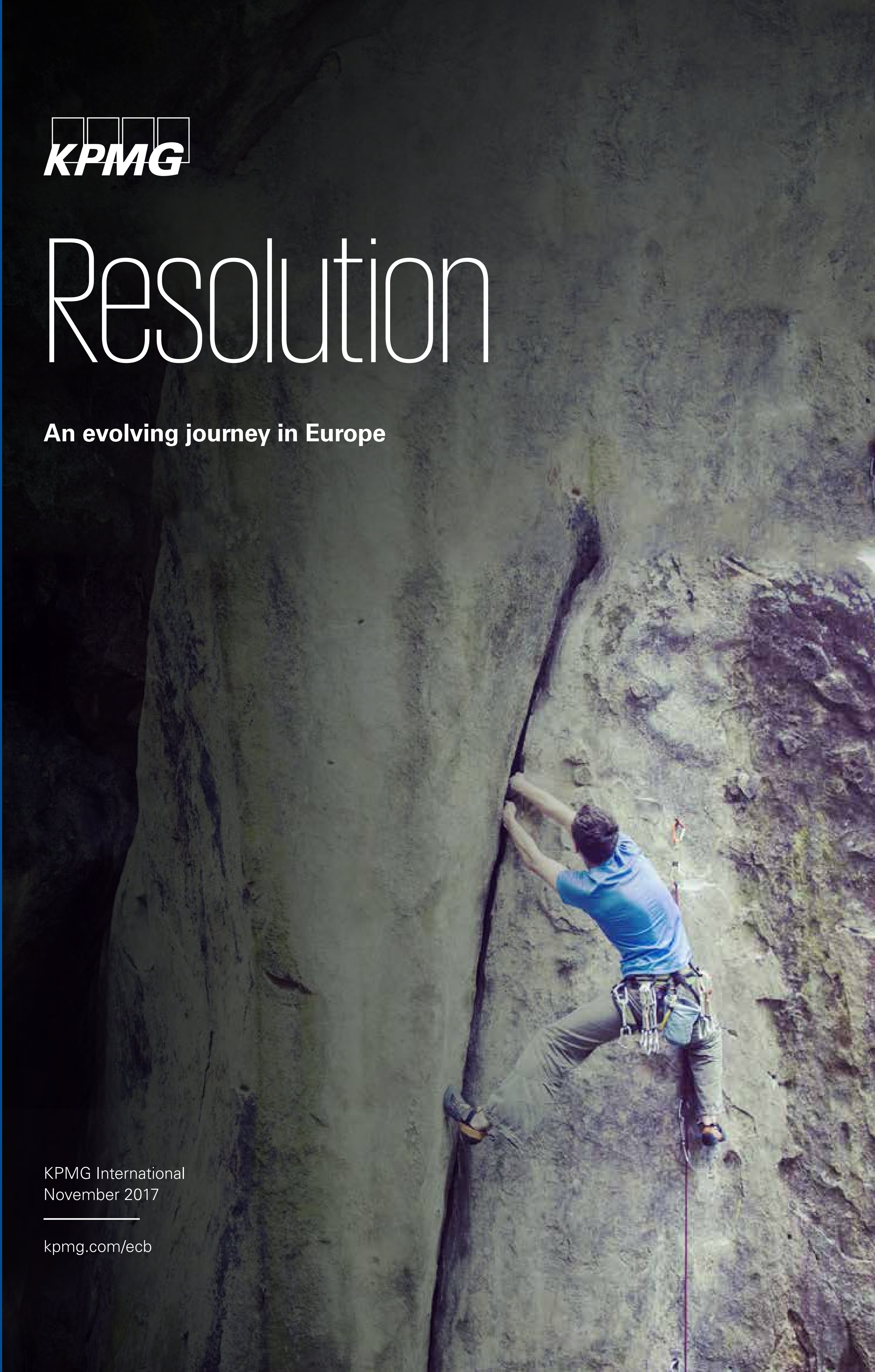


KPMG

Resolution

An evolving journey in Europe

KPMG International
November 2017

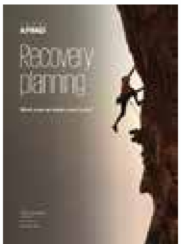
kpmg.com/ecb

Contents

01 Executive summary

Resolution poses many challenges for banks. When designing a commercial banking model with operating structures that are capable of facilitating recovery and resolution, it is essential for banks to understand clearly how to navigate the regulatory requirements and what to focus on to meet each of these specific challenges.

With the main components of a resolution regime for banks now in place across Europe and the regulatory requirements becoming clearer, banks should ensure that the various strands of their recovery and resolution planning work are fully joined-up; that they have identified and are tackling any remaining impediments to resolvability; and that they have implemented commercially viable solutions that meet the needs of customers, investors and regulators.



Recovery planning

Three main areas can be identified as being of critical importance for resolution planning, namely the need for robust operational continuity to enable critical functions to be preserved in a resolution, sufficient loss absorbing capacity, and valuation preparedness. Additional complexities must also be carefully assessed, such as anticipating the potential issues arising from having operations across jurisdictions.

This paper discusses primarily these challenges facing larger banks in Europe, and follows KPMG International's earlier paper on Recovery Planning.

The post-financial crisis regulatory reform agenda included not only a wide range of prudential and governance requirements intended to reduce the likelihood of failure of financial institutions, but also measures to enable failing systemically important financial institutions (SIFIs) to be 'resolved' in a more orderly manner and without cost to taxpayers.

The main regulatory requirements for the resolution of failing SIFIs were set out in 2011 by the Financial Stability Board in its Key Attributes for Effective Resolution. These Key Attributes formed the basis of the EU's Bank Recovery and Resolution Directive (2014). Legislative and regulatory requirements are being developed further by the European Commission, the European Banking Authority and by resolution authorities such as the Single Resolution Board and the Bank of England.

The main components of a resolution regime for banks are now in place in Europe, although many of the details continue to evolve:

- A legal framework that establishes resolution powers and tools as an alternative to using insolvency proceedings or providing government support for failing banks;
- National and banking union-wide resolution authorities undertaking resolution planning and establishing resolution strategies for individual banks;
- Resolution authorities undertaking resolvability assessments of individual banks, focusing on banks' organisational and legal entity structures, operational continuity in resolution, loss absorbing capacity, valuation capabilities to underpin the use of resolution tools, restructuring in resolution (including the sale or transfer of entities or business units and the winding down of some activities), and liquidity support in resolution (where banks need to have sufficient unencumbered assets in their operating entities to support access to central bank funding); and
- A general presumption that the resolution strategy to be applied to a failing bank would vary according to the size and nature of the bank – the largest and most systemically important banks would be subject potentially to the full range of resolution tools in order to stabilise them ahead of a subsequent restructuring, some medium sized banks with significant critical functions might be resolved through the sale or transfer of these parts of their business to other banks, and small banks would generally be subject to national insolvency regimes and the activation of deposit guarantee schemes.

Some resolution powers and tools have already been used to 'resolve' failing banks in Europe, either in combination with some government support or to avoid entirely the use of public funds.

In this paper we address five key potentially challenging resolution areas for banks, investors and policy makers

