were fully protected

THE PORTUGUESE EXPERIENCE

Weight in PT banking system
(% total assets, Dec-2013)

21%

Relevance in the PT economy
(total assets in % of GDP, Dec-2013)

55%



OBJECTIVES

Seamless **continuity of critical functions** was achieved

Financial stability was preserved

Public accounts protected as much as possible

Deposits and assets held by customers were fully protected

THE PORTUGUESE EXPERIENCE

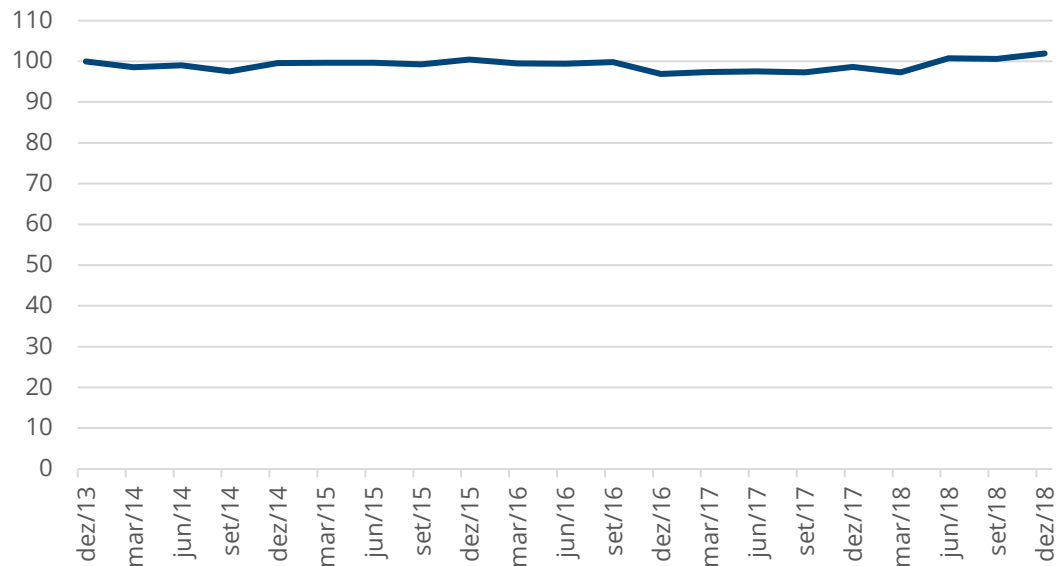


Financial stability was preserved



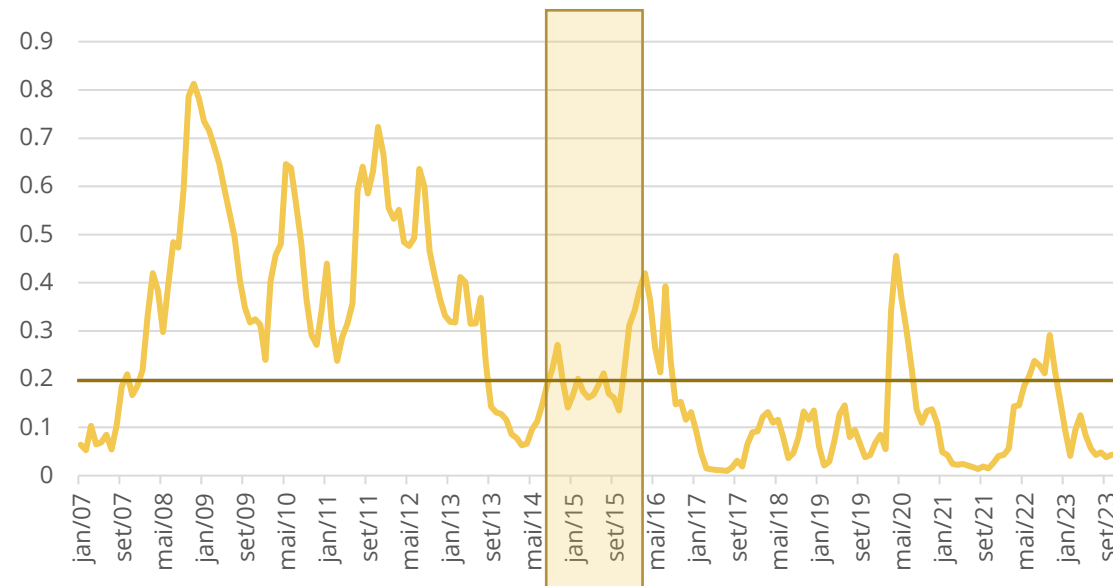
Deposits and assets held by customers were fully protected

Evolution of customer deposits in PT Banking system
(Jan/13 – Dec/18)



Source: Banco de Portugal.
Note: Base 100 as at 31/12/2023.

