

Bail-in rules for member institutions of an IPS – proportional or not?

EUROPOLIS, Berlin
9th of January 2017

Dr. Olaf Ahtelik

Legal Department

National Association of German Cooperative Banks (BVR)

Schellingstraße 4

10785 Berlin

Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.





- What is an IPS?
- Are there specific regulations for member institutions of an IPS with regard to resolution action?
- Are there specific regulations for member institutions of an IPS with regard to the bail-in rules?
- Conclusions



- **What is an IPS?**
- Are there specific regulations for member institutions of an IPS with regard to resolution action?
- Are there specific regulations for member institutions of an IPS with regard to the bail-in rules?
- Conclusions



- IPS = Institutional Protection Scheme
- Legal Basis = Article 113(7) of Regulation (EU) No 575/2013 (CRR)
 - An institutional protection scheme (IPS) is referred to in Article 113(7) of Regulation (EU) No 575/2013 as a contractual or statutory liability arrangement **which protects its member institutions and ensures that they have the liquidity and solvency needed to avoid bankruptcy where necessary.**
- According to that provision, competent authorities may waive selected prudential requirements or allow certain exemptions for IPS member institutions (e.g. having a risk-weight of “zero” to exposures to counterparties with which the institution has entered into the institutional protection scheme).



- Most important requirements for recognition according to Art. 113(7) CRR:
 - The arrangements ensure that the IPS is able to grant support necessary under its commitment from funds readily available to it.
 - The IPS disposes of suitable and uniformly stipulated systems for the monitoring and classification of risk, which gives a complete overview of the risk situations of all the individual members and the IPS as a whole, with corresponding possibilities to take influence.
 - The IPS conducts its own risk review.
 - The IPS draws up and publishes on an annual basis, a consolidated report comprising the balance sheet, the profit-and-loss account, the situation report and the risk report, concerning the IPS as a whole.
 - The adequacy of the systems is approved and monitored at regular intervals by the relevant competent authorities.



- The task of an IPS (such as the one run by the BVR) is to impede financial difficulties at its affiliated banks, including the prevention – as worst case – of insolvencies.
- This task involves restructuring affiliated banks in financial difficulties in such a way that they are able to meet their legal obligations.
- The restructuring begins before supervisory requirements had been breached.
- The BVR protection scheme also acts preventively to identify any adverse financial trends at cooperative banks as quickly as possible and.



- Obligations of institutions towards the IPS are among other things:
 - Contributions to the IPS Guarantee Fund.
 - Reporting obligations to the IPS.
 - Auditing obligations.

- Instruments used by an IPS are among other things:
 - Actions to encourage a change in an institute's operating policy.
 - Request for an institute to prepare a restructuring plan.
 - Imposition of personnel and/or material requirements on institutes.
 - Funding measures (e.g. guarantees, loans, recapitalization investments).



- The BVR protection scheme (IPS) is Germany's first deposit guarantee fund for banks and is financed entirely without government support.
- Since its creation in the 1930s it has always ensured that all affiliated banks have been able to meet their financial (and supervisory) obligations, particularly with regard to the deposits of retail customers.
- Since its establishment:
 - no compensation has ever had to be paid to depositors because no compensation event has ever occurred;
 - no customers of affiliated banks have ever lost their deposits;
 - no affiliated bank has ever become insolvent.

What is an IPS (VI)



Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.