Operational continuity

Loss absorbing capacity

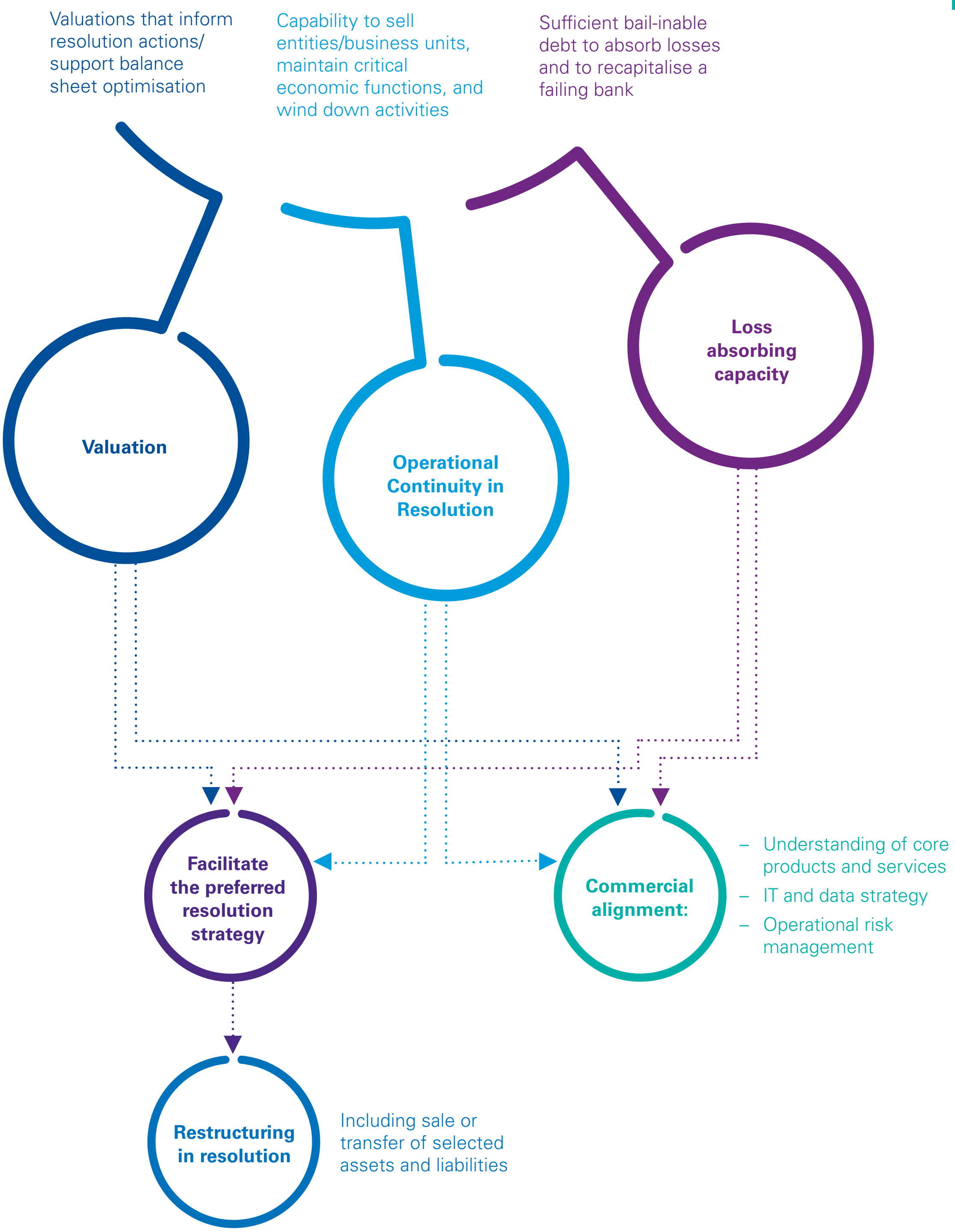
Valuation

Cross border resolution

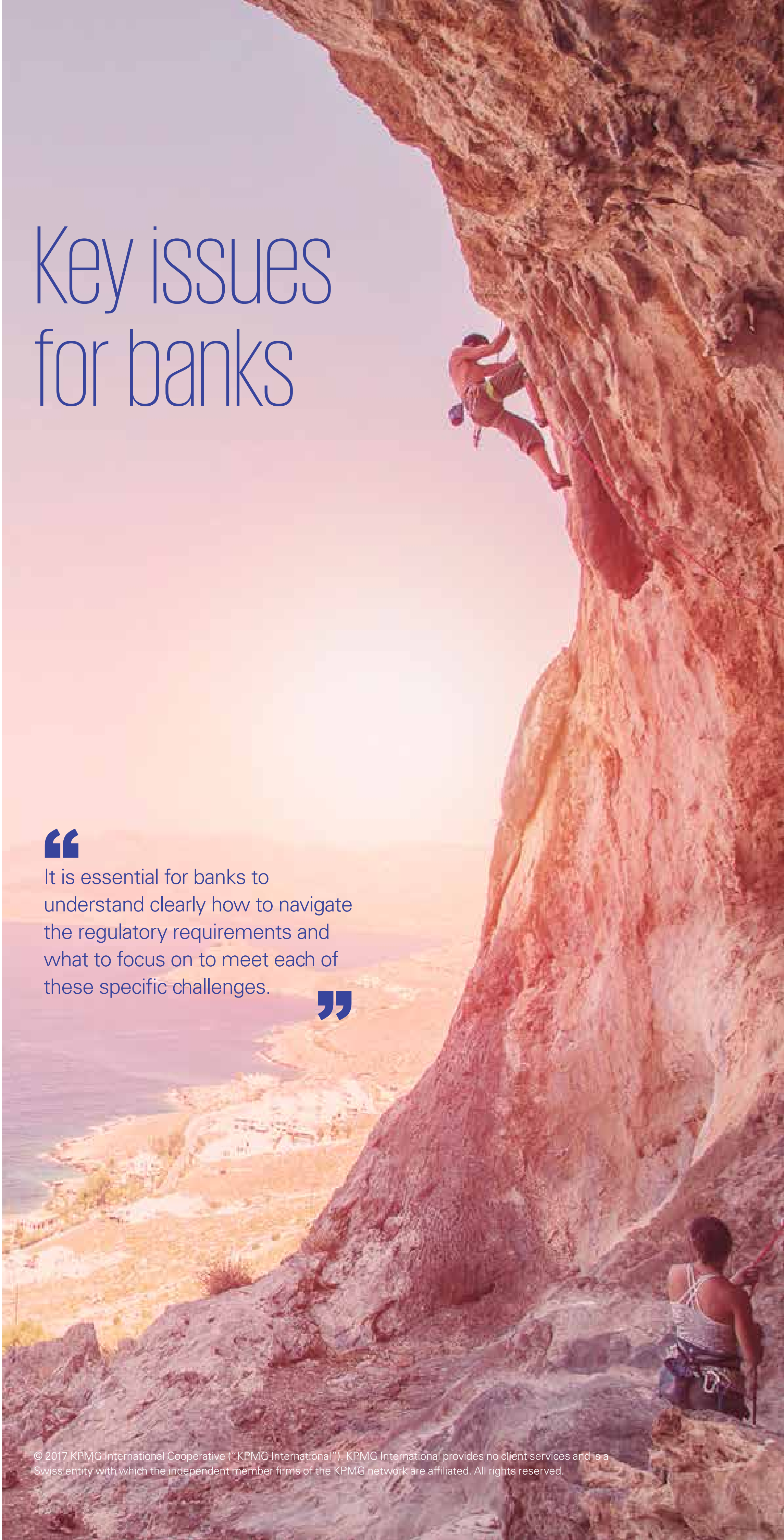
Resolution in practice

01

Connecting the parts together



02 Key issues for banks



> It is essential for banks to understand clearly how to navigate the regulatory requirements and what to focus on to meet each of these specific challenges.

Operational continuity

Focus on the critical operational and finance-related services on which a bank's critical functions depend.

Banks need to demonstrate how their operational structures would facilitate recovery actions and would deliver both financial and operational resilience in resolution.

Resolution in practice

Some reluctance to put banks into liquidation or resolution without taxpayer support.

Some actions demonstrate a degree of flexibility in the choices available to the authorities.

May require further clarification of how and when resolution tools should be used.

Loss absorbing capacity

Different national requirements on major banks to hold a minimum amount of own funds and eligible liabilities.

Continuing uncertainty until BRRD2 and other EU legislative changes are finalised.

Need for cross-border banks to position 'internal' MREL.

Expensive for banks to meet loss absorbing requirements.

Cross-border resolution

Different and evolving national approaches to resolution.

Difficult to reach agreement across home and host jurisdictions for internationally active banking groups.

Uncertainties in the allocation of 'internal' loss absorbing capacity across jurisdictions.

Valuation

Focus on different types of valuation – to determine whether a bank should be put into resolution, and the use of resolution tools, including bail-in to absorb losses.

Raises questions about banks' valuation preparedness – to what extent do their data and systems facilitate (or hinder) the ability of a resolution authority to run different types of valuation at very short notice?

02 Key issues for banks

1. Operational continuity

Supervisors and resolution authorities are increasingly expecting banks to be able to identify, map and document the critical operational and finance related services on which a bank s critical functions depend; and to demonstrate how these critical services could be maintained if a bank was put into resolution – especially where these services are provided by third parties, or by intra group providers that are separate from the regulated bank itself.

Many banks face large scale and demanding exercises to identify, map and document all their critical services, and to demonstrate that these services are sufficiently resolution proof.

Banks should run fire drill exercises to test the extent to which their operating structures support recovery and resolvability, including the ability to dispose of entities and business units, to wind down certain activities and to preserve the operation of critical functions.

Some banks may be required by their resolution authority to move the provision of some of these critical services to within a banking group or even to within the regulated bank itself. This is consistent with the increasing focus of supervisors on outsourcing by banks more generally.

2. Loss absorbing capacity

Banks subject to a resolution strategy will face higher costs and constraints on their funding strategies as a result of requirements to hold a minimum amount of own funds and eligible liabilities that are straightforward to bail in, and to pre position 'internal' loss absorbing capacity around banking groups. Banks funded primarily through customer deposits (retail and corporate) and regulatory capital may find that they have in effect to convert some customer deposits into medium term subordinated (or non preferred) debt. This may be an expensive, cumbersome and lengthy process for some banks, given the limited appetite of investors to hold such bail inable debt.

Banks that have placed eligible debt instruments with retail investors may be required to issue additional eligible liabilities to less vulnerable investors, to enable resolution authorities to protect retail investors in a resolution.

Different resolution authorities in Europe are imposing different loss absorbing requirements on banks under different timetables. Meanwhile, a host of details remain undecided, including decisions on precisely which types of debt will be eligible to meet loss absorbing requirements.

3. Valuation

Different bases for valuation are required to determine whether a bank should be put into resolution (based on normal accounting and prudential rules) and to determine the choice of resolution tools, including the bail in tool (based on economic values, using prudent and conservative assumptions).

Banks need to have the valuation capabilities to enable these different types of valuation to be undertaken by a third party valuer at short notice.

Banks therefore need to be able to demonstrate that they have:

- Sufficiently complete, accurate and readily available data and information (failings in these areas have already been exposed by banks' and supervisors assessments of whether banks meet the Basel Committee principles for risk data aggregation and reporting);
- Robust systems to enable a third party valuer to undertake promptly both types of valuation ahead of resolution; and
- Adequate governance, documentation and internal and external review procedures to support resolvability preparedness.

02

> Many banks face large-scale and demanding exercises to identify, map and document all their critical services, and to demonstrate that these services are sufficiently resolution-proof.

4. Cross border resolution

International banking groups should be aware of potentially costly differences in the requirements imposed by national authorities, including:

- Differences in the detailed information to be provided to the relevant resolution authorities;
- The assessment by resolution authorities of which economic functions should be regarded as being critical and of what is required to ensure sufficient operational continuity in the event of resolution;
- The extent to which resolution authorities require groups to change their business activities and their legal and operational structures to enhance resolvability;
- The conditions under which the authorities would trigger a resolution;
- The use of resolution strategies, tools and powers by resolution authorities; and
- National demands for banks to hold loss absorbing capacity in specific jurisdictions.

5. Resolution in practice

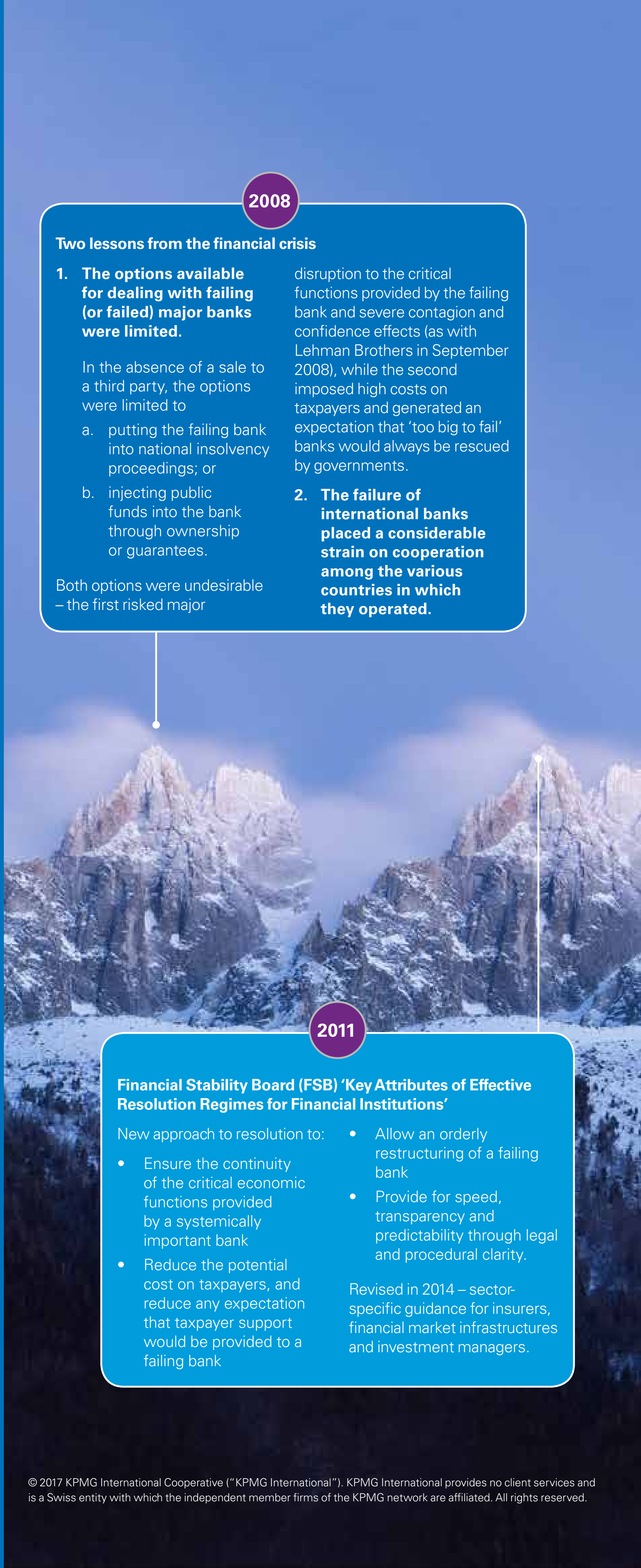
Recent examples of situations where the authorities have had to deal with failing banks show that in some cases national authorities may be inclined to rescue even relatively small banks that may not have been identified in advance as being of systemic importance or as providing critical economic functions to a material extent.

