HELMUT ETTL
Executive Director,
Austrian Financial Market Authority

Winding down smaller and mid-sized banks – A possible way forward

Since the establishment of the new crisis management and resolution framework in 2015, the number banks declared failing or likely to fail has been limited. The number of resolved banks according to the new framework is even lower. One possible reason is that for a certain type of banks the resolution framework is not (fully) suitable. But exiting the market through ordinary insolvency proceeding seems to be not suitable either due to the potential negative impact on financial market stability – leaving the supervisory authority in kind of a limbo situation to forbear the ultimate supervisory measure, declaring a bank failing or likely to fail.

Moreover, the resolution regime as such was developed to counteract the "too big to fail" hypothesis. Thus, it was created for the big, systemic banks. Therefore, it might be not proportional and too intrusive for smaller banks.

For this and various other reasons, it is a consensus that there is the need for a further improvement of the crisis management and resolution framework for these so-called small and mid-sized banks – banks that are too small for resolution, but potentially too big for ordinary insolvency. For sure EDIS combined with an "EDIC" would be the solution for such problem. Unfortunately, this seems to be a rather long-term solution. Steps in between are necessary.

There are various possible ways forward, all of them with positive aspects and drawbacks. All of them are circling mostly around one crucial element – funding of winding the failing bank down. Let me try to outline one of these options: One could argue that only the systemic banks should be eligible for resolution. For smaller banks, it should be either ordinary insolvency including triggering the DGS or an alternative administrative wind down procedure, which could be developed alongside the following principles:

Losses have to borne by shareholders and holders of regulatory capital (AT1 and T2) first. The failing bank must exit the market. Only relevant parts of the bank should be safeguarded (e.g. covered deposits) by transferring them to other market participants. There might be the need for external financing (capital and liquidity) to support the transfer-mechanism. As covered deposits are concerned, DGS could step in and support. A strict least-cost-principle-test should be a pre-condition. Internal preparation of banks for the implementation of such a transfer-tool will be necessary. Such preparation could include a certain financial cushion for supporting the transfer (reserved assets) or bearing losses (additional gone-concern instruments beyond regulatory capital requirement).

As mentioned above – this is only one possible way forward. There are several others. But we should always bear in mind: losses will not vanish – they have to be borne by someone and they have to be allocated in the process of winding down a failing bank. We should strive for the most efficient way and aim for using as less public and mutualized financial means as possible.