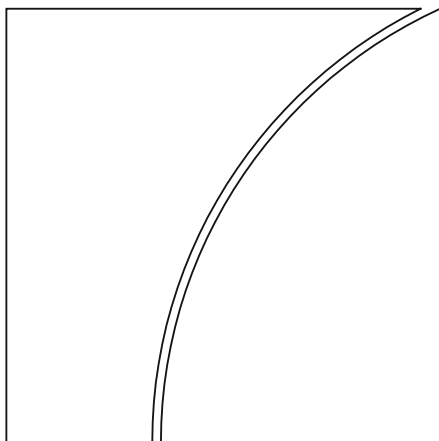




# Financial Stability Institute

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### Bank transfers in resolution – practices and lessons

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# Bank transfers in resolution – practices and lessons<sup>1</sup>

## Executive summary

**Transfer transactions can be a useful tool in the resolution of failed banks.** Under such strategies, a healthy third party, typically itself a bank, takes over the entirety or parts of a failing bank's portfolio, or the entire legal entity of the failing bank. The adoption of bank transfers as a resolution tool can offer a number of advantages in comparison with other strategies. For instance, in contrast to a bank liquidation and depositor payout, transfer transactions can preserve important economic functions of a failed bank, including the provision of credit; they can limit the role of public authorities in managing the assets of failed banks; and they can avoid a lengthy and costly liquidation process for transferred assets. In addition, if uninsured deposits are included in the transfer, a transfer may reduce the risk of bank runs and contagion, as well as preserving access to those deposits. Separately, a transfer may require a lower level of loss-absorbing capacity at the failing bank compared with that required for a resolution based on an open bank bail-in. This aspect may make transfers a particularly relevant tool for resolving mid-sized banks, which may not be able to issue the larger amounts of loss-absorbing liabilities needed to support a bail-in strategy. Finally, a transfer may be combined with other resolution tools, such as a bail-in of selected bank creditors and, on a temporary basis, a bridge bank.

**The use of transfer strategies in resolution is not widespread, but there is increasing interest in it.** While a majority of jurisdictions' resolution frameworks include transfer tools, transfer strategies are not, at a global level, the most common way of resolving failing banks, although there are some jurisdictions in which transfers are routinely employed. Bank transfers were employed in the recent episodes of bank failures and distress in March 2023, in the United States and Switzerland for resolution of mid-sized banks and the state-sponsored acquisition of a global systemically important bank, respectively. There may therefore be interest in making this tool better understood and more easily accessible for resolution authorities.

**This paper discusses the practical aspects of failed-bank transfers and highlights the key trade-offs.** It draws on considerations identified by selected authorities whose resolution frameworks include bank transfers, and their practical experiences with these transactions. By breaking down this resolution strategy into its main components, the paper highlights key decision points that resolution authorities need to consider when adopting this strategy and aims to improve understanding of existing trade-offs and how authorities may address them.

**Transfer strategies require authorities to consider a number of factors at the same time.** Authorities need to select potential acquirers by considering the readiness and suitability of a third party to take over the failing bank's business. This presupposes the availability of sufficient funding to support the transaction given the asset-liability mismatch that is typical of a failing bank. Funding needs, in turn, are largely influenced by the extent to which the gap between assets and liabilities can be reduced by the failing bank's internal resources, such as its equity or junior debt. Key to the successful implementation of a transfer strategy is the ability of authorities to reconcile each of these elements.

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**As funding is one of the major constraints on the feasibility of a bank transfer, authorities have levers available to reduce “funding gaps” between the value of assets and liabilities transferred.** Authorities can minimise needs for additional funding by exhausting the failing bank’s internal resources to absorb losses. Liabilities that are not included in the transfer can absorb losses as they tend to remain at the failing bank, which is subject to liquidation. Concerning deposits, a main decision point is whether to include both insured and uninsured deposits in the transfer. Authorities need to consider how best to treat “sensitive liabilities”, ie those that, while in theory are capable of being loss absorbing, may be difficult in practice to writedown for social or political reasons, or because a writedown would risk contagion. The inclusion of a material amount of liabilities in the transfer, however, is only possible given either a comparably large level of assets or some flexibility around the level of funding support to the transfer. Accordingly, authorities need to carefully balance tailoring the assets and liabilities included in a transfer – in order to match the preferences of potential acquirers – with meeting the resolution authority’s goals of financial stability. In that regard, funding support by resolution or deposit insurance funds will often be necessary.

**Various measures could facilitate transfers by increasing the amount of external funding available, but the impact of such measures needs to be considered carefully.** A common source of additional funding is the deposit insurance fund, where permitted by the mandate of the deposit insurer. Within the creditor hierarchy, a general depositor preference increases the likelihood of a bank transfer, relative to a preference for insured depositors only, by making funding from the deposit insurance fund more likely to be available. However, unless the asset recoveries are sufficient to repay all depositors, this may imply higher costs to the deposit insurance fund. Shared-loss agreements can reduce the risks to the acquirer, thus increasing the bid price it may be willing to submit, but not without cost to the resolution authority. In rare circumstances, the resolution authority may proceed with a bank transfer under a “systemic risk exception” – which permits the use of deposit insurance funds to complete a transfer even when this transaction is more costly than other resolution measures. Such exceptions are otherwise justified on the grounds of financial instability. However, safeguards are needed to ensure that the resolution authority’s resources are not excessively exposed to the costs of the transaction.

## Section 1 – Introduction

- 1. A bank transfer is a resolution tool in which some or all of a failing bank’s balance sheet is acquired by a healthy third party.** In practice, this transaction involves the market exit of the failing bank after the transfer of some or all of its assets and liabilities to a suitable acquirer.<sup>2</sup> Given differences across legal and regulatory frameworks, the implementation of this concept can vary slightly across jurisdictions, and the term “bank transfer” is employed in this paper in a general sense, without referring to any specific jurisdiction. Its two best known examples are the purchase and assumption (P&A) transaction in the United States<sup>3</sup> and the sale of business tool in the European Union<sup>4</sup>, but it is more widely available. According to the most recent annual survey<sup>5</sup> by the International Association of Deposit Insurers (IADI) of its membership, about 85% of respondents confirm the availability of the transfer tool in their jurisdictions, although fewer than 30% report that this tool has been used for bank resolution in practice (IADI (2023)).
- 2. Banking authorities have become increasingly interested in transfer transactions in the orderly resolution of failed banks.** As documented in recent publications,<sup>6</sup> there is growing interest among authorities and standard-setting bodies in the design and execution of transfer transactions as a means of managing bank failures. Moreover, recent failures of mid-sized institutions<sup>7</sup> and a state-sponsored acquisition of a global systemically important bank<sup>8</sup> (G-SIB) in the past year have raised questions related to bank resolvability and, in particular, the role of transfer strategies in resolution or in managing a bank’s demise. Exploring the feasibility of existing transfer tools in failed-bank resolution can help support the broader goals of crisis preparedness and banking sector stability.
- 3. Failed-bank transfers can be considered an alternative to other resolution strategies such as open bank bail-in or piecemeal liquidation with depositor payout.** In a transfer transaction, certain lending and depositor relationships can be preserved through acquisition by a healthy bank. An open bank bail-in allows the continuation of the operations of the failing bank, after imposing creditor losses – and a

<sup>2</sup> As discussed in Restoy (2023b) and in the section below, the perimeter of the liabilities to be transferred is a sensitive aspect of the design of the transaction. Acquirers are typically other banks, but not exclusively, as discussed later in the paper.

<sup>3</sup> The experience in the United States is frequently taken as a key reference in the literature and in debates about approaches in other jurisdictions. See for instance Gelper and Véron (2020) for a discussion about lessons for the European framework.

<sup>4</sup> In the European Union, there are four resolution tools: the first is the sale of business tool, which is the primary subject of this paper. The second is the bridge institution tool, which may be loosely referred to as a bridge bank in the paper. The third is the asset separation tool, which allows the transfer of assets, rights or liabilities from a failing bank or a bridge bank to an asset management vehicle; this tool is not covered in this paper, given the main thrust of the cross-comparison covered here. The fourth is the bail-in tool, which allows a writedown of debt owed by a bank to creditors or converting it into equity. The bail-in tool may be used to recapitalise a bank under resolution to the extent necessary to restore its viability (open bank bail-in) or in combination with any of the other three resolution tools. In the EU framework, the sale of business tool may be applied individually or in combination with other tools; the asset separation tool must always be applied together with one of the other three resolution tools.

<sup>5</sup> The survey, published in late 2023, reports information as of end-2022. It covers more than 100 country participants.

<sup>6</sup> For instance, the European Banking Authority (EBA) and the EU Single Resolution Board (SRB) reported that they would devote more attention to transfer strategies as part of their work on resolution planning (see Machado (2021), SRB (2021a,b) and EBA (2022)). The Financial Stability Board (FSB) has worked on resolution of non-G-SIBs and published a report on the spring 2023 bank failures, which increases the focus on transfers as a possible tool for safeguarding continuous access to deposits (FSB (2023)). Unidroit is working on a project on bank liquidation which focuses on transfers (Unidroit (2023)). The proposal by the European Commission (EC (2023)) on an enhanced crisis management framework also envisages greater use of transfer strategies.

<sup>7</sup> Resolution of Silicon Valley Bank, Signature Bank and First Republic Bank; FDIC (2023d,e,f). See Box 3.

<sup>8</sup> Resolution of Credit Suisse; FINMA (2023). See Box 2.

possible capital injection – to restore the viability of the bank.<sup>9</sup> In a piecemeal liquidation with deposit payout, insured balances from the failed bank are made available to depositors, while the assets are liquidated and uninsured deposits are settled to the extent that any recoveries can be made.