If national authorities want to apply resolution tools to these banks – not least in order to share the costs of supporting these banks between taxpayers and the creditors of these banks – they may also require such banks to hold greater loss absorbing capacity in advance of any resolution. This would impose higher funding costs on a wider range of banks than was envisaged when the FSB Key Attributes and EU resolution legislation were developed.

03

The evolving regulatory landscape

The post-financial crisis regulatory reforms included measures intended to enable failing systemically important banks to be resolved in a more orderly manner and without cost to taxpayers. We set out here the broad timeline of these reforms, together with the likely evolution of EU legislation on resolution and the evolving role of the Single Resolution Board.



2008

Two lessons from the financial crisis

1. **The options available for dealing with failing (or failed) major banks were limited.**

   In the absence of a sale to a third party, the options were limited to

   a. putting the failing bank into national insolvency proceedings; or

   b. injecting public funds into the bank through ownership or guarantees.

Both options were undesirable – the first risked major disruption to the critical functions provided by the failing bank and severe contagion and confidence effects (as with Lehman Brothers in September 2008), while the second imposed high costs on taxpayers and generated an expectation that 'too big to fail' banks would always be rescued by governments.

2. **The failure of international banks placed a considerable strain on cooperation among the various countries in which they operated.**

2011

Financial Stability Board (FSB) 'Key Attributes of Effective Resolution Regimes for Financial Institutions'

New approach to resolution to:

- Ensure the continuity of the critical economic functions provided by a systemically important bank
- Reduce the potential cost on taxpayers, and reduce any expectation that taxpayer support would be provided to a failing bank
- Allow an orderly restructuring of a failing bank
- Provide for speed, transparency and predictability through legal and procedural clarity.

Revised in 2014 – sector-specific guidance for insurers, financial market infrastructures and investment managers.

03

2014

EU Bank Recovery and Resolution Directive (BRRD)

BRRD based on the FSB's Key Attributes - covers recovery planning, resolution planning, triggers for resolution, resolution tools, government stabilisation tools, resolution funds and cross-border agreements.

Includes an expectation that (other than in exceptional cases) at least 8 percent of a failing bank's total liabilities (including own funds) would be bailed in before any recourse is made to a resolution fund, and that the maximum contribution from a resolution fund would be the equivalent of 5 percent of the bank's total liabilities.

Finalised in 2014, for transposition into national law by January 2015, with the bail-in tool becoming operational by January 2016.

Single Resolution Mechanism Regulation (SRMR) supplemented the BRRD for banking union Member States by establishing the Single Resolution Board (SRB) and a Single Resolution Fund (SRF).

2015

FSB 'term sheet' for total loss absorbing capacity (TLAC)

Global systemically important banks (G-SIBs) required to hold TLAC (regulatory capital and other subordinated debt) of at least 16 percent of risk weighted assets and 6 percent of the leverage ratio denominator from 1 January 2019, and 18 percent and 6.75 percent respectively from 1 January 2022 (emerging economy G-SIBs are subject to a longer implementation period).

Capital buffer requirements apply over and above the minimum TLAC requirement.

Mechanism for material sub-groups to hold 'internal TLAC' through the down-streaming of TLAC eligible liabilities from a parent 'resolution entity' to such sub-groups. Resolution of the parent entity would trigger the writing-down or conversion into new equity of the down-streamed instruments, to meet losses and to recapitalise material sub-groups.

Supplemented by Basel Committee standards (2016 and 2017) on the treatment of holdings of TLAC by other banks, and Pillar 3 disclosure requirements.

2016

Single Resolution Board (SRB)

SRB granted full legal powers from January 2016.

Directly responsible for resolution planning, resolvability assessments and resolution actions for significant banks in the EU banking union area (those directly supervised by the ECB) and for 15 additional cross-border banking groups (as at end-December 2016).

National resolution authorities remain directly responsible for all other banks in the banking union, although the SRB could take over direct responsibility for these banks at some point.

Single Resolution Fund (SRF)

Banking union-wide fund built up between 2016 and end-2023 to reach at least 1 percent of banks' covered deposits – likely to be around €55 billion.

The SRF could be used to guarantee the assets or liabilities of a failing bank, purchase assets of a bank in resolution, contribute to a bridge bank or asset management company, enable certain creditors to be excluded from bail-in in extraordinary circumstances, and compensate creditors under the 'no creditor worse off than under liquidation' principle.

Evolution of the BRRD

The details of the BRRD and SRMR have been expanded through a continuing process of Delegated Regulations from the European Commission; implementing technical standards and guidelines issued by the European Banking Authority (EBA); national legislation; and rules and guidance issued by resolution authorities.

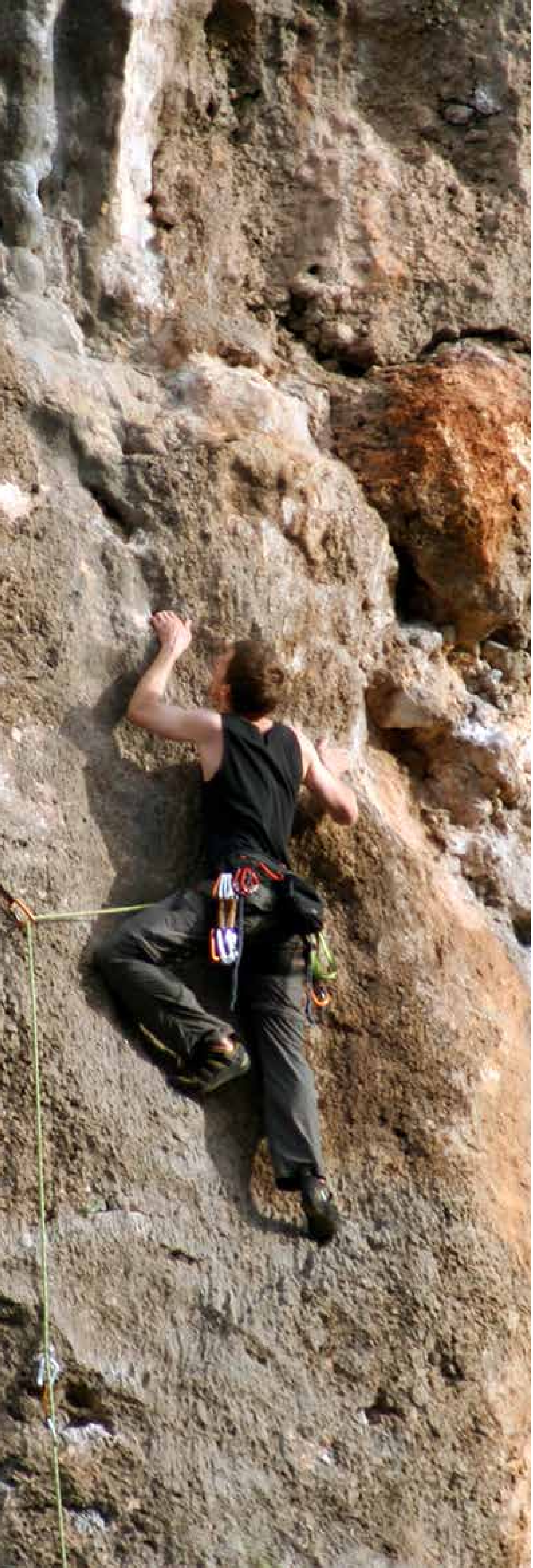
In November 2016 the Commission put forward proposals to amend the BRRD, SRMR and the Capital Requirements Regulation in order to align more closely the EU and FSB requirements on loss absorbency and to introduce greater clarity to the specification of bail-inable debt and to the order in which a failing bank's abilities would be bailed in.

On EU G-SIBs and TLAC, these proposals included:

- Implementing the FSB's minimum TLAC requirements for EU G-SIBs;
- Allowing a resolution authority to apply an add-on to the TLAC requirement for an EU G-SIB, if that is necessary under the preferred resolution strategy;
- Applying 'internal TLAC' by requiring material EU subsidiaries (that are not themselves resolution entities) of non-EU G-SIBs to hold 90 percent of what their TLAC requirement would have been on a stand-alone basis;
- Amending the eligibility criteria for Additional Tier 1 and Tier 2 regulatory capital instruments to include a requirement that such instruments would be written down or converted into equity at the point of non-viability;
- Requiring TLAC eligible liabilities to be of at least one year residual maturity and subordinated (with some exceptions) to other liabilities, and subject to similar pre-redemption approval procedures as apply to regulatory capital instruments; and
- Holdings of other G-SIBs' TLAC would be deducted from a G-SIB's own TLAC on the basis of a corresponding deduction approach (a less punitive treatment than the Basel Committee standard under which holdings of TLAC that do not count as regulatory capital are deducted from the Tier 2 capital of the holding bank);

More generally, the Commission is proposing:

- Requiring each bank's minimum requirement for own funds and eligible liabilities (MREL) to be set using both a risk-based exposure amount and the leverage ratio exposure measure;
- Setting 'internal MREL' requirements equivalent to internal TLAC;
- Allowing a resolution authority to require eligible liabilities to be subordinated in order to facilitate the application of the bail-in tool, while recognising the scope for part of the MREL requirement to be met through non-subordinated debt instruments;
- Including structured notes in the list of instruments eligible for bail-in, where they have a fixed principal amount repayable at maturity;
- A partial harmonisation of the bank insolvency creditor hierarchy across the EU, by creating a new class of MREL-eligible 'non-preferred' senior debt instruments that would be bailed-in in resolution after capital and other subordinated instruments but before other senior liabilities, and would rank behind other senior liabilities under national insolvency;
- A less onerous requirement on contractual relationships between EU banks and non-EU entities, by allowing resolution authorities to waive, under certain conditions, the obligation to insert contractual clauses meant to ensure third country recognition of the bailing-in of liabilities issued in third countries, in particular for liabilities that do not count towards MREL;
- Recognising the concepts of 'resolution entities' (entities to be resolved) and 'resolution groups' (subsidiaries that belong to a resolution entity); and
- An early intervention (ahead of putting a bank into resolution) moratorium power to suspend payments for up to 5 days.



03

Single Resolution Board

In its first cycle of resolution planning during 2016 the SRB sought a better understanding of banking groups and barriers to resolution, and undertook initial assessments and the preparation of resolution plans. By the end of 2016, the SRB had developed 92 resolution plans.