Ca. 1000 legally independent Member Banks → Pay rbc*

Capital Stock

Measures
(Prevention & Rehabilitation)



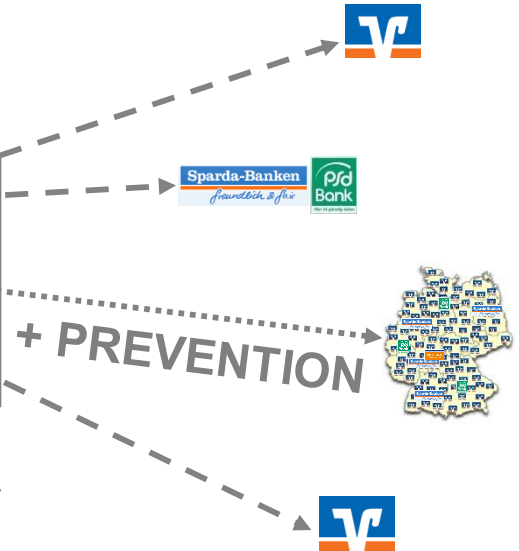
 **80** Jahre
Sicherungseinrichtung des BVR




INSTITUTIONAL PROTECTION SCHEME (IPS)

* **Special Asset of the BVR**
(with independent, completely separate accounting, governance, and auditing)

§ information and sanctioning rights of the IPS



 „Protection, but obligations“

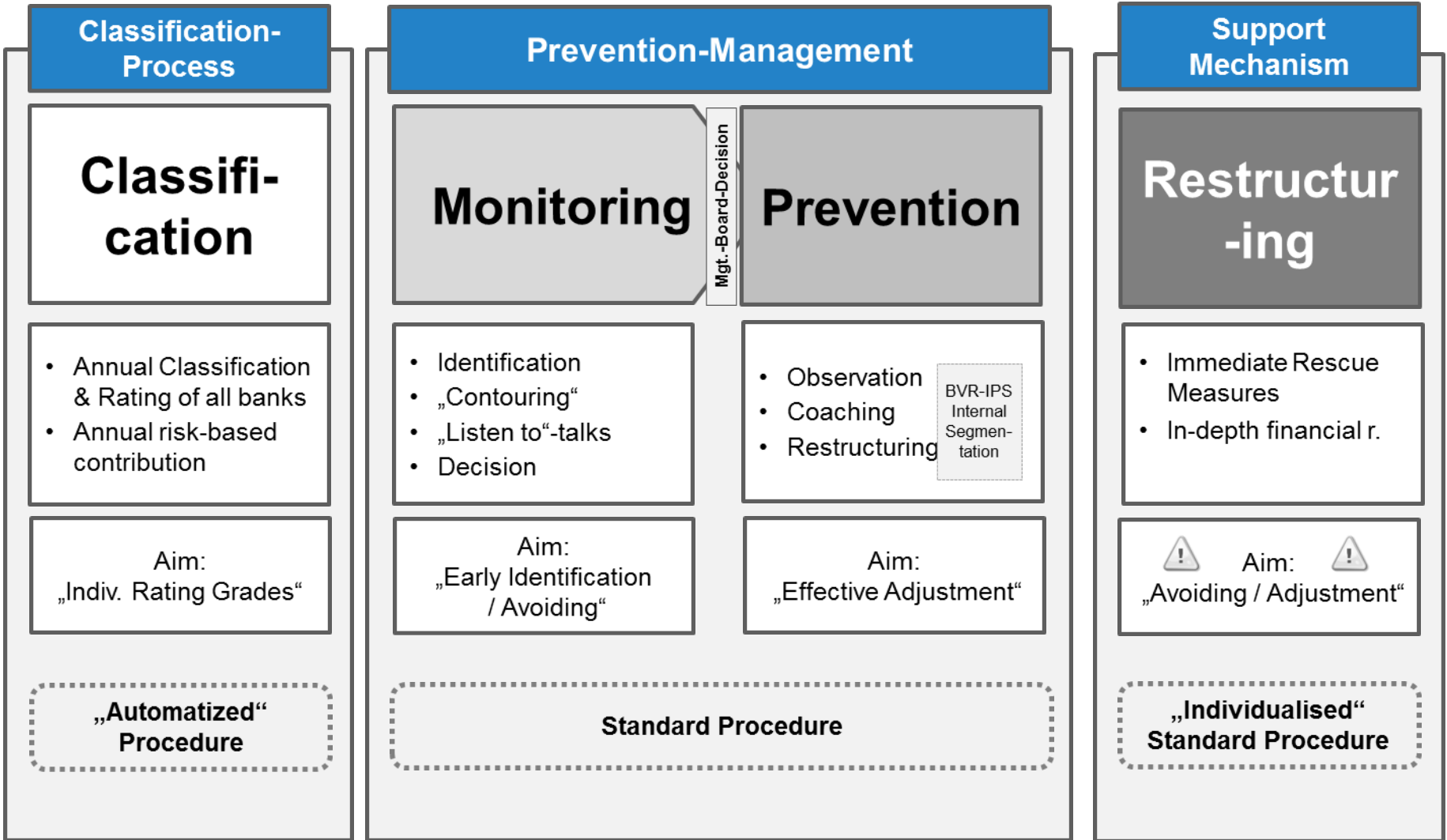
* **Risk-based contributions**
(since 2004!)