Composite indicator of financial stress
(Jan/07 – Nov/23)



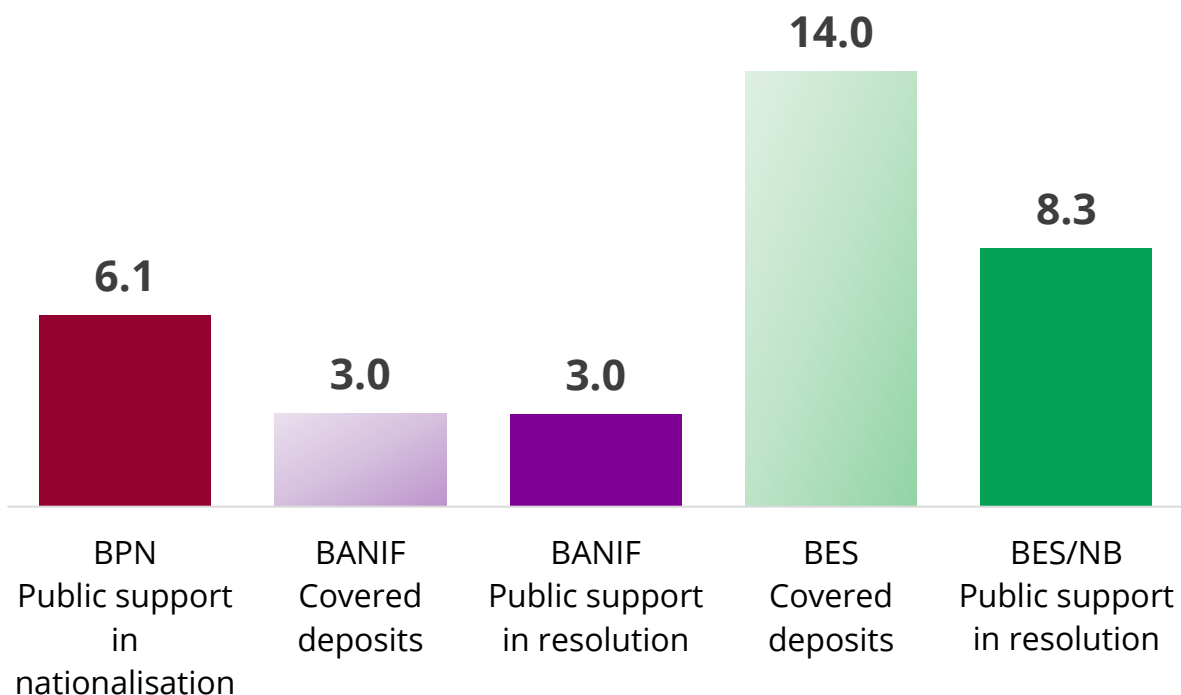
Sources: Banco de Portugal.
Note: The threshold (0.2) is the value identified as the threshold for a change from a “low stress” regime to a “high stress” regime.

THE PORTUGUESE EXPERIENCE

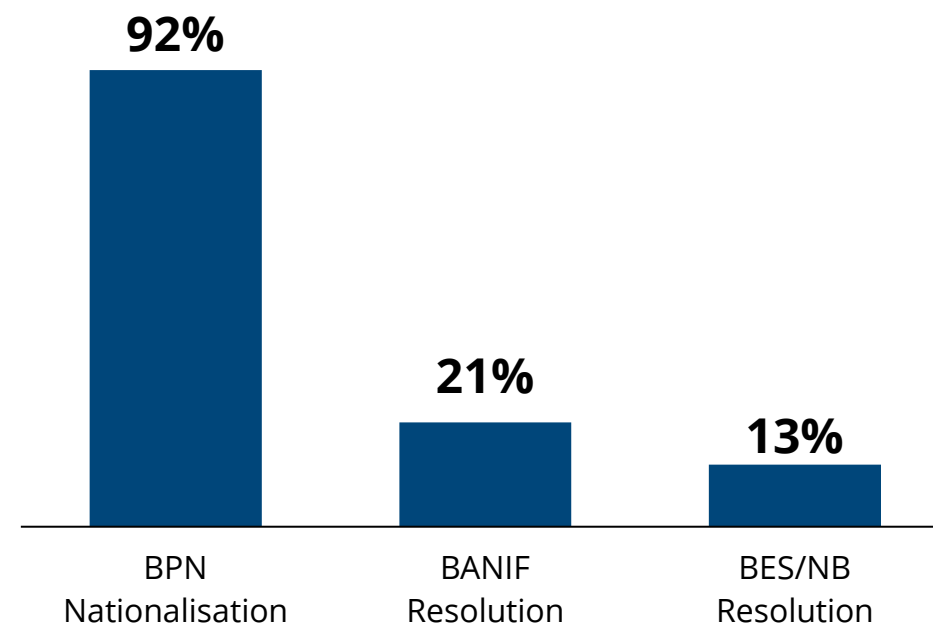


Public accounts protected as much as possible

Public support to BES/NB, BANIF and BPN
(in aggregate and absolute values)



Public support to BES/NB, BANIF and BPN
(in % of the assets of each bank – last balance before the intervention)



Moreover, where the Resolution Fund was used, some recovery will be obtained from Oitante and Novo Banco and the remaining amounts will be recovered through contributions paid by banks over time. The impact on public accounts will be neutral in the medium to long run.



OBIGADO

JOÃO FREITAS

Head of the Resolution Department
BANCO DE PORTUGAL

FUNDO DE RESOLUÇÃO | Secretary-General
FUNDO DE GARANTIA DE DEPÓSITOS | Secretary-General

jfreitas@bportugal.pt
www.bportugal.pt | www.fundoderesolucao.pt | www.fgd.pt

[linkedin.com/in/joaoffreitas](https://www.linkedin.com/in/joaoffreitas)