The SRB also worked during 2016 on:

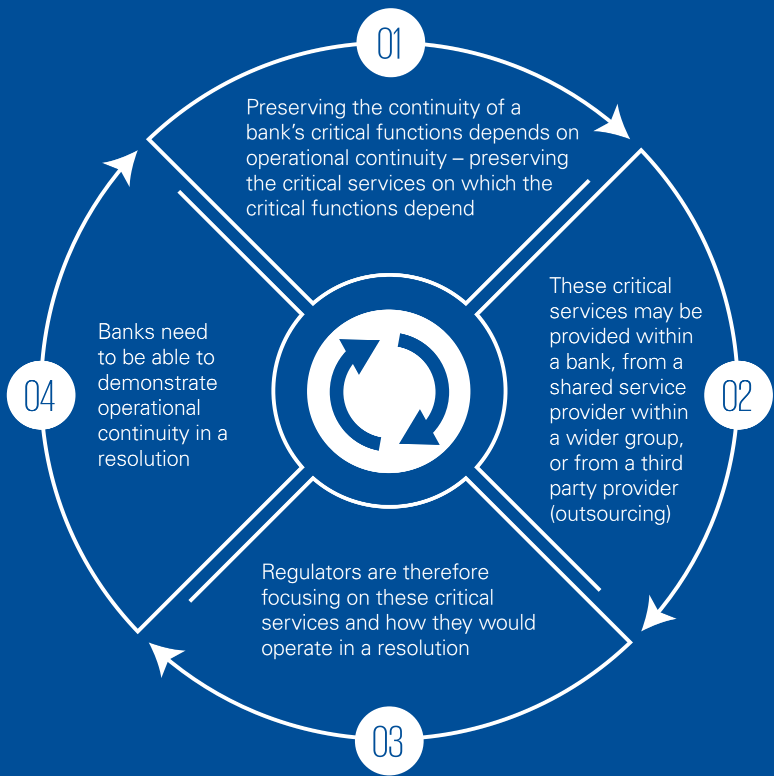
- Initial assessments of available MREL, in terms of the amounts, quality and location within groups of loss absorbing capacity;
- Liability data reporting;
- The scope for funding and liquidity in resolution, in terms of access to central liquidity and the impact of asset encumbrance and margin requirements;
- Operational continuity; and
- Cross-border recognition of resolution actions.

During 2017, in addition to further work on MREL targets and operational continuity the SRB has focused on:

- Enhancing resolution readiness through the further development of bank-specific resolution plans, preferred resolution strategies and potential post-resolution restructuring scenarios;
- Preparing the SRB's own crisis management manual, and undertaking dry run exercises based on the range of resolution tools;
- Implementing its first resolution of a bank;
- Identifying critical functions, assessing their criticality, and considering their separability in resolution;
- The identification of substantive impediments to resolvability;
- Fostering cooperation and cross-border relationships, including with the ECB, UK PRA, Federal Reserve Bank and Federal Deposit Insurance Corporation; and
- Enhancing its oversight function over less significant institutions (including through the prior assessment by the SRB of the resolution decisions of national resolution authorities) to ensure consistency of actions within the banking union.

04

Operational continuity



One key objective of resolution is to preserve the continuity of a failing bank's critical functions. These might include deposit-taking; lending to borrowers such as retail customers and SMEs where the reliance on bank-specific credit information may make it difficult for another provider to substitute for these services rapidly and effectively; clearing, payment and settlement services; and some forms of wholesale market and trading activities.

Much of the early emphasis of resolution planning therefore focused on identifying the critical functions supplied by banks in general; identifying which banks supplied significant critical functions (all systemically important banks are likely to supply some critical functions, but some other banks may also supply one or more critical functions to a material extent, even if they are not designated as being of global or national systemic importance); and planning to use resolution tools in a way that would preserve the continuity of these banks' critical functions.

It also became clear from this resolution planning process that the continuing supply of critical functions – at the point of resolution, during any stabilisation period, and during the restructuring of a failing bank – depended on preserving the continuity of the various services on which this supply was based. For example, as set out in a 2015 guideline from the EBA, a core list of operational and finance-related services and facilities supporting banks' critical functions would include human resources, IT, transaction processing, real estate and facility provision or management, legal services and compliance functions, treasury related services, trading and asset management, risk management, valuation, accounting and cash handling.

> One key objective of resolution is to preserve the continuity of a failing bank's critical functions.

As discussed in FSB guidance issued in August 2016, banks may rely (to varying extents and in different combinations) on three broad types of providers of critical services:

- 'in house' provision within the same regulated entity that provides the critical function;
- 'intra group' provision (within a regulated or an unregulated entity) servicing more than one regulated entities that provide critical functions; and
- 'outsourced' third party service providers (including financial market infrastructures).

The discontinuation of any critical services could lead to an inability of a bank to perform its critical functions. This might arise because, in resolution, book transfers of assets or liabilities would not necessarily transfer the critical services on which the continuity of these functions depends; or the relevant critical services may be located elsewhere in a group (for example in an entity that is sold to a third party or put into liquidation as part of a resolution) or provided by a third party that discontinues the service as a result of the bank being put into resolution; or key staff may simply walk away from a failing bank.

The operational continuity of critical services has therefore become a key aspect of resolution planning, with a particular emphasis (in particular where critical services are provided on an intra-group or outsourced basis) on the 'resolution-proofing' of:

- the contractual provisions relating to rights of use and access, pricing structures, operational resilience and resourcing of the provision of critical services;
- the financial resources of the providers of critical services; and
- the governance of, and management information systems relating to, critical services by banks and banking groups.

04

The SRB, Bank of England and FSB have all emphasised the importance of operational continuity. During 2016 the SRB focus here was on the capacity of a bank in resolution to raise funding, access to financial market infrastructures (FMIs), the effectiveness of service level agreements (intra group and third party) and the management information systems required to ensure operational continuity.

In 2017 the SRB has focused on the continuity of critical outsourced or shared services, such as IT infrastructure and software related services, necessary to support the continued provision of critical functions; and access to FMIs – understanding the conditions for the continued participation of a bank in resolution in FMI services, and preparing fast track procedures to transfer participation to a bridge bank.

Meanwhile, the Bank of England's July 2016 Supervisory Statement on operational continuity sets out expectations on banks to ensure the operational continuity of critical services to facilitate recovery actions, orderly resolution and post-resolution restructuring. The key expectations here are that a bank should:

> “Expectations on banks to ensure the operational continuity of critical services, to facilitate recovery actions, orderly resolution and post-resolution restructuring.”

- Undertake a comprehensive mapping and documentation of critical services from providers to critical functions, to provide clarity on what critical services need to be maintained in resolution. This may involve identifying legal entities, business lines or divisions that perform critical functions and the critical services they receive and / or provide. This mapping should also include a description of the services and information on the jurisdiction of each party, the service delivery model used, the ownership of assets, the infrastructure used, pricing and contractual arrangements;
- Be able to demonstrate how its operational arrangements supporting critical services facilitate resolution, within a reasonable time; and
- Describe what would happen to critical services if resolution tools were applied, including how the bank's operational arrangements would facilitate separability and restructuring within a reasonable time, while preserving the continuity of critical functions.

A bank should also meet the relevant elements of the PRA's supervisory requirements on outsourcing (for services provided intra-group and from third parties), including:

- Maintaining responsibility for critical services and not outsourcing any functions that require senior management judgement or decision-making that could affect the prudential soundness or risk appetite of the bank;
- Ensuring that critical services providers have sufficient financial resources to allow the continuity of provision of critical services during and after resolution;
- Ensuring that intra-group critical services providers will remain operational despite the failure of any group entities, by ensuring that the critical services provider has change capabilities and operational contingency arrangements; demonstrating that operational resilience is not affected by the loss of key business clusters or entities post-resolution; and ensuring that the critical services provider has sufficient staff and expertise dedicated to the critical services provision to carry out post-restructuring activity if necessary;
- Ensuring that a critical services provider, whether intra-group or third party, cannot change the arrangements of service provision as a result of a bank (or part of a banking group) entering resolution;
- Demonstrating that the bank has identified and documented the critical services it receives. The PRA's expectations vary depending on whether a separate legal entity is providing the service or if the service provision is between business units within a bank;
- Entering into service level agreements between business units of a bank, intra-group entities or third party providers that are objective and on third party terms;
- Articulating clearly how access to operational assets (such as data, intellectual property, premises, licences and leases supporting critical services) will be maintained in a resolution; and
- Ensuring that a critical services provider located within a group has its own governance and management structure in place.

In its July 2017 progress report on resolution, the FSB reported that it had found inadequacies in arrangements for operational continuity in many G-SIBs. Most G-SIBs assessed by the FSB were found to have identified their critical services and had mapped these services to critical functions, business lines and legal entities, including through the development of global service catalogue tools. A number of G-SIBs had also amended, or were in the process of amending, service level agreements to include specific resolution clauses, including in some cases through the development of a single global master services agreement. However, work remains to make operational continuity arrangements fully operational in resolution and to ensure that providers of operational services have sufficient financial resources to continue in resolution.

One specific area of operational continuity focused on by the FSB was the continuity of access to FMIs. The FSB concluded that significant further work is needed to ensure the robustness of arrangements to support continued access to FMIs by a bank in resolution, where the steps taken to date by G-SIBs mostly relate to the initial identification of critical FMI services and associated levels of payments and settlement activity. Only a few G-SIBs were found to have developed contingency plans to support continued access.

The FSB therefore issued (in July 2017) guidance on the continuity of access to FMIs during and following the entry of a bank into resolution, covering:

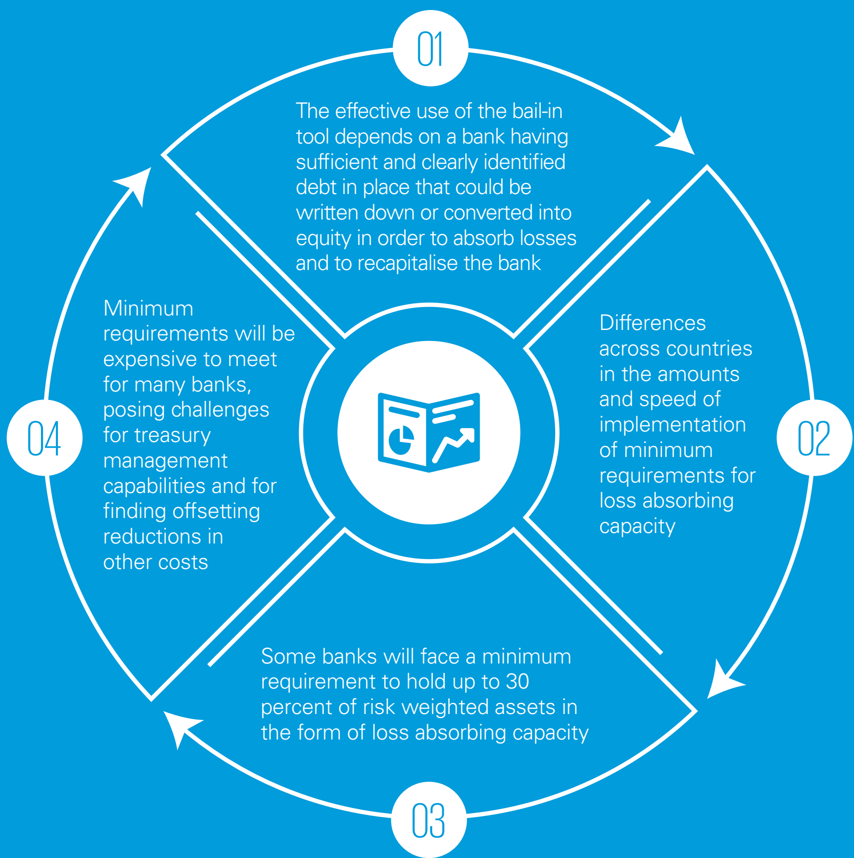
- The continuity of access arrangements by FMIs (and by intermediaries that facilitate access to FMIs) – planning for the resolution of a user of FMI services, taking into account the interaction between the resolution regimes that apply to their service users and their own risk management framework, and clarifying in advance the actions they may take in the event of a resolution of a user;
- Measures that G-SIBs should take to facilitate their continued access to critical FMI services in resolution, including by ensuring that obligations to FMI service providers can be met throughout resolution; and
- Cooperation and information sharing between the relevant supervision and resolution authorities of FMIs and G-SIBs, both ahead of and during a resolution.

