

# The Insufficiency of Traditional Safety Nets: What Bank Resolution Fund for Europe?

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*The views expressed in this paper represent the authors' views and not necessarily those of Bank of Spain or the Eurosystem*

## Outline

- Our proposal
- Background
- BRRF:
  - Functions
  - Intervention capacity and funding
  - Governance

## Our proposal

- Priors:
  - “Bottom up” banking crisis and not with “top down” caused by sovereign debt crisis ... but it would have alleviated fiscal costs
  - Resolution laws establish SEIR → Aimed at limiting losses
  - Take as granted decentralized safety net in EU w/o questioning its adequacy

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3

## Our proposal

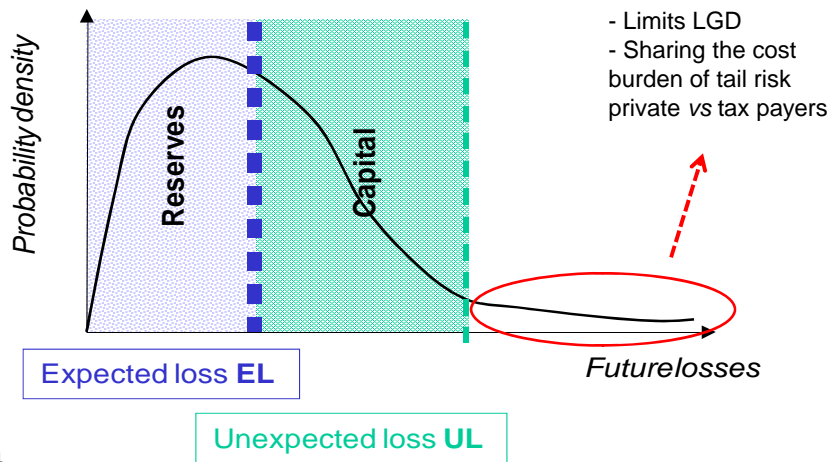
- National BRRFs funded by FIs contributions
  - FI “contribution” based systemic importance
  - BRRF part of effective bank resolution framework
    - Shifts the government’s tradeoff between bailing out and restructuring in favor of restructuring
- Alternative to systemic capital surcharges: (+)
  - FI “contribution” BRRF vs K add-on systemic banks
  - Applicable to all FIs (not only banks)
  - (+)Transparent: Funds outside the FI

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4

## Our proposal



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5

## Our proposal

- *Doluca, Klüh, Wagner, Welter di Mauro (May, 2010)* German Council of Economic Experts
  - EU perspective: Functions, intervention capacity, definition of contributions and governance arrangements demand harmonization
- *Perotti and Suarez(2009); Acharya and Richardson (2010)*
  - BRRF vs Part of the general tax revenues
  - Resolution tool vs macroprudential tool

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## Outline

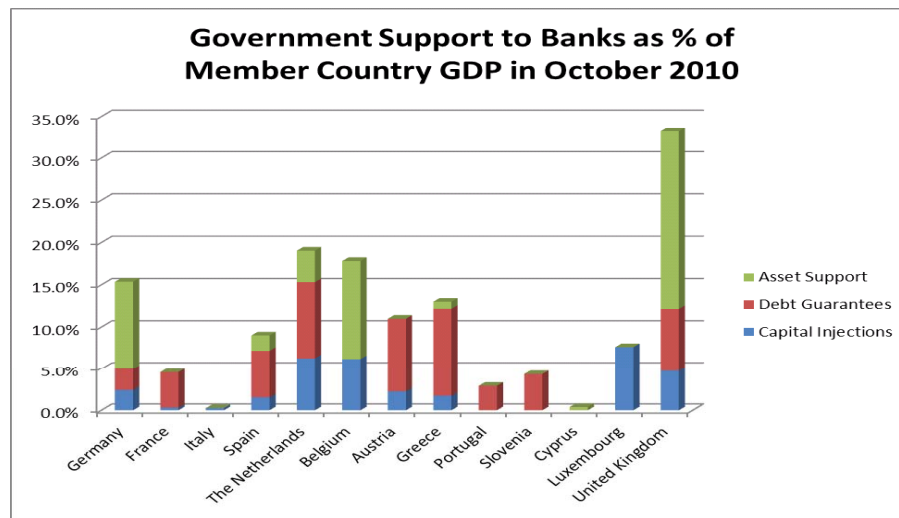
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7