4. **Failed-bank transfers can contribute to orderly resolution by helping to preserve access to deposits and supporting the provision of credit.** In a transfer transaction, insured (and often uninsured) deposits may be transferred to an acquirer. To the extent that any uninsured deposits are protected in the transfer, this can contribute to stability by reducing the incentive for a run on banks. Furthermore, failed-bank transfers can help preserve franchise value and the ability to lend based on the transferred deposits of a failed bank, as well as better preserve asset values by avoiding a fire sale in liquidation.<sup>10</sup> This helps sustain the availability of credit in the local economy associated with the transferred business. It also preserves the value of existing lending relationships at the failed bank.<sup>11</sup> Separately, the acquisition of all or part of the failing bank by a healthy third party and the associated stabilisation of its value may be more supportive of market confidence than recourse to other resolution options, such as liquidation.

5. **In addition, transfers can reduce the role of public authorities in managing failed banks' assets, keeping those assets in the private sector.** A transfer can help limit the role of authorities in managing the assets of a failed bank by passing a significant portion of those assets to a healthy acquirer. By contrast, in a liquidation, the competent resolution authorities may remain exposed to and engaged with the management, directly or indirectly, via the appointment of a professional liquidator of the failed bank's assets until they can be disposed of. Public authorities may be less efficient in liquidating failed banks' assets than private concerns.<sup>12</sup> Private sector acquirers may have more expertise in managing these kinds of assets and their incentives are more aligned with maximising asset value.

6. **Other resolution strategies may not enjoy the same advantages.** An open bank bail-in can also ensure the continuation of core activities of the failing bank and preserve its relationship with customers and depositors. However, the conditions for carrying out a successful open bank bail-in may be more restrictive. In particular, an open bank bail-in requires a higher loss absorbency in the failing bank as a precondition to restoring its viability. A transfer strategy may be feasible even when loss-absorbing capacity at the failing bank is limited, assuming that the transfer may be partial. When comparing a transfer to a deposit payout and bank liquidation, no losses are imposed on any insured or uninsured deposits that are transferred to the acquirer, while in a payout and liquidation, only the insured deposits are guaranteed in full. Depending on the structure of the creditor hierarchy, uninsured depositors in a bank liquidation may receive only partial reimbursement, or in theory nothing at all, once the failed bank's assets have been liquidated.

7. **Transfer transactions also benefit from a high degree of flexibility.** This may help authorities in responding to specific market conditions in which the operation is to take place. First, authorities can tailor the scope of the transfer to meet potential acquirers' interest in the failing bank. With this, and provided safeguards for the authorities are in place to protect the public purse, the chances of a successful sale of the bank can increase considerably. Second, transfers to private sector purchasers may be combined with other resolution tools,<sup>13</sup> such as bail-in or, as a temporary arrangement, a bridge bank.<sup>14</sup> For instance, a bail-in of subordinated debt can help lower the outstanding liabilities in a transfer, thus

<sup>9</sup> In some jurisdictions, adoption of open bank bail-in as a resolution strategy may be restricted to certain types of banks, particularly systemically important banks. In others, while in theory not limited to G-SIBs, open bank bail-in is unlikely to be feasible for mid-sized banks, given their limited capacity to issue sufficiently large amounts of loss-absorbing liabilities.

<sup>10</sup> See James (1991) and Bennett and Unal (2015) for discussion on franchise value of deposits in failed banks.

<sup>11</sup> See Petersen and Rajan (1994) and Berger and Udell (1995) for discussion on value in bank-borrower relationships.

<sup>12</sup> See James (1991).

<sup>13</sup> They may also be combined with other resolution powers. In the European Union, for instance, together with a sale of business, capital instruments may be written down and converted.

<sup>14</sup> See Gruenberg (2023) and Restoy (2023b).

reducing the amount of funding required to complete the transfer and increasing options for resolution. Additionally, in some jurisdictions, the organisation of a temporary bridge bank may be permitted to facilitate the resolution of a failed bank.<sup>15</sup> Bail-in and bridge banks may thus be used in combination with transfers to a private sector purchaser, helping to increase the feasibility of transfer options in resolution.

8. **Some operational aspects may present challenges for bank transfers.** The success of this approach is conditional on market conditions at the time of failure, and potential acquirers' interest in the failing bank. In times of stress, valuation capabilities and the availability of accurate, comprehensive and readily available data may be more limited. In addition, when only part of the failing bank is transferred, the degree of separability of its activities strongly affects the feasibility of the transaction. Finally, a transfer can work well only when the transferred activities/bank can be successfully integrated into the acquiring bank's activities.

9. **A transfer transaction requires that some key conditions are met, starting with the need to have suitable potential acquirers and processes.** A successful failed-bank transfer requires that authorities identify a willing acquirer that is suitable from a regulatory perspective to assume the business offered in the transaction. This raises additional questions about the attractiveness of the failed bank's business from a commercial perspective, ways to market it and whether the potential acquirer would fulfil supervisory and licensing requirements if it is a new entrant to the relevant market. Resolution authorities must ensure that acquirers are able to make the purchase from a place of strength, as cascading failures after an acquisition could harm market confidence and deepen a crisis. In addition, the overall transfer process must be seen as transparent to markets, subject to justified exceptions to preserve confidentiality, as any impression of biased treatment or improper subsidies has the potential to reduce public confidence in the process.

10. **Funding is another essential condition affecting transfer strategies, and it can present significant challenges for resolution authorities.** Financial support is essential in executing transfers, due to the common shortfall between the value of a failed bank's assets and liabilities to be transferred. Such support may take the form of cash payments to the acquirer or alternative forms, such as shared-loss agreements (SLAs) or guarantees on acquired assets. Yet authorities pursuing transfer transactions face difficult trade-offs, as well as practical challenges relating to how to structure the transaction and in identifying the appropriate level of funding support.

11. **This paper analyses the transfer tool and experiences in a selected group of resolution authorities.** The analysis draws upon the key features of the frameworks in a small sample of jurisdictions that all include bank transfers within their toolkits. The jurisdictions were selected in order to have some geographical variation, as well as to reflect some differences in banking sector organisation. They also include a wide range of experience in managing bank transfers, from practices established but still in their infancy, to those conducting transfers on a routine basis over the past couple of decades. The range of jurisdictions and experiences provide some illustration of possible trade-offs in objectives and outcomes associated with the design of this bank resolution instrument, as well as challenges for jurisdictions that have not yet used this tool extensively. The sample<sup>16</sup> is composed of Colombia, Indonesia, Italy, the United

<sup>15</sup> Authorities may create a temporary bridge bank as a new depository institution from selected assets and liabilities of the failed bank and with new management. Its use is infrequent but may occur in certain cases where conditions do not permit enough time for effective marketing, there are concerns for systemic risk related to the failure or a bridge is believed to be the best option to preserve the franchise value of the failed bank. The bridge bank continues normal bank operations on a temporary basis until a final resolution can occur. For instance, a bridge bank was used as part of the recent resolution of Silicon Valley Bank in the United States; see Box 3 for further details on this resolution and Chapter 6 in FDIC (2017) for a general discussion of bridge bank usage.

<sup>16</sup> In the United States, around two thousand P&As have been conducted since the creation of the FDIC. In the years since the Great Financial Crisis of 2007-09, P&A transactions have accounted for almost 95% of all resolutions of failed banks. In Italy, the Bank of Italy has long-standing experience in the sale of assets and liabilities within the context of its national insolvency proceedings. Under the current legal frameworks, no bank transfers have yet been conducted in Colombia or Indonesia. In the European Union, the SRB has led two resolutions that include bank transfers.



States and the resolution authority in the European Banking Union (BU), ie the Single Resolution Board (SRB).<sup>17</sup> The analysis may help identify common practices and challenges that policymakers and practitioners might face – both in the early design and in the execution of failed-bank transfers.

12. **The remainder of this paper is organised as follows.** Section 2 introduces the building blocks that compose a bank transfer. Section 3 discusses the composition of the transfer. Section 4 describes key features of the transfer process, while Section 5 presents the requirements for eligible bidders. Section 6 covers the funding needs associated with a bank transfer and how they affect the design of the transaction. Section 7 concludes by taking stock of the discussion in the previous sections. On that basis, it draws lessons on features that may facilitate the use of bank transfers as a resolution tool.

## Section 2 – Designing a bank transfer

13. **Operationalising a failed-bank transfer requires consideration of several factors, starting with the assets and liabilities to be transferred.** On the liability side, a main decision point concerns the inclusion in the transfer of both insured and uninsured deposits, or only the former. Authorities will need to respect the creditor hierarchy applicable in their jurisdiction. Beyond that, the type of liabilities to be included in the transfer may reflect whether they are considered “sensitive liabilities”, ie those that are in theory capable of being loss absorbing but may, in practice, be difficult to writedown for social or political reasons, or because a writedown would risk contagion (Restoy (2023b)). The inclusion of a material amount of liabilities in the transfer is, however, only possible against either a comparably large level of assets or the availability of sufficient funding support for the transfer.

14. **Authorities also need to understand the market in which the failed bank will be sold.** Failed banks are sold to an acquirer through a market transaction, typically in an auction held by the resolution authorities. Eligible bidders can submit their bids<sup>18</sup> and winners are selected by authorities in accordance with their jurisdictional mandates. A successful match between market interest in the failing bank and the composition of the transfer requires a good understanding of market conditions by the authority in charge of the sale. This understanding allows authorities to define a combination of the assets and liabilities to be included in the transfer and other potential features, such as guarantees, that may foster interest in the transaction while also satisfying statutory objectives. Understanding market conditions requires both good monitoring of prospective demand, and early preparation and marketing for a possible sale, as discussed below. Authorities also need to define the pool of eligible bidders, considering possible trade-offs between the benefits of a larger pool (eg higher sale price or faster sale) and possible related risks (eg limited suitability of new entrants in the market).