Operational continuity: key challenges for banks

- Demonstrating that they are focused on the key outcomes of operational continuity. This goes beyond simply working their way through the many design principles highlighted in this chapter.
- Pulling together the roles of operational continuity in both recovery planning (including the operational support for the prospective sale of entities or business units) and resolution planning (the financial and operational support to deliver the resolution strategy and to preserve the continuity of critical functions).
- Determining which staff (IT, operations, human resources and risk) should remain in the regulated entities and which can be transferred into service companies, and to meet the potentially conflicting expectations of different national regulators in this respect.
- Establishing an oversight and control framework – similar to a third party risk management framework – to demonstrate to regulators that the regulated entities are exercising appropriate oversight over their service companies.
- Implementing a suitable and resolution-proof internal charging model for critical services provided by service companies.
- Using the work they do on operational continuity not just to enhance resilience but also to improve the efficiency and transparency of their operations and to improve the management of operational risk, not least by developing operational continuity in the context of commercial objectives and aligning critical services with the products and services provided to customers and counterparties.

05

Loss absorbing capacity

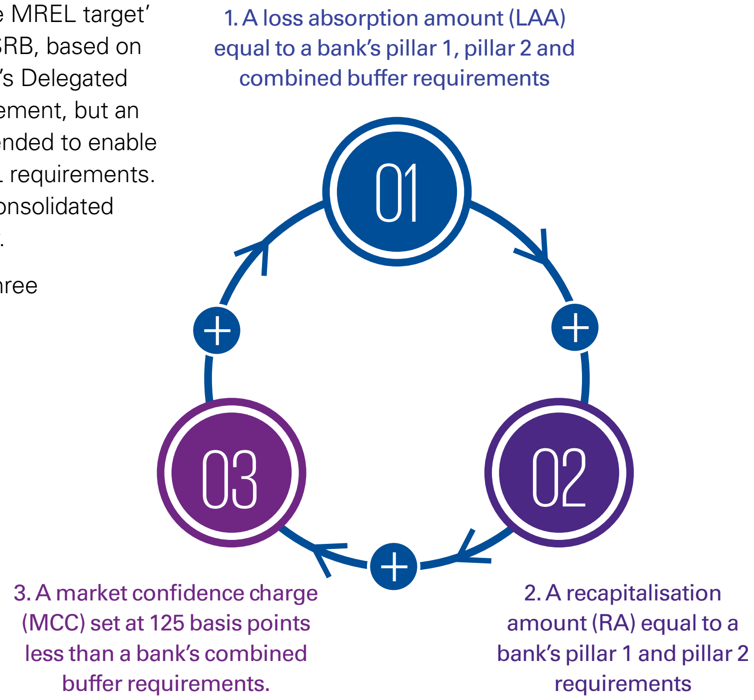


The European Commission is proposing EU legislation to implement the FSB 'term sheet' total loss absorbing requirements for EU G-SIBs and to bring the MREL minimum requirements in Europe closer into line with the FSB standards. Meanwhile, resolution authorities across Europe are following different paths in terms of the quantum and speed of implementation of the minimum requirements applied to banks under their jurisdiction.

Single Resolution Board (SRB)

The SRB has set a general 'informative MREL target' for all banks regulated directly by the SRB, based on the default formula in the Commission's Delegated Regulation. This is not a binding requirement, but an orientation towards a future target intended to enable banks to prepare for their future MREL requirements. The informative target applies at the consolidated level of the EU parent resolution entity.

This informative target is the sum of three components:



In addition, the SRB target includes a minimum MREL of 8 percent of a bank's total liabilities including own funds (thereby translating the BRRD limitation on using bail-inable debt before contributions from a resolution fund into a specific minimum MREL requirement), but not a TLAC-style minimum leverage ratio-based MREL target.

As with the FSB TLAC requirements, most MREL instruments have to be subordinated – the SRB target for EU G-SIBs is for at least 13.5 percent of risk weighted assets and the combined buffer requirement to be met through subordinated instruments. The SRB has also clarified that structured notes, liabilities issued by SPVs or entities established outside the EU, and notes governed by third country law cannot currently be included as eligible instruments for inclusion in meeting a bank's MREL target, but uninsured and non-preferred deposits with maturity over one year can be included. The SRB has not yet specified how debt held by retail investors[1] (which can be seen as being an impediment to resolution), or cross-holdings of MREL among banks, will be treated.

1. The Joint Committee of the European Supervisory Authorities issued a strong 'reminder' warning in November 2014 that banks should take consumer protection considerations into account when issuing their own capital instruments to retail consumers, but did not ban such sales.

On MREL, the SRB intends during 2017 to:

- Refine the methodology and to set MREL targets for EU parent entities at a consolidated level for a first set of major banking groups under the SRB remit, where the preferred resolution strategy is based on using the bail-in tool;
- Begin to reflect bank-specific features in setting MREL targets, including taking into account the preferred resolution strategy (so the recapitalisation amount might be lower if, for example, the strategy would be to bail-in only part of a group), business model, funding and risk profiles (so the loss absorption amount might be higher if some liabilities – such as retail held debt, or funding required to support critical services – might be excluded from bail-in), and the resolvability assessment for each bank regulated by the SRB;
- Develop the planned binding targets for major banking groups, including specific MREL requirements for these groups in late 2017 or early 2018. Resolution colleges are expected to discuss these targets by the end of 2017. The new MREL requirements will be developed of the basis of current legal frameworks;
- Consider the potential for contributions from deposit guarantee schemes;
- Set targets for internal MREL within resolution groups and introduce a methodology for MREL targets under multiple point of entry resolution strategies;
- Consider transition periods for individual banks for meeting their MREL targets;
- Refine policy regarding the deduction of cross-holdings, the subordination requirement, and the treatment of structured notes, SPV issued liabilities outside the EU and liabilities governed by a country outside the EU; and
- Provide greater clarity on the implications of a breach of minimum MREL requirements and of MREL guidance, the reporting and disclosure by banks on the amount and composition of their stack of MREL eligible liabilities, and information on creditor hierarchy.

The SRB does not intend to publish individual decisions on MREL targets (but some individual banks may choose to do so).

> "During 2017 the SRB intends to begin to reflect bank-specific features in setting MREL targets."

UK

The Bank of England has set MREL requirements for major UK banks. The (non-leverage ratio) part of the MREL calculation for each bank is:

- From January 2020, twice the Pillar 1 requirement (excluding buffers) of 8 percent of risk-weighted exposures, plus the bank's Pillar 2A requirement.
- From January 2022, twice the Pillar 1 requirement and twice the bank's Pillar 2A requirement.

So for a bank with a 4 percent Pillar 2A requirement, the MREL requirement would be 20 percent of risk-weighted assets from January 2020, and 24 percent from January 2022. The size of the Pillar 2A requirements on major UK banks explains why these banks end up with a higher MREL requirement than the 18 percent FSB minimum TLAC requirement (from 2022).

The various buffer requirements – including the capital conservation buffer of 2.5 percent, any counter cyclical capital buffer and any SIB surcharge – and any (undisclosed) Pillar 2B add-on are additional to these MREL requirements. In addition, these banks must meet the leverage-ratio based TLAC requirements as set by the FSB.

MREL requirements for major UK banks, as percentage of risk weighted assets

	From January 2020				From January 2022			
	Gone concern	Going concern	Interim MREL	Plus buffers (excluding Pillar 2B)	Gone concern	Going concern	MREL	Plus buffers (excluding Pillar 2B)
HSBC	8%	11.8%	19.8%	22.9%	11.8%	11.8%	23.6%	26.7%
Barclays	8%	12.0%	20.0%	24.5%	12.0%	12.0%	24.0%	28.5%
Lloyds	8%	12.5%	20.5%	23.9%	12.5%	12.5%	25.1%	28.4%
RBS	8%	11.8%	19.8%	24.0%	11.8%	11.8%	23.7%	27.8%
Standard Chartered	8%	10.8%	18.8%	22.4%	10.8%	10.8%	21.6%	25.2%
Santander UK	8%	12.9%	20.9%	24.4%	12.9%	12.9%	25.9%	29.3%

Source: Bank of England, 2017

The Bank of England has also issued a consultation paper (October 2017) on its approach to the setting of internal MREL for the material subsidiaries (representing at least 5 percent of a group's risk-weighted assets, operating income or leverage exposures) of major UK-headquartered banking groups and major UK subsidiaries of overseas banking groups. The Bank proposes that:

- Internal MREL eligible liabilities will need to meet the same criteria as apply to external MREL;
- In deciding where to set the internal MREL requirement within the 75-90 percent range, the Bank will take into account the credibility of the resolution plan, the availability of other resources in the group that could be readily deployed to support the material subsidiary, and the scaling of internal loss-absorbing resources applied by overseas authorities to material subsidiaries located in their jurisdiction;
- Where a ring-fenced retail bank is part of a material sub-group, internal MREL for the top entity of the material sub-group will be set at 90 percent as a starting point, unless the Bank is satisfied that the wider group has sufficient readily-deployable resources to justify moving to a lower calibration in the range; and
- Internal MREL requirements will apply from 1 January 2019 for material subsidiaries of G-SIBs, and from 1 January 2020 for other firms.

The Bank is also intending to publish summaries of major UK firms' resolution plans and the Bank's assessment of their effectiveness. The Bank believes that greater transparency over the progress being made towards removing barriers to resolvability will incentivise firms to prioritise those actions.

Sweden

The Swedish resolution authority (Riksgalden) has set MREL requirements for the major banks based on a loss absorption amount and a recapitalisation amount both equal to a bank's total capital requirements (excluding the combined buffer requirement and the Pillar 2 systemic risk component), plus a market confidence amount equal to at least the combined buffer requirement.

For the largest banks in Sweden (with a Pillar 1 capital requirement of 8 percent, Pillar 2 of 2.5 – 5 percent, and combined buffer requirements of around 6.5 percent) this equates to an MREL requirement in the region of 30 percent. These requirements are being phased in by 2022.

Denmark

Pending a transition to an EU-wide MREL requirement, major banks in Denmark will be subject to a requirement to hold total MREL of twice minimum capital requirements (where the minimum requirements include combined buffer requirements).

Switzerland

The Swiss G-SIBs will be subject (by the end of 2019) to a TLAC requirement (including all buffers, except the counter cyclical capital buffer) of 28.6 percent of risk-weighted assets and 10 percent of the leverage ratio exposure measure, with at least half of each ratio in the form of bail-inable subordinated instruments. A reduction of up to 2 percentage points could be allowed depending on improvements to the resolvability of these G-SIBs, provided the resulting requirement remains above the FSB minimum TLAC requirements.

