AT A GLANCE

Estimating the bridge financing needs of the Single Resolution Fund: How expensive is it to resolve a bank?

Summary of the external paper

This external paper (authors *Willem Pieter De Groen, Daniel Gros, Center for European Policy Studies*, November 2015), requested by the ECON Committee, assesses whether further bridge financing could potentially be needed for the Single Resolution Fund during the transitional period from 1 January 2016 to 31 December 2023.

FOCUS OF THE PAPER

The paper bases its estimate on a sample of 72 banks which received restructuring aid in the euro area since 2007. Assuming that the Single Resolution Mechanism would have been in place at that time and that the full financing capacity of the SRF had been available, the authors calculate the amount of losses which could have been covered by the SRF. They notably apply the burden-sharing requirements provided in the SRM regulation, ensuring that prior contribution of shareholders and other creditors amounts to a minimum of 8% of total liabilities including own funds and that the contribution of the SRF is limited to no more than 5% of total liabilities including own funds.

After estimating the potential resolution costs to be borne by the SRF, the authors focus in section 3 on the funds available for bank resolution. They first estimate the amount of funds which could be directly used by the SRF, in line with the Intergovernmental Agreement. Then they look at alternative funds available for resolution: temporary transfers from other compartments, borrowing from third parties including other resolution schemes, sales of shares, deposit guarantee schemes as well as the ESM Direct recapitalisation Instrument. Analysing three different scenarios (failure of a single bank, failure of a small group of banks, failure of a large number of banks), they assess whether the funds available for bank resolution would be sufficient.

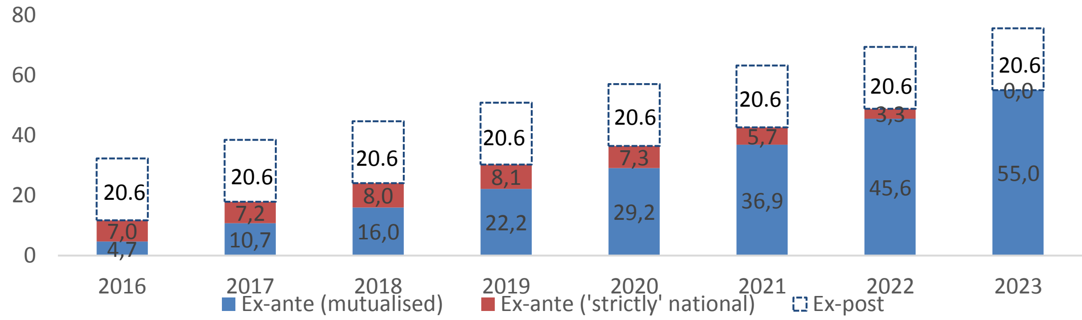
KEY FINDINGS

- **If in 2007 the bail-in rules had already been in place and the Single Resolution Fund had already been set up, the SRF would have contributed €72 billion to the aided banks' total losses of €313 billion.** This is less than the total amount of funds available to the SRF after the transitional period (€55 billion of ex-ante contributions and €21 billion of ex-post contributions which could be called as advance payments). This is mainly explained by the greater contribution of other creditors under the new legal framework, since excess own funds and bail-in of creditors would have absorbed €153 billion of losses.

- **If in the same scenario different assumptions are used (static vs dynamic balance sheet, 8% vs 12% capital requirement, operational income excluded or not), the total amount of losses to be covered by the SRF would range from €58 billion to €101 billion.** This refers to the total amount which would have been contributed by the SRF over the period 2007-2014.

- **Despite the fact that the overall endowment seems to be sufficiently large, the actual amount of contributions directly available to the SRF will be limited in the first years of the transitional period:** only part of the funds collected by the SRF are mutualized, and the borrowing capacity (for example to finance ex-post contributions in the short term) may be limited if the SRF wants to preserve its credit rating or its financing capacity in the years that follow.

Figure 1: Cumulative contributions to SRF during transition (2016-2023)



- **Among the alternative sources of funding, the authors estimate that in 2016 about €10 billion could be transferred either from other national compartments within the SRF, from other resolution schemes or from deposit guarantee schemes,** while the borrowing capacity of the fund could in theory reach the amount needed to finance ex-post contributions, i.e. €21 billion.

- **If a bank failure occurs in isolation, the SRF seems to have sufficient funds from the start to deal with most cases, except if the bank is large.** The authors find that from the third year of its existence, the SRF would also be able to handle the failure of large single banks.

- **If only a limited number of small and medium sized banks fail in different countries, the SRF might have sufficient funds from January 2016 to cover up to 5% of total liabilities.** The authors draw this conclusion from the analysis of the period 2011-2014, with 2 to 9 failures per year costing between €1.4 billion and €9.7billion each year.

- **During the early years, however, the SRF would not be sufficient to withstand a major banking crisis.** According to the authors, a bridge facility may be needed to cover a total maximum shortfall on SRF funds amounting to around €45 billion: *"taking into account some safety margins, a size similar to the €60 billion of the direct recapitalisation instrument of the ESM would be appropriate".*

- **The authors also highlight the limitations imposed on the SRF when providing liquidity support, which makes it more difficult to undertake asset relief measures.** The authors conclude that "*a credit line with, for example, the ECB or the ESM in combination with an exemption to the maximum contribution of 5% of total liabilities for liquidity purposes might be needed under these circumstances*".

The whole paper is available on the homepage of the European Parliament at the following address: http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/542687/IPOL_IDA(2015)542687_EN.pdf.