15. **Finally, authorities need to consider the level of funding that may be required to complete the transaction.** As explained below, the latter can be enhanced either by increasing the level of internal funding through bail-in, or with external funding, for instance from the deposit insurance fund or the

<sup>17</sup> In the European Union, the SRB is the competent resolution authority for “significant institutions”, ie those that are subject to consolidated supervision by the European Central Bank (ECB). Of the other banks, ie “less significant”, those that are established in more than one member state in the banking union, also fall within the remit of the SRB. This implies that resolution planning and decision-making for those banks is centralised at the European level under the Single Resolution Mechanism (SRM), which comprises the SRB and the national resolution authorities in each member state. In addition, a bank failure may be managed by the SRB also for other European banks, whenever a public interest assessment concludes that a resolution action is necessary in the public interest. In all other cases, national resolution authorities are in charge of managing a failing bank within their jurisdiction. Insolvency frameworks in the European Union are not harmonised across member states and insolvency proceedings are managed at the national level ie without the involvement of the SRB. For details see Restoy et al (2020).

<sup>18</sup> Some jurisdictions may require bidders to submit their bids as a single price for a pre-determined quantity of assets and liabilities. Others allow bidding along multiple dimensions of the transfer, such as a discount on assets, a premium on deposits, the selection of assets and liabilities to be included or other transaction features.

resolution fund. This type of funding may be helpful to make the transaction more feasible for potential acquirers.

16. **While conceptually separate, all of the above elements need to be considered simultaneously.** When designing a transfer transaction, authorities need to recognise that all steps are closely interconnected. For instance, authorities may respond to market interest by expanding the scope of the transfer to a sufficiently large amount of assets to match the inclusion of the desired liabilities. Funding support by the resolution authority may also help to complete the transaction.

17. **The remaining sections discuss the design of the elements of a bank transfer in sequence and in light of discussions with the selected jurisdictions.** Differences across jurisdictions shape the way in which the above elements are combined. The experience of the selected jurisdictions, which have either conducted bank transfers or have at least considered how to conduct them as part of their resolution toolkit, helps to shed light on possible trade-offs in the implementation of this resolution tool.

### Section 3 – Composition of a bank transfer

18. **Some key parameters shape the composition of a failed bank's portfolio for transfer.** In particular, the selection of items for transfer may be driven by jurisdictional mandates or constraints to which the authorities are required to adhere in implementing their resolution strategies, as well as legal considerations.

#### Legal structure of transfer transactions

19. **Transfer transactions are typically structured as asset deals.** In these cases, which constitute the majority of usage in the sample under analysis, the assets (eg loans, mortgages and securities) of the failing bank are transferred, in full or in part, together with (some or all of) its liabilities (eg insured and uninsured deposits).

20. **Another form is so-called share deals.** In these cases, the shares representing the ownership interest in the failing bank as a legal entity are transferred to the acquirer, rather than the individual assets and liabilities. Typically, shares are transferred for a purchase price that is symbolic (eg EUR 1) or even negative (with the acquirer receiving, rather than paying, a price). This pricing reflects the reduced (or negative) value that the shares have as a consequence of the bank's failure, and ensures that such reduction in value is allocated to the failed bank's previous shareholders, in line with the principle that losses should first be borne by shareholders. By acquiring title to the shares in a failed bank for a symbolic or negative purchase price, the acquirer, in its capacity as new shareholder, is in a position to recapitalise the bank, for example by injecting its own funds or funds received as a negative purchase price, as needed. The resolutions of Banco Popular in 2017 and Credit Suisse<sup>19</sup> in 2023 are examples of share deals at symbolic or reduced purchase prices (see Boxes 1 and 2).

<sup>19</sup> The merger transaction between Credit Suisse and UBS is not, legally speaking, a share deal, even if the outcomes are functionally similar. See Box 2 for details.

## The resolution of Banco Popular Español

Until its failure in 2017, Banco Popular Español SA (BPE) was the sixth largest Spanish bank. It had been experiencing difficulties for several years and suffered significant outflows in early 2017 (EC (2017)).

In early June 2017, following the assessment of the European Central Bank (ECB) that BPE was failing or likely to fail owing to liquidity pressure, the SRB and the Spanish National Resolution Authority (FROB) decided that it was in the public interest to sell the business of BPE to the Spanish global systemically important bank, Banco Santander SA of Spain (Santander) (SRB (2017b)). The positive assessment reflected the view that the sale would protect all depositors of Banco Popular and preserve financial stability. The resolution scheme entered into force on the same day, following its endorsement by the European Commission.

On the day following the SRB's decision (SRB (2017a)), the SRB transferred all of the shares of Banco Popular to Banco Santander. In particular, all the existing shares (Common Equity Tier 1) and the Additional Tier 1 instruments were written down to absorb losses that had been incurred up to that moment at the level of BPE, while the Tier 2 instruments were converted into new shares, which were transferred to Banco Santander for the price of EUR 1, without the need to obtain approval by BPE shareholders.<sup>①</sup> As a result, BPE continued to operate under normal business conditions as a solvent and liquid member of the Santander group with immediate effect. Moreover, as BPE had become a subsidiary of Santander, the latter was able to reallocate group resources of EUR 7 billion to BPE, thereby strengthening the standalone capital base of BPE. Following the acquisition, the BPE business was restructured and integrated into the broader Santander group.

The transaction can be seen as a transfer strategy structured as a classic share deal, with the acquirer becoming the new parent of the failing bank. As such, the acquirer is in a position to recapitalise the failing bank and continue its business and functions.

<sup>①</sup> Following actions by shareholders and other creditors affected by the resolution of Banco Popular, in November 2023 the General Court of the European Union confirmed the legality of the SRB's decision not to compensate them (see SRB 2023).

### 21. **Share deals may offer operational and strategic benefits but also pose specific challenges.**

In general, this approach is followed when, because of the size of the bank and the complexity of its business, a transfer of individual assets and liabilities is deemed operationally too difficult or too time-consuming for a crisis intervention. It may also be used when resolution action is targeted at an entity, such as a bank holding company, which does not itself hold deposits, allowing the transfer of an entire banking group. On a more strategic level, share deals obviate the need to distinguish between transferrable and non-transferrable assets and liabilities, thus allowing the entirety of the failing bank's business to be included in the transfer, which may be conducive to stability. It also avoids the need to transfer individual asset and liability contracts, which can complicate resolution, particularly for complex, cross-border banks. On the other hand, share deals will result in any contingent or unknown liabilities of the failed bank (including litigation risk) being indirectly assumed by the acquirer, which may be detrimental to the acquirer's own business. Lastly, share deals allow the continued existence of the failing bank as a legal entity. Overall, resolution authorities need to judge whether such continuity, coupled with a new shareholder, new management and replenished capital, is a desirable "fresh start".

22. **Surveyed jurisdictions differ in their approach to share deals.** In the United States, share deals have not been used to date although they have been considered for bridge depository institution resolutions. Rather, it is the failing bank's assets and liabilities (or a portion thereof) that are transferred to the acquirer, while shares representing ownership in the bank as a legal entity are cancelled, as the bank is put in receivership and ceases to exist as a legal entity, thereby losing its charter. In contrast, some other selected jurisdictions allow for share deals. In Colombia, for instance, authorities have the power to order a troubled bank to merge with another bank, subject to the latter's consent.<sup>20</sup> In the European BU, the SRB

<sup>20</sup> Use of a bridge bank as a temporary tool before the sale of the whole legal entity of the bridge bank may be considered another example of a share deal.

may use its sale of business tool to transfer ownership in the shares in the failing bank to an acquirer,<sup>21</sup> as was the case in the failure of Banco Popular, which became a subsidiary of Santander Group (see Box 1).

23. **A separate legal aspect concerns the legal mechanisms to implement the transfer.** For instance, information available may be incomplete at the time the transfer transaction is carried out, and the applicable resolution/insolvency framework may have different provisions for dealing with it. Among the surveyed jurisdictions, in the United States, the Federal Deposit Insurance Corporation (FDIC) implements a transfer through contractual arrangements with the acquirer. This contract has terms to allow for adjustments after the transaction has been executed if new information becomes available. Authorities in jurisdictions with different legal approaches typically rely on regulation or secondary legislation to effect resolution powers which affect property rights.

Box 2

### The resolution of Credit Suisse

Credit Suisse (CS) was Switzerland's second largest bank up until its demise in March 2023, with total assets of CHF 531 billion as of end-2022. It had been experiencing difficulties for several years before that, and in 2022 and early 2023 suffered significant and rapid outflows. As of end-2022, CS reported total shareholder equity of CHF 45.3 billion, a CET1 ratio of 14.1%, a Tier 1 leverage ratio of 7.7% and outstanding AT1 bonds amounting to CHF 16 billion. Its shares traded at CHF 1.86 on 17 March 2023, implying a market capitalisation of about CHF 8 billion.

In response to rapidly eroding market confidence, the Swiss authorities announced on 19 March 2023 that UBS and CS would enter into a merger agreement. The key elements of that transaction, which was supported by Swiss government emergency decrees, are the following:

- A share swap whereby CS shareholders receive 1 UBS share for 22.48 CS shares, implying a valuation of CS at CHF 3 billion, ie significantly below CS market capitalisation and reported shareholder equity. This valuation, while imposing losses on CS shareholders, allowed UBS to report substantial profits due to negative goodwill effects on the combined balance sheet resulting from the merger, strengthening the capital base of the new group. The merger did not need to be approved by either CS or UBS shareholders, as this requirement was abrogated by emergency decree.
- A Swiss government guarantee granted to UBS for losses in excess of CHF 5 billion and up to a total of CHF 9 billion. While this guarantee can be considered a component of the overall purchase price negotiated by UBS for the merger, it was not used and terminated in August 2023 (UBS (2023b)).
- A complete writedown of all AT1 instruments issued by CS, amounting to CHF 16 billion in total. This, too, can be considered a component of the overall purchase price of the transaction as all future interest payments under these instruments were cancelled following the merger.<sup>①</sup>

The transaction, which was further supported by significant central bank liquidity assistance (not all of it collateralised) and supervisory requirements for the new group, including changes in management, can be seen as a transfer strategy structured as a share deal. This is because the CS holding company was merged into the top UBS company and all CS entities became subsidiaries of the combined group of UBS and CS, allowing for a continuation of the entire business of CS under that group. The pricing of the transaction reflects a significant loss to CS shareholders and loss absorption by holders of CS AT1.