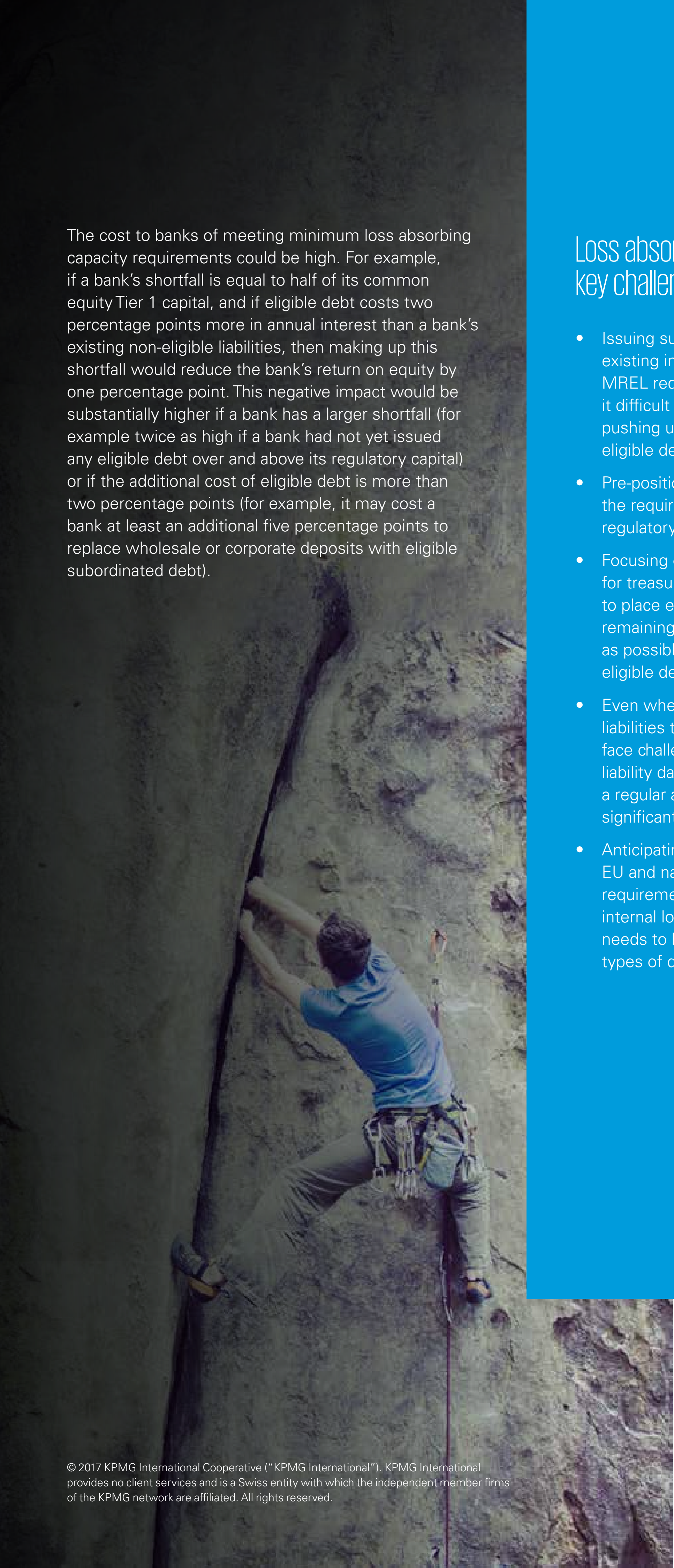
Shortfalls and costs

The Basel Committee Basel 3 monitoring exercise now includes a report on the progress made (through new issuance and the conversion of debt into TLAC-eligible debt) by G-SIBs in meeting the FSB's TLAC requirements. As at end-December 2016, five of the 25 G-SIBs in the monitoring sample would fail to meet the minimum TLAC requirements that will apply from 2019, with a combined shortfall of €20 billion (and a largest individual shortfall equivalent to 2 percent of the bank's RWAs). This is sharply down from the position at end-June 2016, when nine G-SIBs had a combined shortfall of €131 billion. 12 G-SIBs would not meet the higher requirements that will apply from 2022, with a combined shortfall of €116 billion (and a largest individual shortfall of 4.5 percent of RWAs). This is again a sharp reduction from end-June 2016, when 18 G-SIBs had a combined shortfall of €318 billion.

EBA data for end-December 2015 show a shortfall of between €221 billion and €298 billion across a sample of 133 EU banks against the SRB's informative MREL requirements (including MREL of at least 8 percent of total liabilities). This shortfall is equivalent to around 5 to 5.5 percent of these banks' total risk weighted assets. 65 of the 133 banks (and nine out of twelve EU G-SIBs) would not meet the informative MREL target if the most severe assumptions are applied.

It is clear from these monitoring exercises and from bank-specific calculations published by market analysts that:

- Shortfalls against minimum loss absorbing requirements are very unevenly distributed across banks;
- Some banks have made considerable progress in issuing eligible debt or converting existing debt into eligible form, but other banks are finding this difficult to achieve; and
- The Basel Committee and EBA data do not reflect the higher minimum requirements set by some national resolution authorities – these higher requirements would result in larger shortfalls.



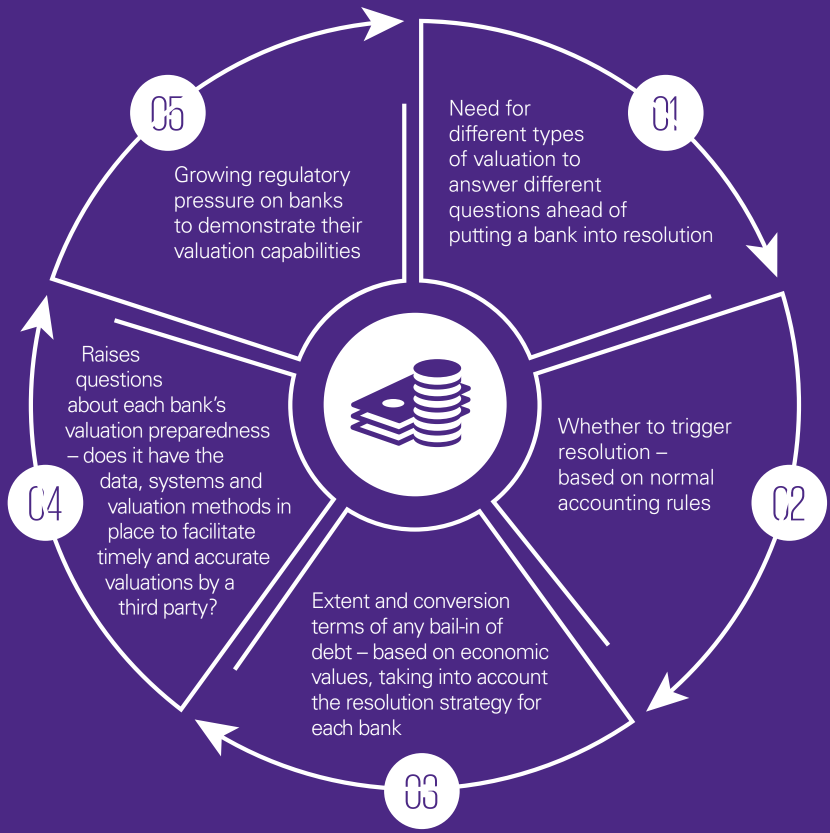
The cost to banks of meeting minimum loss absorbing capacity requirements could be high. For example, if a bank's shortfall is equal to half of its common equity Tier 1 capital, and if eligible debt costs two percentage points more in annual interest than a bank's existing non-eligible liabilities, then making up this shortfall would reduce the bank's return on equity by one percentage point. This negative impact would be substantially higher if a bank has a larger shortfall (for example twice as high if a bank had not yet issued any eligible debt over and above its regulatory capital) or if the additional cost of eligible debt is more than two percentage points (for example, it may cost a bank at least an additional five percentage points to replace wholesale or corporate deposits with eligible subordinated debt).

Loss absorbing capacity: key challenges for banks

- Issuing sufficient eligible debt (or converting existing ineligible debt) to meet external TLAC/MREL requirements. Some banks may find it difficult and expensive to attract investors, pushing up significantly the cost of servicing eligible debt.
- Pre-positioning 'internal' MREL/TLAC to meet the requirements of both home and host regulatory authorities.
- Focusing on the implications of these challenges for treasury management, and for the need to place even more emphasis on reducing remaining controllable costs to offset as far as possible the higher costs of servicing eligible debt.
- Even where banks have sufficient MREL liabilities to meet their MREL target, they may face challenges in providing sufficiently detailed liability data to their resolution authority, on both a regular and ad hoc basis. This may require significant investment in IT and data architecture.
- Anticipating and responding to the various EU and national authority level regulatory requirements on the amounts of external and internal loss absorbing capacity that each bank needs to hold, and on the eligibility of different types of debt instrument.

06

Valuation



Resolution raises a number of key considerations relating to valuation. A decision needs to be taken on whether to put a bank into resolution. If a bank is put into resolution then decisions need to be taken on the choice of resolution tools and the extent and conversion terms of any bail-in of liabilities (both to absorb existing losses and to recapitalise the failing bank to guard against future losses). And if the bail-in tool is used then a (later) determination will be required of whether any creditors would have been better off had the bank gone into insolvency.

The European Banking Authority (EBA) has issued Regulatory Technical Standards on valuations in the context of resolution. The standards clarify the basis for three different types of valuation:

Valuation 1:

To determine whether the conditions for triggering resolution are met.

The EBA standards make clear that this type of valuation should follow normal accounting and prudential rules relevant to an assessment of whether a bank meets the conditions for continuing authorisation (so the rules applying to the preparation of financial statements and the calculation of regulatory capital ratios). No account should be taken of any actions that the resolution authority might take if the bank is put into resolution.

Valuation 2:

To inform the choice of resolution tools, including the extent of any bail-in of liabilities, and to determine (where relevant) the rate at which non-equity liabilities should be converted into new equity.

This valuation may depart from accounting and prudential rules, because potential losses should be assessed using economic values (the present value of future cash flows), in particular where the resolution strategy is based on the sale of businesses or assets within a defined disposal period. In addition, this valuation should be based on prudent and realistic assumptions, in an attempt to avoid situations where the eventual losses are not covered by the initial bail-in amount. This may result in the inclusion of a conservative buffer to reflect probable losses that the valuer has not been able to estimate with sufficient accuracy as part of a provisional valuation.

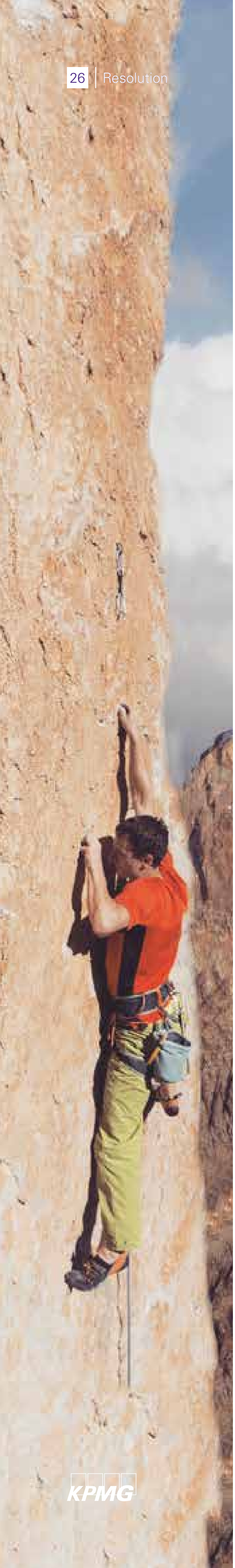
In some cases Valuation 2 may be conducted on a preliminary basis ahead of a bank being put into resolution, but then repeated and finalised at some point after resolution. This will depend on the degree of uncertainty ahead of resolution and the extent to which there is scope to finalise bail-in amounts and conversion rates after resolution.