What is an IPS? (VII)



Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.

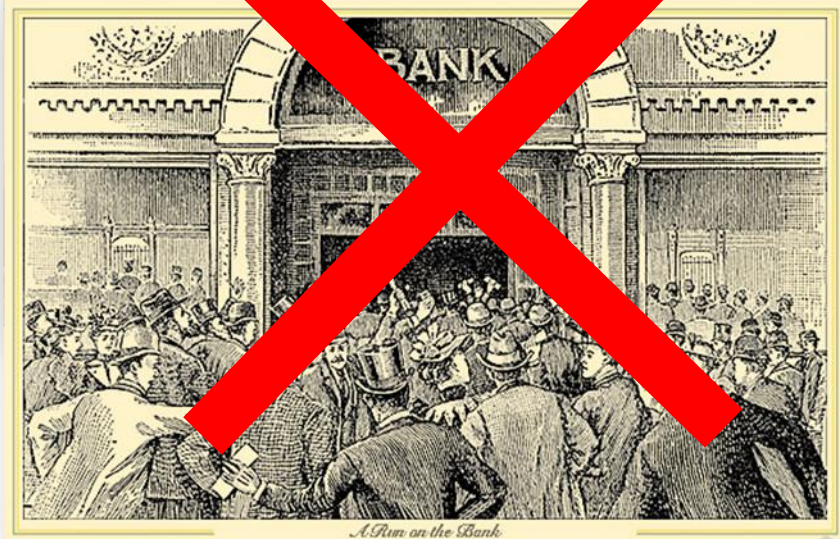


What is an IPS (VIII)



Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.



„Track record“ BVR-IPS

- ✓ Successfully since more than 80 years
 - ✓ NO compensation case!
 - ✓ NO bank run!
 - ✓ Highest trust of customers
 - ✓ NO advertisement campaign
 - ✓ IPS financed by member banks contributions
- ➔ NO TAXPAYER's MONEY!



- What is an IPS?
- **Are there specific regulations for member institutions of an IPS with regard to resolution action?**
- Are there specific regulations for member institutions of an IPS with regard to the bail-in rules?
- Conclusions

Are there specific regulations for member institutions of an IPS with regard to resolution (I)



Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.

- There are specific regulations for member institutions of an IPS with regard to resolution in the BRRD / SRMR to address the aforementioned - and meanwhile also recognized by the ECB – benefits of an IPS, in particular:
 - Article 32(1) BRRD*: *“Member States shall ensure that resolution authorities shall take a resolution action in relation to an institution ... only if the resolution authority considers that all of the following conditions are met: ...*
 - (b) having regard to timing and other relevant circumstances, **there is no reasonable prospect that any alternative private sector measures, including measures by an IPS ... would prevent the failure of the institution within a reasonable timeframe; ...”***

* Compare also Article 18(1) (b) SRMR

Are there specific regulations for member institutions of an IPS with regard to resolution (II)



Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.