<sup>①</sup> In this case, shareholdings were not written down before the AT1 instruments were.

<sup>21</sup> Alternatively, the SRB may also use its bridge institution tool; this tool however has not yet been applied in practice.

## Asset-liability mismatch

24. **The mismatch between the value of assets and liabilities can influence the composition of the transfer.** In many failed-bank transactions, the transfer of part or even all of the assets may not be sufficient to fund the transfer of all critical liabilities. Typically, the market value of a failed bank's assets is not enough, on its own, to fund the transfer of liabilities in resolution, and authorities must pay acquirers an amount equal to the size of that funding gap between assets and liabilities to complete the transfer.<sup>22</sup> The larger the difference between the value of assets and the value of liabilities to be transferred, the more funding is needed by resolution authorities to complete the transfer.<sup>23</sup>

25. **There can be tension in the treatment of liabilities in a failed-bank transfer between a desire to minimise the asset-liability gap and preserving economic stability.** Insured deposits are always included in failed-bank transfers.<sup>24</sup> Authorities may also prefer to include uninsured deposits in the transfer to help preserve stability. For many acquirers, uninsured deposits are also seen as desirable because they help fund existing assets and contribute to the franchise value of the failed bank. However, regardless of whether this is the case, including uninsured deposits increases the value of the liabilities transferred relative to the assets and can increase the need for funding.

26. **The inclusion of uninsured deposits in a transfer can depend on the systemic nature of the failing bank.** In Indonesia, for instance, transfers involving systemic bank failures are expected to include uninsured deposits along with the insured deposits. However, transfers involving non-systemic failures are expected to include insured deposits only. In the United States, the recent failure of Silicon Valley Bank provides a separate example of a transfer of uninsured deposits in the case of a systemic bank failure where the FDIC exercised a systemic risk exception to guarantee all bank deposits in an effort to limit contagion. The resolution strategy in this case also combined the initial use of a temporary bridge bank with the eventual transfer of the assets and liabilities from the bridge bank to a suitable acquirer (see Box 3).

<sup>22</sup> As discussed in the funding section, bail-in can also help to reduce the asset-liability gap.

<sup>23</sup> Cross-border operations can complicate the composition of the transfer design. Aside from potential difficulties regarding contracts governed by foreign law, it is necessary for resolution authorities to assess the practical and legal effects of cross-border transfers on critical contracts and business functions. In particular, concerns may arise in relation to the applicable contractual rights involving other entities in the same financial group of the failing bank or with contractual positions relating to off-balance sheet vehicles. Additionally, the treatment of cross-border operations in a transfer will, in general, require close cooperation between home and host authorities in the analysis of the fit and proper requirements for the potential acquirer, the documentation of the transfer and coordination in the actual conduct of the transaction. Finally, the question of efficient and effective cross-border recognition, and the complexity of various legal doctrines, may involve time-consuming court-based processes that make outcomes difficult to predict. See Zhou et al (2012) for further discussion.

<sup>24</sup> In the United States experience, certain types of brokered deposits may not be desired by the acquiring institution. For those insured deposits, the FDIC will retain them in the transfer and pay them out directly.

## The resolution of Silicon Valley Bank

On 10 March 2023, the California Department of Financial Protection and Innovation closed Silicon Valley Bank (SVB) and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. Initially, the FDIC created a Deposit Insurance National Bank (DINB), to which all insured deposits of the failed bank were transferred (FDIC (2023a)),<sup>①</sup> and all assets from the failed bank were retained by the FDIC for later disposition. Uninsured deposits were to be paid a partial advance dividend<sup>②</sup> until the remaining assets could be settled.

Subsequently, on 12 March, the Department of the Treasury, the Federal Reserve and the FDIC issued a joint statement announcing a systemic risk exception for SVB (FDIC (2023b)). US authorities were concerned that the lack of access to the bank's uninsured deposits and likely haircut to those depositors was leading to a run on uninsured deposits at other banks which could contribute to a broader crisis. The decision to protect all deposits was made to increase public confidence and safeguard the banking system.

As a result of the systemic risk exception, on 13 March, the FDIC created a temporary bridge bank designed to protect all depositors – insured and uninsured – of SVB (FDIC (2023c)). A bridge bank is permitted to acquire both the assets and the liabilities of a failed institution on a temporary basis to allow more time for resolution.

On 26 March, the FDIC entered into a purchase and assumption agreement with First-Citizens Bank & Trust Company of Raleigh, North Carolina involving (FDIC (2023e)):

- the acquisition of all deposits;
- the purchase of about USD 72 billion in assets (about USD 90 billion in securities and other assets were retained in the FDIC receivership for later disposition);
- a shared-loss agreement on commercial loans purchased in the transaction; and
- equity appreciation rights for the FDIC in First Citizens Bancshares, Inc common stock with a potential value of up to USD 500 million.

The former branches of SVB opened as First-Citizens Bank & Trust Company on Monday 27 March with depositors of the former bank automatically becoming customers of the acquiring bank.

<sup>①</sup> A DINB is a temporary bank created to provide banking services to insured depositors when there is no acquirer and a prompt payout is not possible. <sup>②</sup> Advance dividends are payments made to uninsured depositors immediately or soon after a bank failure, representing the FDIC's conservative estimate of the ultimate receivership asset value.

27. **Legal risks can influence the scope of liabilities included in a transfer.** For instance, Italy indicated a preference to transfer all of the failed bank's liabilities to the acquirer. While the inclusion of all liabilities can exacerbate the asset-liability mismatch, this decision is seen as better protecting creditors, thus avoiding potential legal challenges by depositors remaining in the residual entity. Additionally, all liabilities may be included in the transfer because together they are viewed as contributing to preserving the franchise value of the failed bank.

28. **On the asset side, jurisdictional mandates regarding resolution costs also influence the perimeter of a transfer transaction.**<sup>25</sup> In some surveyed jurisdictions, ie Colombia and the United States, resolution authorities are required to select the least costly bid in resolution.<sup>26</sup> This may not always coincide with transferring all of the failed bank's assets, depending on how prospective acquirers weigh their bids. If bidders are willing to pay higher prices to exclude certain assets from the acquisition, it is possible that a partial transfer of assets would be the least costly resolution. However, not all least cost

<sup>25</sup> That is, the selection or identification of assets, liabilities or other items eligible for inclusion in a transfer.

<sup>26</sup> A least cost test ensures that the resources of the deposit insurance fund are used in a manner least costly to the fund, relative to all other resolution options. There are possible exceptions for failures deemed to be a systemic risk.

mandates have the same implications for the perimeter of the transfer transaction. In Indonesia, for instance, while a least cost criterion<sup>27</sup> is applied in selecting the winning bid, the bids must be submitted for the entire or half of the performing asset portfolio.

29. **Some surveyed resolution authorities consider other constraints when defining the scope of the assets and liabilities to be included in the transfer.** Italy indicated they may place emphasis on financial stability in their selection of a winning bid, including the indirect costs to financial stability in the wind-down of the bank. In that case, transferring as much of the failed bank's assets and liabilities as possible could be deemed most conducive to that goal and to protecting depositors. For the orderly resolution of large systemically important banks, the SRB also considers the feasibility of the transaction and the ability to successfully integrate the operations of the failed bank into the acquiring bank. The feasibility of the transaction involving more complex institutions may thus have an impact on the scope of the transfer.<sup>28</sup>

30. **Transfer scoping is more constrained in jurisdictions where insured depositors rank senior to uninsured depositors.** A jurisdiction's creditor hierarchy may also affect the scope of the portfolio in a transfer. With insured depositor preference and super-preference,<sup>29</sup> the subrogated claim of the deposit insurer following a payout of insured deposits ranks above uninsured deposits in the creditor hierarchy. This increases the recovery rate for the deposit insurer in a bank liquidation, but it limits the amount of funding available to execute a transfer. Section 5 covers the aspect of funding in resolution in more detail.

## Section 4 – Preparation

31. **Preparation is key to the successful execution of failed-bank transfers.** When a bank fails, resolution authorities need to be prepared to act quickly. Authorities face significant challenges and time constraints in the marketing and sale of failed banks. These are particularly relevant, given that authorities must also accomplish resolution swiftly and in a way that preserves market confidence.

### Monitoring and understanding acquirer markets

32. **An important element of early preparation is monitoring and understanding the market for failed banks, even when there are no pending failures.** One of the most critical elements for successful bank transfer is the identification of bidders that are both qualified and likely to bid. This may involve a pre-vetting process of financial qualifications in periods when there are no bank failures, as well as communication of bidder interests regarding future acquisition opportunities. Beginning this process only when failure becomes evident can add significant time and uncertainty to the resolution. Already having sound knowledge about the potential bidder pool at the time of failure, taking into account the market interest in the structuring of potential transaction perimeters and being able to notify potential bidders quickly allows authorities to begin marketing the transfer more effectively.

<sup>27</sup> Seven other factors (economic condition, complexity of the bank's problem, bank market share, resolution time requirements, investor availability, effectivity in resolution and other conditions) also determine the decision on the resolution method.

<sup>28</sup> The application of the EU asset separation tool may also help to define the composition and scope of the transfer and make the transaction more likely to succeed. Excluding certain assets, rights or liabilities with this tool can help increase acquirers' interest (and capacity to successfully bid), as well as decrease the uncertainty about asset quality in comparison to applying the sale of business tool alone. The combination of the two may increase the feasibility of the transaction as well as the sale price.

<sup>29</sup> With insured depositor preference, insured depositors rank senior to both uninsured depositors and other unsecured creditors, but the latter rank equally. Also, with super-preference, insured depositors rank senior to both uninsured depositors and other unsecured creditors. However, uninsured depositors rank senior to other unsecured creditors.



33. **The exact nature of early preparation efforts varies across jurisdictions.** Each of the resolution authorities in the selected sample indicated that they undertake some form of ex ante preparation to try to understand acquirer markets. The process differs significantly between jurisdictions, but all serve to help authorities act more expediently whenever a failure occurs.