Several authorities have highlighted impediments to resolvability arising from firms' limited valuation capabilities. Some G-SIBs have implemented changes to management information systems to improve month-end accounting processes, but questions remain regarding the ability of banks to replicate month-end processes for a resolution and the capacity of management information systems to incorporate resolution specific valuation assumptions. The Bank of England has referred to this as a lack of 'valuation preparedness' on the part of banks, and has issued a consultation paper on valuation capabilities to support resolvability in August 2017.

Valuation 3:

To determine whether any creditor should be compensated under the 'no creditor worse off than under liquidation' principle.

This valuation should be undertaken on a gone concern basis, estimating the discounted value of cash flows that could reasonably have been expected to arise under the relevant national insolvency procedures for banks. This counterfactual outcome then needs to be compared with the treatment of creditors and shareholders in resolution.



Bank of England proposals on valuation preparedness

The Bank of England's August 2017 consultation paper follows the Bank's long-standing concern that systemically important banks ('banks') may not have the data, systems and processes in place to enable them to be valued by a third party valuer in a timely and robust manner to determine both (a) whether the bank should be put into resolution because it has failed or is likely to fail, and (b) the choice of resolution tools – in particular the use of the bail-in tool to absorb losses and recapitalise the bank.

Timely and robust independent valuations will be a key input into the Bank's decisions on the application of resolution tools. However, such valuations will depend on banks themselves having sufficient valuation capabilities in place prior to resolution. Shortfalls in these capabilities would constitute an impediment to the resolvability of a bank, in response to which the Bank of England could require a bank to address these shortfalls directly or require a bank to hold additional loss absorbing capacity (MREL).

The proposed policy would apply to banks (major UK banks, their material overseas subsidiaries, and material subsidiaries of foreign banks) subject to resolution strategy and MREL (loss absorbing capacity) requirements. These banks would be expected to establish, maintain and demonstrate valuation capabilities that meet seven principles:

1. **Data and information: Banks should ensure that the underlying data and information are complete and accurate, and that relevant data and information would be readily available to a valuer.**

Banks should collect and hold all relevant data and information that would be reasonably considered necessary to enable timely and robust resolution valuations, including:

- unconsolidated balance sheets for all active entities within the UK resolution group
- loan-by-loan data tapes for loan portfolios
- supporting information for material assumptions that will need to be made for the valuation analysis of loan portfolios, including historical payment data, forbearance, and other management information
- internal credit reviews (notably for more heterogeneous loan exposures)
- granular data on trading positions and liquidity management, including investment securities, repo transactions and derivatives
- information on:
  - netting and set-off arrangements
  - collateral
  - intra-group assets, liabilities, and guarantees
  - the carrying value of non-financial assets and liabilities
  - contingent liabilities and assets
  - creditor hierarchies and asset encumbrance
  - special purpose vehicles
  - forecasted financial information, including profit and loss, balance sheets, and management information supporting the strategic plan
  - management budgets and forecasts, leases, service contracts, and staff costs.

These data and information need to be complete, accurate and reliable, and to be supported by robust processes and controls and regular verification, including reconciliation and testing. All relevant data and information should be capable of being made readily available to an independent valuer, for example through a virtual data room.

2. **Valuation models: As necessary to meet the timeliness objective, banks should have valuation models in place that are available to be tested and used by a valuer.**
3. **Valuation methodologies: Valuation models should use methodologies that are consistent with the methodologies a valuer could reasonably be expected to apply in producing valuations that meet the robustness objective.**

Banks' valuation models should use methodologies that produce valuations of assets, liabilities, instruments or business units based on expected realisable cash-flows reflecting their nature and intended treatment or uses in resolution; at a level of granularity that ensures the valuations meet the robustness objective; and that comply with relevant requirements under the applicable resolution regime and resolution strategy of the bank in question.

4. Valuation assumptions: Banks should have models and processes that use realistic valuation assumptions, and that enable a valuer to review, revise, and demonstrate sensitivity to these assumptions if necessary.
5. Governance: Banks should apply sound governance arrangements and processes to ensure that valuation capabilities are maintained in business-as-usual and available prior to and during resolution.

Banks should have clear and documented procedures in place to ensure that valuation capabilities are compliant with these principles, including clear decision-making protocols, oversight arrangements, and internal review functions. To the extent possible, this should be incorporated into existing governance arrangements for other aspects of firms' data and modelling capabilities.

Banks should identify a relevant individual to be responsible for reviewing and monitoring compliance with these principles and ensuring steps are taken to remedy any shortcomings.

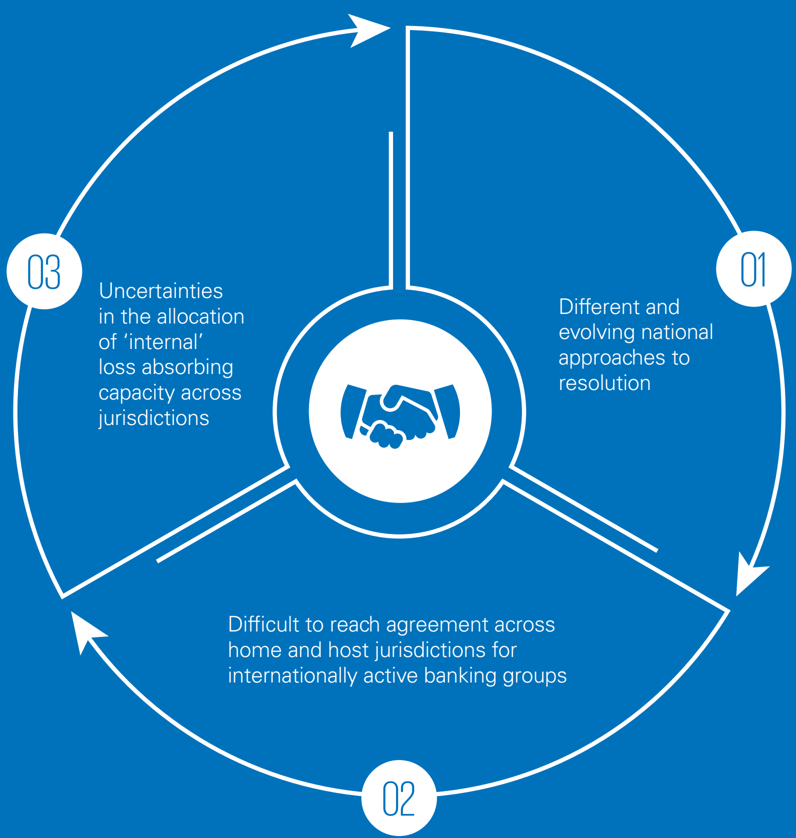
6. Transparency: Banks should document, and be open with the Bank and the valuer about, their valuations capabilities and any associated limitations.
7. Assurance: Banks should periodically review and evaluate their valuations capabilities with regard to these principles, and should facilitate reviews undertaken by the bank or a third party to test compliance.

Valuation: key challenges for banks

- Meeting the data, documentation, modelling methods and assumptions, governance, transparency and assurance requirements being developed by resolution authorities.
- Creating an effective, efficient and joined-up valuations centre of excellence to drive business as usual valuations and recovery option valuations, and to facilitate the valuations required in resolution.
- Some updating of systems, financial reporting processes and greater transparency of key management assumptions may be required to facilitate valuations under both hold and sale scenarios, and to allow a switch in assumptions between these two scenarios.
- Banks may need to hold more robust data on cash flows to support third party economic valuations of banking book assets for the purpose of using resolution tools.
- Planning for the solvent winding down of a trading book and adjusting the fair value of marketable assets should go a long way towards addressing trading book valuation requirements for the use of resolution tools, but the challenge of moving from an accruals to a cash flow basis may require access to documents and data that are not currently captured adequately in banks' systems.
- Using enhanced cash flow data, documentation and valuation capability to support due diligence on potential asset disposals or liability management exercises, to add credibility to recovery options, and to shorten the lead times and reduce the costs of asset disposals within recovery and resolution.

07

Cross-border resolution



KPMG

Cross-border resolution may be the greatest remaining challenge of the post-crisis reform agenda.

Part of the problem here is the difficulty in reaching agreement across jurisdictions on a resolution plan that is credible both for a cross-border banking group as a whole and for each of its subsidiaries across various jurisdictions. Host jurisdiction resolution authorities may have concerns here about the extent of information-sharing by the home jurisdiction resolution authority; there may be inconsistent powers and different approaches to resolution planning across jurisdictions; and there may be a lack of mutual trust among the relevant resolution authorities.

The other part of the problem here is that when a cross-border bank is failing each resolution authority may act independently to preserve host country financial stability and to preserve local creditor interests – the post-crisis regulatory reforms may not have fully addressed the 'global in life, but national in death' issue. National interests are always likely to emerge in practice, whatever is agreed in advance.

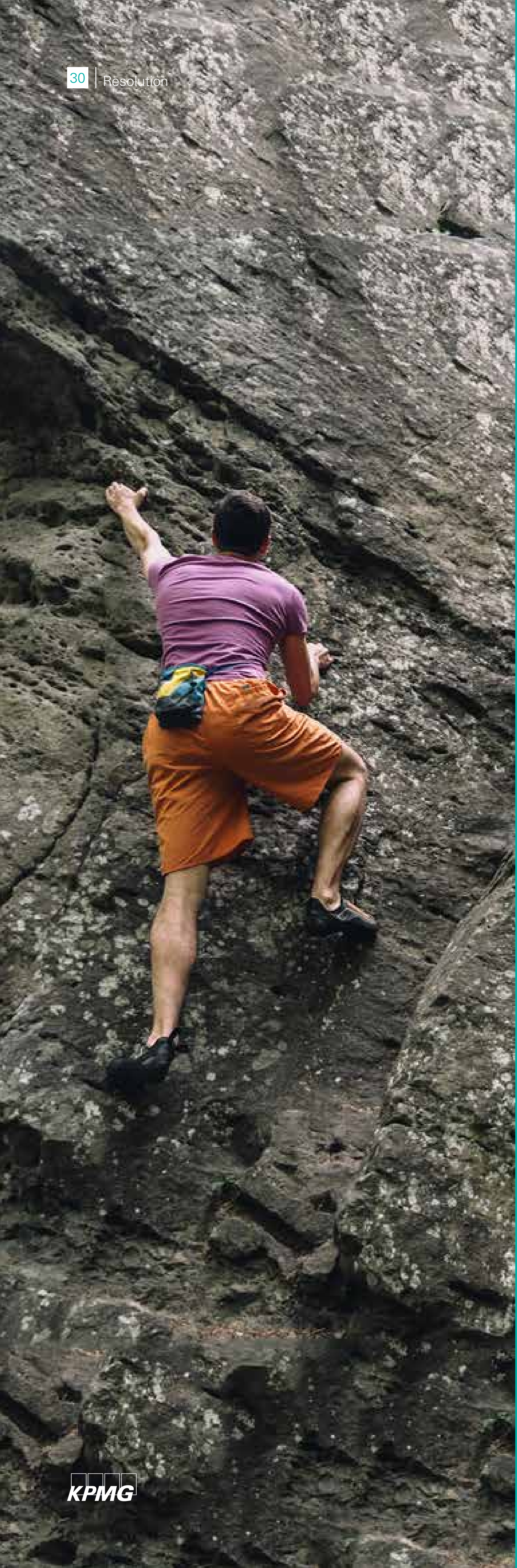
> "The post-crisis regulatory reforms may not have fully addressed the 'global in life, but national in death' issue."