- Article 32(1) BRRD can therefore be summarized as follows:
 - The purpose of an IPS is to prevent the failure of its members.
 - Membership in an recognized (and therefore well-funded) IPS according to Art. 113(7) CRR is an effective and functioning risk-mitigating tool.
 - Therefore, in case of an aforementioned IPS, there is no need for triggering resolution and no need for resolution actions (including bail-in).



- What is an IPS?
- Are there specific regulations for member institutions of an IPS with regard to resolution action?
- **Are there specific regulations for member institutions of an IPS with regard to the bail-in rules?**
- Conclusions

Are there specific regulations for member institutions of an IPS with regard to the bail-in rules (I)



Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.

- There are no specific regulations for member institutions of an IPS with regard to the bail-in rules in the BRRD / SRMR to address the benefits of an IPS.
 - On the one hand it could be argued that no specific regulations are necessary: Due to the fact that one condition for taking resolution action is, that an IPS could not prevent the failure, the risk mitigating effect of an IPS is already taken into account before the bail-in rules could be applied by resolution authority.
 - On the other hand it could be argued that the bail-in rules are in case of an IPS – like the one run by the BVR - redundant and the question arises, why member institutions of an IPS – even if the SRB had determined the financial capacity of an IPS (in the context of ex ante-contribution to the SRF) - are subject to the MREL-requirement?

Are there specific regulations for member institutions of an IPS with regard to the bail-in rules (II)



Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.

- The preliminary draft of the BRRD of the Commission had contained at least the following paragraph with regard to MREL:
 - *The requirement under paragraph 1 [maintaining at all times a sufficient MREL amount] **shall be mandatory for those institutions** the failure of which due to their size, complexity or interconnectedness to other institutions or to the financial system in general could have an adverse effect on financial stability or the economy of a Member State or the Union.*
- In the final draft of the BRRD this limitation had been deleted. Size, business model, funding model and risk profile of an institution are now just subsequent criteria for the determination of MREL, but these criteria are not initial requirements of the admissibility of the determination of MREL for an institution by the resolution authority.

Are there specific regulations for member institutions of an IPS with regard to the bail-in rules (III)



Jeder Mensch hat etwas, das ihn antreibt.

Wir machen den Weg frei.

- Article 2(2) Delegated Regulation (EU) 2016/1450 just determines:
 - *“Where the resolvability assessment concludes that liquidation of the institution under normal insolvency proceedings is feasible and credible, the recapitalisation amount [to determine MREL] shall be zero, unless the resolution authority determines...”*
- It is unclear why only the liquidation of an institution under normal insolvency proceedings results in a recapitalization amount of zero although alternative private sector measures, including measures by an IPS, are an equal condition/requirement for resolution and resolution action.

* Delegated Regulation specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities.



- What is an IPS?
- Are there specific regulations for member institutions of an IPS with regard to resolution action?
- Are there specific regulations for member institutions of an IPS with regard to the bail in-rules?
- **Conclusions**



- The IPS of the German Cooperative banks had – in contrast to the current resolution regime including bail-in - passed the reality test for more than eighty years.
- No affiliated bank of the IPS has ever become insolvent. Never taxpayers money had been used in the history of the German cooperative banking sector.
- There are sophisticated and long-tested preventive measures in place. If nevertheless necessary, guarantees or – as a last resort – financial funding measures can be applied.
- Also directly by the ECB supervised banks had been backed by the IPS in the last financial crisis.
- The IPS has excellent financial resources for funding measures.



- Against this background the risk-mitigating effect of an IPS is recognised by the BRRD/SRMR just in an inadequate and insufficient way:
 - Recovery and resolution requirements for member banks of our IPS are on closer inspection in full - and not only with regard to bail-in or MREL requirements - unproportional.
 - IPS member institutions should – at least - be explicitly excluded from the MREL-requirements.
 - As a minimum such institutions should be excluded from any reporting and disclosure requirements concerning MREL.