34. **The structure of the financial system and the number of financial institutions in operation can influence preparation efforts by resolution authorities.** With a large banking market with many potential acquirers,<sup>30</sup> the resolution authority in the United States relies upon supervisory criteria to be able to quickly identify potential bidders as the need arises. It maintains an ongoing list of eligible bidders that meet certain financial criteria and have expressed a general interest in acquiring failed banks. Additionally, eligible bidders can communicate certain preferences, such as locations in which they may be interested in acquiring a failed bank. The bidder list can quickly be filtered for the characteristics of the failing bank once known, and then used to identify and notify potential bidders of the acquisition opportunity. In jurisdictions where the bidder market may be smaller, eg Colombia and Indonesia, maintaining active communication between regulatory authorities and potential acquirers even when there are no pending failures helps authorities understand the market landscape and quickly identify a pool of potential bidders in the event of a bank failure.

35. **Resolution plans can support preparation efforts by resolution authorities.** As the central resolution authority for the BU, the SRB regularly draws on information provided by all banks under its remit. In particular, where transfer tools are expected to be used, the banks are required to contribute towards identifying potential acquirers as part of their plans for winding down in failure. This enables resolution authorities to prepare scenarios and act more efficiently in resolving the bank if failure occurs. Similar plans for resolution are regularly submitted by systemically important banks in the United States and reviewed by the authorities to inform planning exercises in case of failure.

36. **Resolution authorities can also rely on external expertise.** In Italy, for instance, an independent special administrator is appointed to perform the transfer of bank assets and liabilities in those bank failures where the insolvency proceeding is preceded by a temporary administrator. The latter, with the support of independent legal advisers, draws upon his or her expertise in the banking sector to help identify a pool of potential bidders and select the best offer. In this case, the temporary administration serves as kind of an ex ante preparation for identifying bidders and prearranging the liquidation plan when a bank failure occurs. In the BU, the SRB has framework contracts with independent valuers, investment banks and transaction advisory service providers, as well as legal advisers, with expertise to support the resolution decision.

## Information collection

37. **Information gathering is another critical element for successful transfers.** Once a bank is deemed failing or likely to fail, early preparation with respect to information gathering becomes an important focus for many jurisdictions.<sup>31</sup> Resolution authorities need details about the portfolios of failed banks in order to evaluate the expected costs in resolution, and to compare those costs to the submitted bids. Some of the assets may be very complex or illiquid, and they may be hard to value. In addition,

<sup>30</sup> The US banking sector has more than 4,000 banks, not all of which will necessarily be eligible or interested in acquiring a given failed bank. However, more concentrated banking systems with few banks may find it more challenging to find potential acquirers and to keep negotiations confidential.

<sup>31</sup> Globally, some jurisdictions may make efforts to ensure that legislation aimed at protecting consumers, employees or taxpayers provide that the transfer of a substantial portion of assets and liabilities will render the new acquirer responsible for the liabilities of the failing banks in relation to eg wages and labour claims or taxes. These rules are typically introduced to avoid bank management transferring the activities of the failing bank to connected parties to renege on liabilities of this type. However, these provisions can become significant obstacles to conducting a transfer, especially when there is little time to complete due diligence.



certain records may be flawed or difficult to find or verify. Collecting this information takes time and may require cooperation from existing bank management for access and other institutional details.

38. **Acquirer due diligence and pricing depend on the quality and completeness of failed-bank information provided.** Potential acquirers also need detailed information on failing banks to be able to perform due diligence to properly assess the desirability of the acquisition and to inform their bids. They need to understand the existing operational details of the target acquisition, such as number of employees and salaries, existing premises, leases and rentals, information technology contracts and so on, in order to assess the practicalities of how the failed bank might be integrated into the acquiring institution. In addition, resolution authorities have indicated that the amount of information provided for due diligence can be critical to the quality of acquirer bids, as lower bids tend to be submitted when information is incomplete or uncertain. Thus, providing detailed information on an acquisition target is a key element in both potential acquirers' willingness to bid as well as the quality of bids placed.

39. **Mandates allowing information gathering by resolution authorities before failure can significantly assist in the marketing and selling of failed banks.** To aid in collecting this information, several jurisdictions in the sample, ie Indonesia, the BU and the United States, have mandates allowing resolution authorities to begin collecting relevant information at banks when failure seems likely, but before it becomes certain. This usually involves a requirement issued from banking supervisors that bank management must cooperate with resolution authorities in their gathering of information to prepare for resolution. This "pre-process" does not influence the likelihood of actual failure or the ability to pursue other alternatives to failure, but it does allow more time for information collection and marketing before failure might occur. Such efforts can help contribute to an orderly transfer if and when the bank does fail and can play an important role in facilitating the continuity of access to deposits and credit.

40. **Jurisdictions may differ in terms of when resolution efforts occur with respect to bank failure, and when it becomes publicly known.** In some jurisdictions in the sample, ie Indonesia, the BU and the United States, collecting information and marketing the bank before failure (ie prior to the bank reaching the point of non-viability) helps resolution authorities achieve an orderly transfer. In that case, maintaining confidentiality in any pre-resolution activities is paramount to avoid alarming markets and possibly hastening the certainty of failure, or destroying franchise value before resolution can be settled. In Italy, the use of a special administrator in resolution involves the collection of relevant information and marketing efforts after the bank has already been put under temporary administration in the context of early intervention measures and before a declaration that the bank may be failing or likely to fail. This reflects a preference for publicly observable resolution activities, with the aim of promoting public confidence and transparency in the process.

41. **Different approaches to the timing of marketing reflect an inherent trade-off between time to prepare and transparency in the moment.** The evaluation of this trade-off for individual jurisdictions may be influenced by the degree of public confidence derived from observed market outcomes at failure versus observed real-time interventions. On the one hand, customers and financial markets may be reassured that the failed bank has already been acquired by a healthy institution at the time the failure is announced. On the other hand, the public may derive confidence from observing that the competent authorities are intervening and seeing the intervention happening. The evaluation of this trade-off may also be influenced by concerns about information leaks<sup>32</sup> precipitating a bank failure. Another potential factor is the characteristics of the bank being resolved – challenges related to size and complexity may further reinforce jurisdictional preferences for early preparation versus a publicly observable process.

42. **Virtual data rooms are a useful means to make information about target banks available to prospective bidders.** All of the sampled jurisdictions employ or foresee the employment of virtual data rooms (VDRs) as an effective means to share detailed information on the target bank's balance sheet and

<sup>32</sup> Looking beyond the specific features of the surveyed jurisdictions, in countries where there may be few consequences for breaching confidentiality provisions (eg due to weak legislation, slow court procedures or weak judicial institutions) conducting a confidential process related to a failing bank may be extremely challenging.

operations.<sup>33</sup> This allows interested bidders to carry out their due diligence in a secure manner. In jurisdictions where marketing begins before failure, eg the United States,<sup>34</sup> potential bidders are only given very general information about the acquisition opportunity until an agreement is signed to ensure confidentiality. In that country, once the confidentiality agreement is signed, the potential bidder is given the name of the failing institution and access to all of the information in order to submit an informed bid. In jurisdictions where publicly observed interventions occur, the identity of the target acquisition opportunity may be known from the beginning.

## Structuring the transfer

43. **Flexibility in considering asset transfer strategies is critical to achieving viable resolution outcomes.** Despite any typical resolution outcomes experienced across jurisdictions, most of the authorities in the sample ie Colombia, Italy, SRB and the United States, stressed the ability to consider varied strategies for transfer. Not all failures are alike, and not all failures occur under identical market circumstances. Having flexibility in structuring the transfer is important to find a viable outcome in resolution.

44. **There are many considerations with respect to how assets may be transferred in a bank failure.** Resolution authorities are keenly aware that achieving higher bids on assets can help lower funding requirements in a transfer. To that end, transferring the entire portfolio in some cases is thought to be conducive to higher bid prices because it preserves more of the existing lending relationships at the failed bank, and bidders may value those relationships highly. In other cases, bidders may not wish to acquire certain non-performing loans or portfolios with particularly high expected losses, and they may be willing to place higher bids to acquire only the better assets. For any assets held back in the transfer, authorities must consider how those assets will be worked out and any costs incurred in doing so.

45. **The ability to consider feedback and preferences from prospective bidders in structuring transfer transactions can help authorities in the resolution process.** In some jurisdictions, bidders can influence the composition of the acquired portfolios in their feedback and communication with resolution authorities during the marketing process, and in the specified terms of their bids. While authorities are restricted by constraints under their mandates<sup>35</sup> in terms of selecting the final winning bid, the ability to consider feedback and preferences from prospective bidders in structuring the transfer can help them market the transaction more effectively, increase auction participation and achieve a feasible transfer outcome.

46. **In many cases, bidders may place both conforming and non-conforming bids in the failed-bank auctions.** Several resolution authorities in the selected sample indicated that they may consider both conforming and non-conforming bids placed by interested bidders. Conforming bids typically follow the standard transaction terms offered by resolution authorities. Non-conforming bids may include conditions or contingencies that deviate from those standard terms in any number of ways. Bids that might

<sup>33</sup> Supervisors can require the management of the failing bank to collect key contractual and management information at an early stage (eg when a bank is put on a watchlist). This can contribute to preparing all the necessary information for a VDR and limit the risk that management may interfere with the necessary collection of information. In particular, it may reduce the scope of management malfeasance, for instance, in the form of asset stripping or destruction of documents, especially in cases where there may have been fraud or mismanagement in connection with the failure.

<sup>34</sup> In the United States, for instance, formal resolution activities typically begin when the failing bank's primary regulator sends a prompt corrective action (PCA) letter indicating that the bank is critically undercapitalised or insolvent. A marketing plan is drawn up by the FDIC, and marketing efforts begin soon thereafter. The Federal Deposit Insurance Act specifies a 90-day timeline from PCA issuance in which a failing bank is to be placed in receivership. For sudden liquidity failures or fraud, the timeline for marketing efforts can be much shorter.