## Background



Source: EU Commission

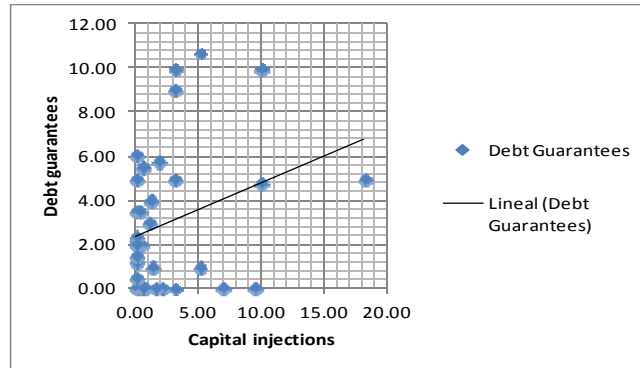
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## Background

Capital injections and debt guarantees in €bill (October, 2010)



Source: Author's analysis of EU Commission data for German, French, Dutch, Austrian and Portuguese banks

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- **BRRF:**
  - Functions
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## BRRF: Functions

- **Guarantees** for the issuance of banks' senior debt, when normal access to the capital market is not possible in an early phase of a formal resolution process
- Funding for the **take-over of banks' impaired assets**
- Provide finance for a **bridge bank**

→ Changes in the national laws that give **different powers** to decide and to execute reorganization/winding up to **different authorities**: EU Directive

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11

## BRRF: Funding

- Contribution of financial institution  $i$

$$c_i = NSAC_i \beta_i x_i$$

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12

## BRRF: Funding

### (a) Limits to moral hazard

- Necessary condition: SEIR
- BRRF not an insurance fund
- Levies should be paid “ex ante” by all banks legally incorporated in each country (subs)
- FIs take first losses of the BRRF

### (b) Limits to pro-cyclicality

- Levies should be paid “ex ante”
- Levies take into consideration the banks’ structural systemic importance and should be periodically reassessed
- Funding of BRRF over a sufficiently long period of time

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## BRRF: Intervention capacity

- Max. [4% GDP;  
Avg. adjust. eligible liabilities]
  - Average amount of gov’t capital injections by Member Countries is 5 % (2010 )
  - 2- 4 % of each countries’ GDP (IMF, April 2010)
    - » Sweden 2.5 % GDP
    - » Germany 4% GDP
    - » Luxembourg 5% GDP
  - BRRFs will be different among countries and overtime within a country
- If additional funding needed: Market issuance with gov’t guarantees, repaid by the FIs

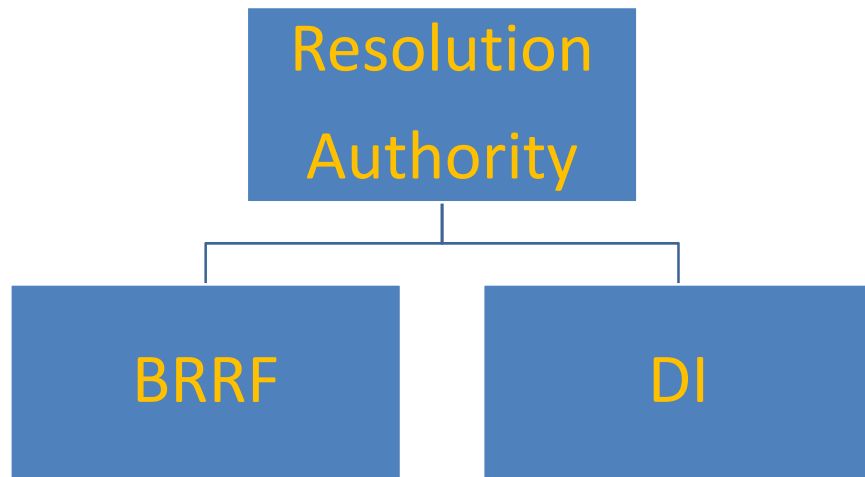
	Total Support % GDP	Fin Sector Support % GDP	Average Bank Eligible Liabilities / GDP(%)
IMF-EU program Ireland	51.97	21.40	23.79
IMF-EU program Portugal	46.53	7.16	3.32
IMF-EU program Greece	46.32	4.21	6.03

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14

## BRRF: Governance



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## Conclusion

- Our proposal aims at **redirecting** existing regulatory proposals
- Towards further **strengthening resolution** authority
- Extra costs of regulation, more effectively **limit the public costs** of financial distress

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16