Apart from the establishment of crisis management groups, the main tool to address these cross-border concerns is the requirement on subsidiaries to hold loss absorbing capacity locally, either through raising external debt or equity, or through the down-streaming of debt or equity from a parent or group holding company. This is intended to provide host resolution authorities with confidence that there is sufficient loss-absorbing and recapitalisation capacity available to subsidiaries in their jurisdictions with legal certainty at the point of entry into resolution. The proposal from the European Commission that major foreign banks operating in the EU should operate through an intermediate parent undertaking provides one mechanism for this.

The FSB issued guidance in July 2017 to assist with the setting of internal TLAC requirements by host resolution authorities. This covered the respective roles of home and host resolution authorities in:

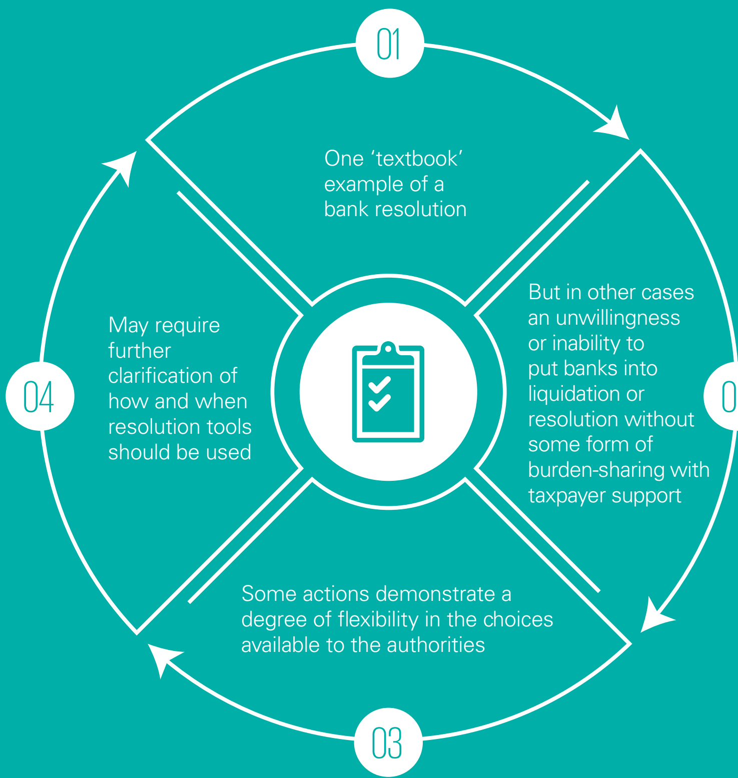
- Identifying material sub-groups and the distribution of internal TLAC among those entities;
- Determining the composition of internal TLAC and the scaling of the internal TLAC requirement within the 75 percent – 90 percent range consistent with the TLAC term sheet in a manner that supports the preferred resolution strategy;
- Determining the issuance strategy for TLAC (which could be issued directly to the resolution entity or indirectly through multiple legal entities);
- Considering the availability of non-prepositioned TLAC to cover the risks on the resolution entity's own balance sheet and to recapitalise any direct or indirect subsidiary of the resolution entity; and
- Determining the triggers for internal TLAC and the process under which a write-down and/or conversion into equity would be undertaken.

07



08

Resolution in practice



The implementation of the BRRD and the SRMR and subsequent EBA guidelines and Commission delegated regulations were intended to clarify how the authorities should deal with failing banks in Europe.

The use of resolution tools was intended to enable the critical economic functions of a failing systemically important bank to continue to be provided, without taxpayer support, while losses were absorbed and the failing bank was recapitalised and/or restructured. Smaller failing banks should be put into liquidation, with retail and SME depositors protected through deposit guarantee schemes.

Three recent cases illustrate that while the BRRD resolution tools can be used quickly and effectively in some circumstances, there is also flexibility to take different approaches.

Banco Popular Espanol, the sixth largest banking group in Spain, was the first resolution action taken (on 7 June 2017) by the Single Resolution Board (SRB):

> “Smaller failing banks should be put into liquidation, with retail and SME depositors protected through deposit guarantee schemes.”

- The European Central Bank (ECB) concluded that Banco Popular was failing or likely to fail, in particular because of the rapid deterioration in its liquidity;
- The SRB decided that there was no reasonable prospect that a private sale of Banco Popular could be completed in sufficient time (and any recovery plans Banco Popular had in place had not succeeded in restoring the bank's health); and
- The SRB concluded that resolution action was in the public interest (rather than putting Banco Popular into insolvency proceedings) to ensure the continuity of critical functions (deposit taking, lending to SMEs and payment and cash services) and to preserve financial stability.

The SRB used the bail-in and the sale of business resolution tools in order to (i) write off the bank's equity and additional Tier 1 capital instruments; (ii) convert the bank's Tier 2 subordinated debt into new equity; and (iii) sell Banco Popular in its entirety to Banco Santander for the price of €1. Banco Santander then recapitalised Banco Popular by injecting around €7 billion of capital.

This was a relatively straightforward resolution. There was no need to bail-in any creditors beyond those holding regulatory capital; for the authorities to restructure the bank (for example by selling "bad" assets to an asset management company); to establish a bridge bank; or for taxpayer support. In effect, resolution was used to wipe out the claims of the holders of equity and subordinated bonds (thereby absorbing the losses) in order to create an entity that was attractive for purchase by a larger bank at a nominal price.

Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A. were put into a government-assisted liquidation (over the weekend on 24-25 June 2017):

- The ECB concluded that these two banks were failing or likely to fail;
- The SRB concluded that there were no alternative supervisory or private sector measures that could prevent the failure of the banks; and
- The SRB also concluded that for these two banks, resolution action would not be in the public interest, in particular because neither of these banks provided critical functions, and their failure was not expected to have a significant adverse impact on financial stability.

These two banks were therefore put into liquidation, to be wound up under national (Italian) insolvency proceedings. But the Italian government also argued that there was a regional economic risk from the failure of two important lenders in the Veneto region. The European Commission agreed that State Aid could be provided because there would not be a distortion to competition and the two banks would be restructured through a closure of some branches and a reduction in staff numbers. The Italian government then provided €4.8 billion to Intesa Sanpaolo, to enable Intesa Sanpaolo to purchase the "good" assets of the two banks for a token price of €1 while maintaining its capital ratios, and provided an additional €12 billion in government guarantees to support the "bad" assets of the two banks, which will be held separately.

The Italian government noted that it was difficult to force losses on bond holders in the two failing banks, because some of the bonds were held by retail investors. In addition, €10 billion of senior bonds issued by the two banks had earlier been guaranteed by the Italian government, with the agreement of the European Commission, at a time when the two banks had been deemed to be solvent.

Although public funds can be provided under the EU's State Aid rules, this case demonstrates the peculiarity of the SRB and the Italian government reaching different judgements about whether the failing banks posed a risk to financial stability. It also demonstrates the constraints imposed on the authorities where banks have not pre-positioned themselves with sufficient bail-inable debt that could be used within a resolution to absorb losses and to recapitalise a failing bank, without the need for taxpayer funding.

Monte dei Paschi di Siena, the fourth largest Italian bank, is being dealt with through a different route:

- The ECB has confirmed that the bank is solvent and meets its capital requirements.
- However, the bank is required to raise new capital due to the outcome of a scenario-based stress test that is set to maintain financial stability in the context of a systemic crisis.
- The bank's shareholders and junior creditors have contributed €4.3 billion to absorb losses and partially recapitalise the bank, thereby limiting the use of taxpayer money, but the bank was unable to raise fresh external capital.
- Eligible retail bond-holders can seek compensation (of up to €1.5 billion) from the bank for having been mis-sold junior bonds.
- As allowed for under the BRRD in these circumstances, the Italian government will inject €5.4 billion of capital into the bank to complete a 'precautionary recapitalisation' of the bank.
- To comply with EU State Aid rules the bank will sell its non-performing loans (of more than €26 billion) to a privately funded special purpose vehicle (although with a State Aid approved government guarantee on market terms for the senior tranche of the securitised loans); undertake other major restructuring measures (a reorientation of its business model towards retail customers and small and medium-sized businesses, branch closures and staff reductions, and improved credit risk management); impose a salary cap on senior management; and limit its advertising and commercial practices.

Bank	**BRRD resolution tools**				**BRRD alternative**	**Liquidation**	**Taxpayer support**
	Bail-in	Sale of assets	Bridge bank	Asset management company	Precautionary recapitalisation		
Banco Popular Espanol	Yes	Yes – sale of entire bank	No	No	No	No	No
Banca Popolare di Vicenza and Veneto Banca	No	Yes – but out of liquidation, not resolution	No	Yes – but out of liquidation, not resolution	No	Yes	Yes
Monte dei Paschi di Siena	No	Yes – but as a condition for State Aid, not resolution	No	No	Yes	No	Yes

09 How KPMG member firms can help

1. Strategic advice

- Acting as a strategic partner for the recovery and resolution journey, helping banks to bring together the various related elements of recovery and resolution planning – recovery planning, resolution strategy, operational continuity, loss absorbing capacity, valuation, and resolution assessment.
- Challenging banks' thinking around proposed solutions – review and challenge of key inputs, assumptions and outputs.
- Assessing the impact of these elements on banks' commercial viability, and exploring ways of maintaining and enhancing this viability.
- Integrating these elements into banks' governance, risk appetite and risk tolerance, management, internal controls and reporting procedures and processes.
- Bringing together experienced consultants who are familiar with the commercial drivers in banking and the regulatory requirements associated with resolution planning and experienced restructuring professionals who can help to design and implement solutions that remove impediments to resolvability.

2. Operational continuity

- Identifying and benchmarking critical functions and critical services through performing operational due diligence.
- Developing standalone target operating models consistent with regulatory operational continuity requirements.
- Implementing changes to legal entity and operating structures (including the ring-fencing of retail banks in the UK).
- Helping firms to run fire drills to test the extent to which they have delivered operational continuity outcomes around facilitating recovery options and resolution strategy, financial and operational resilience, identifying any gaps, and establishing a remediation plan.
- Resolution-proofing critical services and helping banks to demonstrate the required outcomes to their resolution authority.
- Maximising the commercial benefits of steps taken to enhance financial and operational resilience.

3. Loss absorbing capacity

- Helping banks to issue MREL-eligible securities, including senior non-preferred debt, using a private placement approach.

4. Valuation

- Providing advice on, and quality assurance of, banks' valuation preparedness.
- Acting as a valuer of financial institutions facing difficulties.

5. Reporting

- Preparing information and data for a bank to send to its resolution authority so that the authority can develop a resolvability assessment and resolution plan for that bank.
- Taking a structured approach to collecting and analysing information about the bank, quality assurance over this information, and identifying gaps against the target state of a comprehensive and credible resolution plan.
- For banks regulated by the SRB, this includes the enhancement of their IT architecture and the definition of processes to enable automated Liability Data Reporting (regularly and ad hoc).
- MREL and other Pillar 3 disclosures.

6. Responding to regulators

- Helping banks to respond to issues raised by their resolution authority and supervisor in feedback letters and benchmarking reviews.
- Specific examples include the solvent winding down of trading books and connectivity with financial market infrastructures.

> Resolution poses many challenges for banks. When designing a commercial banking model with operating structures that are capable of facilitating recovery and resolution, it is essential for banks to understand clearly how to navigate the regulatory requirements and what to focus on to meet each of these specific challenges.

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