<sup>35</sup> Typically, this refers to constraints in terms of costs of the transactions. Other constraints may apply under certain conditions (eg the requirement to include both covered and uncovered depositors for transfers involving systemic banks or financial stability considerations).

be considered non-conforming could, for example, exclude certain portfolios in an offering for the whole bank or request some type of guarantee on losses that is not part of the initial offering. In most cases, non-conforming bids must still be able to be priced by the resolution authorities in a timely manner so that they can properly evaluate the potential cost of the bid in execution.

47. **Considering conforming as well as non-conforming bids in failed-bank auctions may benefit the transfer process.** Bidders may have different risk appetites and goals in making a particular acquisition and may thus have very different valuations across a range of transaction characteristics. Consideration by resolution authorities of non-conforming bids that reflect the specific interests of individual buyers can increase bidder participation and can help promote better bids. Several authorities in the selected sample indicated that having some flexibility to accept non-conforming bids was important to finding workable outcomes in the resolution process.<sup>36</sup>

48. **Shared losses can be considered as a tool to make the portfolio of a failed bank more attractive to buyers.** In an SLA, resolution authorities agree to indemnify the acquirer for a share of the losses on the covered portfolio. Typically, specific asset portfolios from the failed bank would be covered by the agreement for a defined duration, and the resolution authorities would incorporate the expected cost of the SLA over that time frame into the estimated cost of the bid being evaluated.<sup>37</sup>

49. **Shared losses can be particularly useful in times when uncertainty is high.** SLAs can be beneficial in cases where uncertainty is high and bidders are hesitant to acquire failed banks. In the case of a liquidity failure, for instance, detailed information about the failed bank's portfolio may be lacking due to the sudden nature of the failure, and there may not be enough time for proper due diligence before the bank must be sold. Additionally, in the midst of an economic crisis, there may be a great deal of uncertainty over the future state of the economy. Shared losses can give some assurance to bidders regarding the tail risk exposure on the failed bank's portfolio.

50. **While there can be benefits at times to the use of SLAs in failed-bank transactions, there may be reservations as well.** In particular, there are costs to administering SLAs, both for the resolution authorities who must monitor the acquirer's adherence to the terms of the agreement, and for the acquirers themselves who must comply with those requirements. Authorities must determine the circumstances in which shared losses might be warranted in their jurisdictions. Further, effective monitoring is needed to discourage undesirable incentives for acquirers to put less effort into working out those loans and shift those costs onto the authorities. Finally, there can be outstanding questions on whether the agreements should not only expose the authorities to incurring downside losses, but potentially also sharing in upside gains on the covered portfolio for the duration of agreement.

<sup>36</sup> Some authorities may prefer to avoid consideration of non-confirming bids if they see it as increasing the scope for moral hazard in the design of the transaction perimeter.

<sup>37</sup> The United States used loss sharing extensively in the aftermath of the Great Financial Crisis of 2007-09. Between 2008 and 2013, 304 out of 489 bank failures involved shared-loss agreements (FDIC (2017)). Most recently, it was used in resolving several bank failures in 2023 due to the particular uncertainties involved. It is not intended as a universal strategy for all failures but is rather considered by authorities depending upon the speed of the failure or the state of the market at failure. Other jurisdictions in the sample expressed a willingness to consider shared losses as a tool available to them in resolution, but have not yet used it in practice.

## Section 5 – Eligibility of bidders

51. **A number of criteria must be met by eligible bidders of failed banks.** To ensure that the acquirer is healthy enough to make the acquisition without compromising its own safety and soundness, or that of the banking sector, resolution authorities must assess the eligibility of bidders to engage in failed-bank acquisitions. Specific criteria can include the amount and quality of capital held by the acquirer, the size of the target bank relative to the acquiring bank, a positive assessment of the long-term viability and profitability of the combined entity, and satisfactory regulatory compliance standings. Some authorities may consider additional aspects, such as experience in the relevant business line and capacity for successful business integration.

52. **Importantly, successful transfers require cooperation between resolution and supervisory authorities.** In all of the selected jurisdictions, resolution authorities indicated that they require the interested bidder in a transfer transaction to have an existing banking licence – granted by supervisory authorities – before being able to bid on failed banks. Additionally, the supervisory authorities must provide their final approval for auction participation before a bid may be placed.

53. **Competition issues can emerge regarding the selection of eligible bidders.** A bank transfer normally increases market concentration when the acquiring bank stems from the same market as the acquired one. Authorities therefore also assess the overall market presence of the bidder and consider compliance of the potential acquisition with anti-trust laws that preserve competition in the sector. However, in the resolution of the largest banks, authorities may be willing to allow for exceptions as it may be the case that only other large banks are capable of making the acquisition. Anti-trust hurdles to failed-bank transfers may become increasingly significant to the extent that banking markets trend towards greater consolidation.

54. **At times, increasing the bidder pool for failed banks may be a desirable option.** For some failed institutions, the number of potential buyers may be small. This could be a product of the failed bank's size, location, specialisation or local market conditions, for instance. In these cases, increasing the bidder pool may help authorities to identify one or more willing acquirer(s) for the entirety or parts of a failing bank. Furthermore, in a crisis, other natural acquirers in the market may also be experiencing distress; authorities may see a need for new capital in the banking system to help avoid a fire sale scenario.<sup>38</sup>

55. **Some of the sampled authorities have considered expanding bidder pools through the involvement of approved foreign banks.** Depending on the size of the domestic banking sector, and the number of possible domestic acquirers, authorities may consider expanding the pool of eligible bidders to foreign banks. When doing so, authorities can choose whether to require that the potential acquirer already has a presence in the country and is therefore, technically, already a local financial institution (eg Colombia) or not (eg Italy).

56. **One jurisdiction in the sample had experience expanding the bidder pool through the involvement of approved private equity entities in failed-bank auctions.** In the wake of the Great Financial Crisis of 2007-09, the United States launched a programme that made conditional charters available to a number of private equity groups which allowed them to participate in auctions for failed banks. The intent was to introduce new capital into the banking system at a time when existing capital was scarce.<sup>39</sup> Many of these private equity acquirers of failed banks subsequently sold their acquisitions to other existing banks several years later, exiting the market once the banking system recovered.

57. **Expanding the pool of eligible bidders for failed banks can also create new challenges.** For

<sup>38</sup> See Schleifer and Vishny (1992).

<sup>39</sup> For further details on private equity participation in failed-bank auctions in the United States, see French et al (2021) and Johnston Ross et al (2021).

instance, in the case of private equity bidder participation, regulators need to establish firm guardrails to ensure that bidder incentives are not contrary to the stability of the banking sector. There may also be regulatory complications, such as whether or not the private equity entity itself would qualify as a bank holding company and needs to be regulated as such, or whether lending to affiliates would be permitted. Further, these efforts would need to be embarked upon jointly with the general support of bank supervisory authorities for any licensing approvals. Resolution authorities may weigh the benefits and drawbacks of these new sources of capital in the banking sector differently under normal versus crisis conditions in the market.

58. **Another trade-off involves the appropriate size of the bidder pool in each jurisdiction.** For some jurisdictions, a large pool of bidders (eg in the United States) may be seen as unequivocally beneficial to the auction process. Others in the selected sample, eg SRB, expressed a need to balance the identification of a sufficiently large pool of possible bidders with the risks of information leakage. This risk increases as the number of entities that are contacted as potential buyers increases and the longer it takes to select them.<sup>40</sup> In addition, inviting a large number of potential bidders could complicate the process as against the need to proceed rapidly. The appropriate balance for each jurisdiction may differ, depending on factors such as the relative size of the market, limitations on resolution resources and the ability to protect confidentiality.

## Section 6 – Funding

59. **Funding is typically needed to complete failed-bank transfers.** If acquirers estimate the value of the marketed portfolio to be below that of the liabilities, the bank transfer will require financial support that is external to the failing bank. Funding needs will depend on a number of factors, such as the composition of the failed bank's balance sheet and the conditions under which it failed. For instance, banks that are highly dependent on deposits for funding purposes are more likely to have a larger asset-liability mismatch due to the significant amount of liabilities to be passed and, hence, more likely to require more external funding to complete the transfer. Alternatively, banks holding very poor-quality assets, or that failed amidst a broader economic crisis, are likely to have a larger asset-liability mismatch due to the lower market value of the assets, and to require more external funding. Other relevant factors might include, for instance, the area of bank activity and the composition of its customer base. The extent of external financing needed to complete the transfer may fall if these factors increase the franchise value of the failing bank and make potential acquirers willing to pay a higher premium on the deposits.

60. **To begin with, authorities may seek to reduce external funding needs by first exhausting the failing bank's internal resources.** The asset-liability mismatch tends to be smaller the greater the amount of liabilities on the failing bank's balance sheet that can easily be left behind, ie excluded from transfer and used to absorb losses. Therefore, authorities may reduce the mismatch by identifying such liabilities. These typically include liabilities that rank junior to those that authorities wish to transfer. To make transfer transactions a more feasible resolution option, prudential policy may require banks to hold sufficient amounts of debt that can be left behind. Examples of these requirements are, at the global level, the total loss-absorbing capacity (TLAC) for G-SIBs, or in the European Union, the minimum requirement for eligible liabilities (MREL). Under the current European Commission proposal (EC (2023)), the MREL

<sup>40</sup> In some jurisdictions, eg the United States, authorities can rely on a list of potential bidders that can be tailored to include those that are considered suitable on the basis of geographical location, size and other pre-set criteria. In this case, expanding the list of possible bidders is rather straightforward. However, in most jurisdictions, given the smaller size of the market and the number of possible bidders, authorities may need to identify possible bidders on a case-by-case basis. Expanding the number of bidders is likely to require some time.

requirement would need to be calibrated with a view to supporting transfer transactions.<sup>41</sup> In the United States, a proposal to increase the amount of long-term debt held by banks would increase their loss-absorbing capacity in resolution (FDIC (2023g)).

61. **To the extent needed, resolution authorities and deposit insurers typically provide the resources for bank transfer transactions.** These resources are industry-funded, often through insurance rates paid on deposits or other special industry assessments, and hence are intended to shield taxpayers from the need to contribute to the costs of failed-bank transfers.<sup>42</sup> Both the Financial Stability Board (FSB) Key Attributes of Effective Resolution Regimes and the IADI Core Principles for Effective Deposit Insurance Systems require private financing, by setting out that jurisdictions should have in place readily available privately financed deposit insurance or resolution funds, or a funding mechanism with ex post recovery of resolution costs from the industry.<sup>43</sup>

62. **Constraints apply to the availability of external funding.** While resolution authorities and deposit insurers may have funding available for failed-bank resolution, and in many jurisdictions it is permitted for this funding to be used to execute failed-bank transfers, it is not always the case that the funding is accessible for specific transfer transactions (see Box 4). As discussed below, this is often due to complex interactions between the institutional frameworks for bank failure management, creditor hierarchy and mandates of the relevant institutions involved.

<sup>41</sup> See EC (2023) and proposed Article 45ca of the Bank Recovery and Resolution Directive (BRRD); for a model to calibrate debt requirements in order to facilitate transfer transactions, see Restoy (2023b).

<sup>42</sup> In the EU, the Single Resolution Fund (SRF) may be used to support the use of resolution tools for a bank in resolution under the Single Resolution Mechanism Regulation, subject to conditions that include a requirement for the prior writedown of at least 8% of the failing bank's total liabilities, including own funds. If a bank is resolved under the BRRD, the national deposit insurance fund must contribute resources to support the resolution if the resolution measure protects continuity of access to deposits and conditions for access to the SRF are met. See Costa et al (2022) for details.

<sup>43</sup> FSB Key Attribute 6.3 (FSB (2014)) and IADI Core Principle 9 (IADI (2014)), respectively.

## The wind-down of Veneto Banca and Banca Popolare di Vicenza

In late 2017, the European Central Bank, as supervisor of significant banks in the BU, declared two Italian banks from the Veneto region (Veneto Banca and Banca Popolare di Vicenza) as failing or likely to fail given their weak capital positions (ECB (2017)). On the same day, in its assessment of whether the conditions for resolution under the relevant European Union regulation were met, the Single Resolution Board concluded that there was no public interest (the banks did not provide critical functions and their failure was not expected to have significant adverse effects on financial stability), and therefore a resolution action was not appropriate. The banks would therefore be wound down under Italian national liquidation procedures.

Consequently, within the context of the domestic insolvency proceedings, the Italian authorities opted for a bank transfer with public support, in order to avoid the considerably high costs, in particular to the regional economy, of a disorderly liquidation. Two days later, the Italian authorities steered a bank transfer transaction, involving the transfer of the assets and liabilities of the banks to another Italian bank, Intesa San Paolo (ISP), except for the non-performing loans (NPLs), a limited number of participations and other stakes, the liability actions against the former directors, top managers and statutory auditors of the banks, equity, subordinated debt, some litigations and risk provisions.

The transfer was conditionally agreed subject to additional safeguards for the acquiring bank provided by law. These included:

- The injection of cash from the Italian government (including EUR 3.5 billion to enable ISP to maintain its capital ratios and keep its dividend policy unchanged, and EUR 1.285 billion to cover restructuring costs related to staff layoffs and branch closures).

- The provision of guarantees (amounting to around EUR 12 billion) by the Italian government, including a guarantee on the credit of ISP towards the liquidated banks for the negative imbalance between the transferred assets and liabilities.

- The transfer of the NPL portfolio to a state-owned asset management company (SGA), that had been set up in the 1990s for the management of the NPLs of another failing bank.

As mentioned above, equity and subordinated debt remained in the residual entity, thus contributing to covering the cost of the crisis. The deposit insurance fund did not intervene as the intervention would have caused systemic financial stress given the size of the funding needs. Instead, government funds were used to complete the transfer. Shortly after the bank transfer was agreed between the Italian authorities and the relevant banks, the European Commission approved the aid measures taken by Italy to facilitate the liquidation of the Veneto Banks.<sup>①</sup>

<sup>①</sup> For details, see EP (2017).

## Institutional framework

63. **The framework for bank failure management, and the respective roles and mandates for deposit insurers and resolution authorities, can vary significantly.** It is only sometimes the case that a single agency both decides on the design of the bank transfer transaction and manages the deposit and/or resolution fund. In fact, the 2023 annual IADI survey (IADI (2023)) shows that only 36% of its membership have a framework in which the deposit insurer is also the resolution authority. Other frameworks may be more complex, involving one authority (a joint resolution authority and deposit insurer) managing two separate funds (a resolution and a deposit insurance fund); or two authorities (a resolution authority and a separate deposit insurer) with two funds available (a resolution fund and a deposit insurance fund).<sup>44</sup> More complex institutional arrangements may make it harder to access these resources to fund bank transfers, especially if the mandates of authorities that are involved in the resolution process – the resolution authority in charge of the decision about the resolution strategy and the deposit insurer with a role in funding that strategy – are not aligned.

64. **Restrictions on the use of deposit insurance funds in resolution can vary significantly as well.** The restrictions may take the form of a least cost requirement, a cost minimisation requirement or a payout counterfactual cap. In jurisdictions with a least cost requirement, authorities must select a resolution method that is least costly to the deposit insurance fund relative to any other resolution strategy. An upper limit to funding would typically not apply as long as it is less costly than the other options (including liquidation). In jurisdictions with a cost minimisation requirement, costs of resolution are considered more expansively, with authorities required to minimise their own broader exposure to losses or broader costs to the financial system.<sup>45</sup> For jurisdictions with a payout counterfactual cap, the cost to the deposit insurance fund in a transfer may not exceed the net cost of reimbursing insured depositors in a liquidation and payout scenario. However, this does not entail an obligation for authorities to conduct the least costly option.

65. **When deposit insurers and resolution authorities are separate entities subject to separate mandates, funding a failed-bank transfer can become more complicated.** When a single agency both decides on the design of the failed-bank transfer and provides the funding, there is essentially a single objective function. The question of funding is already answered by virtue of the fact that the selected method of resolution satisfies the required mandate. If there are separate agencies managing the resolution design and the funding, the process may be more complicated<sup>46</sup> if they are subject to different mandates.<sup>47</sup>

<sup>44</sup> See Costa et al (2022, p 9) for details.

<sup>45</sup> Costa et al (2022) offer more detail on the consideration of different costs taken into account by deposit insurers and resolution authorities when evaluating bids and calculating the payout counterfactual.

<sup>46</sup> However, in Italy for instance, relevant authorities see a prompt and appropriate exchange of information as an effective approach to overcoming possible complications.

<sup>47</sup> The IADI Core Principles stipulate that, in this case, the deposit insurer should have the option (in some cases, such as in the European Union, the obligation) to authorise the use of its funds for non-payout resolution actions. This includes the use of its resources to fund bank transfers. However, for this to take place, the IADI Core Principles also set out a number of conditions that must be met. Amongst others, the deposit insurers should be informed and involved in the resolution process. Also, the bank transfer should result in a viable and solvent bank, limiting knock-on risks to the deposit insurer. Most importantly, contributions by the deposit insurer are restricted to the net cost to the deposit insurer of reimbursing depositors in a liquidation scenario. The latter condition means that if the resolution authority chooses to conduct a bank transfer, and the net costs thereof are less than those associated with a payout, the deposit insurer should have the option to fund such a measure.



## Creditor hierarchy

66. **The ranking of depositors' claims in the creditor hierarchy can significantly affect the accessibility of funding for bank transfers.** The design of depositor preference rules (see Table 1) has far-reaching consequences for the net costs of liquidation and payout, which is typically the counterfactual against which the costs of bank transfers are benchmarked. With insured depositor preference or super-preference, deposit insurers that subrogate into insured depositors' claims rank superior to both uninsured depositors and other unsecured creditors. Given this beneficial ranking in the credit hierarchy, deposit insurers will recover substantially more from the assets of failed banks. As a result, the net cost to the deposit insurer of paying out depositors (ie the volume of insured deposits compensated minus recoveries made) can be significantly lower than the volume of insured deposits and may even be zero. A bank transfer requiring funding by the deposit insurance fund, on the other hand, would not meet the least cost or payout counterfactual cost requirement and would not be completed in those scenarios.

67. **Most deposit insurers operate under some form of depositor preference.** According to the 2023 IADI survey, only 19% of deposit insurers have no form of depositor preference. The rest adopt various types of depositor preference, with the largest percentage in the narrowest preference category – super-preference – ie insured depositors rank senior to both uninsured depositors and other unsecured creditors, and in turn uninsured depositors rank senior to other unsecured creditors (see Table 1).

Types of depositor preference			Table 1
Type	Description	Share of deposit insurers by depositor preference type	
No depositor preference	All depositors rank equally with other unsecured creditors.	19%	
General depositor preference	All depositors rank equally, but senior to other unsecured creditors.	11%	
Insured depositor preference	Insured depositors rank senior to both uninsured depositors and other unsecured creditors. The latter rank equally.	20%	
Tiered depositor preference ("super-preference")	Insured depositors rank senior to both uninsured depositors and other unsecured creditors. Uninsured depositors rank senior to other unsecured creditors.	45%	
N/A		5%	

Source: IADI (2023).

68. **General depositor preference can be more favourable for funding failed-bank transfers.** If the creditor hierarchy moves from super-preference to a general depositor preference, the net cost of a payout increases. This increases the potential for deposit insurers to fund the transfer under a least cost test or a counterfactual payout cap. That said, underfunded deposit insurance schemes can also be a barrier to switching to or adopting a general depositor preference, so the adequate provision of fund resources under different creditor hierarchies is also a critical consideration.

69. **Cost limits for the deposit insurance fund also affect the feasibility of a bank transfer.** For deposit insurers subject to a cost minimisation requirement, the constraints associated with adopting some form of preference for insured depositors rather than a general depositor preference may be less restrictive because the cost of liquidation is no longer the relevant benchmark as broader costs may be taken into account in the resolution.

70. **The impact of creditor hierarchy on funding can depend in part on the liability structure of the failed bank.** A regime awarding preferential treatment to insured depositors will have a more restrictive effect on available funding for a failed bank with a high proportion of uninsured deposits relative to one with fewer uninsured deposits. The higher proportion of uninsured deposits will be associated with

larger recoveries to the deposit insurer, both because fewer depositors will have to be made whole and because the deposit insurer will have priority over a larger proportion of uninsured deposits in receiving proceeds from the liquidation. Yet under a general depositor preference regime, for a bank with a high proportion of uninsured deposits, the proportion of uninsured deposits has less of an impact on available funding. This is because while fewer insured depositors need to be made whole, the deposit insurer must share proceeds of the liquidation with the higher proportion of uninsured depositors on a pro rata basis. Thus, a narrower depositor preference may be even more restrictive under certain failed-bank liability structures than others, with important implications for authorities and their ability to fund resolution strategies.<sup>48</sup> This may be a particularly important consideration, as high proportions of uninsured deposits can also raise the risk of rapid withdrawals, creating risks of contagion to healthier banks.

## Additional measures

71. **Shared-loss agreements can provide some leeway to authorities in the immediate funding outlay for bank transfers.** SLAs can help provide a backstop against extremely poor outcomes on the acquired portfolios, reducing some of the uncertainty for interested bidders. This can benefit the resolution authorities by helping to improve bidder participation and reducing the need for deep discounts on the assets for transfer. Higher bids can help decrease the initial funding needed to complete the transfer which may be particularly important in crises when many banks are failing and available resolution funding may become stretched. In addition, considering that conditions may improve over time, the expected losses to the portfolio at failure may not be as severe as time passes and the economy improves. Thus, the losses paid out over the course of the SLA might be lower than anticipated at failure.

72. **Shared-loss agreements come with financial risks to the resolution authority and deposit insurer.** If significant losses are realised on the portfolio over time, this can increase overall costs to the authorities. In valuing bids with SLAs, authorities may account for such potential future costs and consider the potential impact on the fund's resources going forward. In addition, the monitoring of SLAs comes with significant administrative costs to both authorities and acquirers. This is necessary to minimise the moral hazard risks of such agreements.

73. **Systemic risk exceptions may ease the use of the bank transfer tool.** These exceptions<sup>49</sup> override the funding limitations applicable to deposit insurance funds, thus allowing authorities to fund a transfer when that option is not the least costly available or its cost to the fund is higher than the net cost of a payout. Such exceptions are typically invoked when risks of significant financial instability emerge from the application of funding limitations. For instance, extending coverage to uninsured deposits or not selecting the least costly resolution in specific cases may stem the risk of bank runs and contagion among financial institutions. However, the lifting of funding limits by applying a systemic risk exception can contribute to financial stability only when the resolution authority can access the required funding to support the transfer of the bank. The cost implications may be substantial as this exception may be more likely when dealing with the failure of a large bank.

74. **Systemic risk exceptions may result in a level of depositor protection that deviates from the deposit insurance coverage levels or creditor hierarchy as expressed in depositor preference rules.** The activation of the systemic risk exception allows policymakers to deviate from this original design, but at the risk of creating moral hazard in the system. As a result, such exceptions, where they exist, have

<sup>48</sup> For further discussion on the mechanics of the relationship between funding requirements and depositor preference, see Restoy et al (2020).

<sup>49</sup> According to IADI (2023), 48% of respondents report that, in the event of a systemic failure, different criteria can be used in selecting the resolution tool.

been used sparingly to avoid the build-up of expectations of such a deviation.<sup>50</sup> Moreover, their activation often requires special procedures involving the explicit consent of the government. In the United States, for instance, a provision for determining systemic risk was incorporated into the Federal Deposit Insurance Corporation Improvement Act of 1991. This required that systemic risk exceptions be decided by the Secretary of the Treasury in consultation with the President, after a written recommendation by a two thirds majority of the FDIC Board of Directors and the Federal Reserve Board.

## Section 7 – Conclusions

75. **Transfer transactions can be a useful strategy for orderly failed-bank resolution.** Bank transfers can be associated with a number of benefits in comparison with alternative resolution strategies, such as open bank bail-in and liquidation. In particular, relative to a liquidation, transfer transactions help to maintain the continuity of access to deposits, preserve the value of the franchise, maintain access to credit and other important economic functions, help to avoid a fire sale of liquidated assets and limit the role of public authorities in managing failed banks' assets. In addition, relative to an open bank bail-in, transfers may require lower levels of loss absorption in the failing banks, as only part of the failed bank may be included in the transaction. Finally, transfers to a third-party acquirer may be combined with other resolution tools, such as bail-in of creditors and shareholders and temporary bridge banks. Reviewing frameworks for bank transfers across a sample of selected jurisdictions, and considering general principles for bank resolution, suggests several factors that can impact the feasibility of bank transfer as a resolution option.

76. **Certain minimum conditions must be met for transfer strategies to be both feasible and credible.** The resolution framework needs to explicitly provide the relevant powers for authorities to transfer assets and liabilities. Restrictions in the applicable legal framework may reduce the scope of the applicability of this tool. Importantly, transfer strategies rely on a third-party acquirer being willing and able to complete the transaction, which also requires the authorities to enter into a constructive process with potential acquirers. Furthermore, transfer transactions may need to be supported by external funding, especially if all or a large part of the failed bank's liabilities are transferred. Therefore, some degree of flexibility can materially increase the chances of a successful transfer, provided that resolution authorities or the deposit insurance fund, when separate, are not unduly exposed to loss.

77. **Some design features of the bank transfer process may facilitate this type of transaction.** Data quality in resolution planning and during the resolution phase help to support the desired outcome. In particular, the early and detailed availability of information provided to potential bidders is critical to the transfer process. With adequate time for information collection and due diligence, potential acquirers may be less hesitant to submit bids. Moreover, with less uncertainty about the condition of the target bank, price offers from potential acquirers tend to be higher. This in turn can have important implications for the amount of external funding required to complete the transfer. In addition, strict confidentiality requirements for interested bidders in the marketing and bidding processes help to avoid alarming markets. Finally, for some resolution authorities, flexibility in accepting non-conforming bids as part of a competitive process is seen as a way to support the consideration of a wider range of possible transfer options.

78. **The composition of the failed-bank transfer can affect the feasibility of the transaction in different ways.** In general, the broader the scope of the transfer, the more conducive the strategy to

<sup>50</sup> The size of a deposit insurance fund is typically calibrated against the capacity to cover losses as a fraction of the insured pool and not to deal with the failure of a systemically important bank. The latter would require significantly more resources than those normally available to the deposit insurance fund, for instance, via a backstop from the government. Systemic risk exceptions represent such cases of support to these funds when used in the resolution of larger banks.

achieving stability and continuity of function. However, the inclusion of a broader set of liabilities can increase the asset-liability mismatch and thus increase the need for external funding. A transfer of assets along with insured deposits only, may keep funding needs lower than including other liabilities, but could expose both authorities and acquirers to risks of legal challenge and compensation, and, more importantly, increase the risk to financial stability. Transferring the assets together with the bulk of deposits and other sensitive liabilities may make this resolution option more viable in terms of supporting financial stability, yet it also increases funding needs. Alternatively, transferring the majority of a failed bank's assets and liabilities as a single transaction may best preserve the bank's franchise value, thereby increasing the number and potential value of submitted bids.

79. **Funding constraints have a material impact on the feasibility of bank transfers, and trade-offs need to be carefully assessed.** On the one hand, more stringent funding constraints may appear to save costs to the authorities involved in resolution, but they can also impede the completion of intrinsically valuable bank transfers. Additionally, when the deposit insurer is the resolution authority or supports the resolution action, less stringent funding constraints (through general depositor preference) may increase the net cost of a payout to the deposit insurer, but the likelihood that funding may be accessible to execute a transfer where appropriate also increases.<sup>51</sup> In this respect, when deposit insurance funds are used in resolution, a general depositor preference may be more supportive of financial stability due to the higher financial cap, thus creating more opportunities for executing a failed-bank transfer.

80. **The impact of creditor hierarchy on available funding can depend in part on the liability structure of the failed bank.** A narrow depositor preference may be even more restrictive for funding transfers under certain liability structures, particularly when the failed bank holds a high proportion of uninsured deposit liabilities. This could have important implications for authorities and their ability to support desired resolution strategies. From a wider stability perspective, in times of bank stress, a high proportion of uninsured deposits can raise the risk of rapid withdrawals, which may in turn affect other, healthier banks. As a result, in those circumstances, the ability to execute an orderly resolution – particularly one that minimises losses to depositors – is critical.

81. **Finally, the implications of crisis conditions and the ability to fund failed-bank transfers may need to be considered.** In times of market distress, bidder uncertainty about the future state of the market may depress submitted bid values and increase the cost of a bank transfer compared with a simple payout. Crisis times may, however, be exactly when it is most important to be able to execute failed-bank transfers. An inability to fund transfers in a crisis may limit resolution options and feed market perception of a banking sector collapse. Whether alone or in combination with other resolution tools and powers, it is precisely at these times that avoiding a fire sale in liquidation and executing a successful transfer that preserves economic functions, could be most critical.

<sup>51</sup> A recent proposal by the European Commission supports such a change in Europe. As discussed in Restoy (2023a), the European Commission proposal also makes deposit insurance funds more readily available to support bank transfers in resolution and it aims to expand the range of cases that are dealt with through resolution by effectively preventing the application of national insolvency regimes when public liquidation aid is foreseen. Such changes would bring more failures within the resolution framework, facilitating the use of bank transfers as a resolution tool and providing additional funding, from the Single Resolution Fund, as appropriate.

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