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Directorate D: Government Finance Statistics (GFS) and quality

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Eurostat guidance note on statistical implications of new resolution legislation

Background

Recently, new legislation[1] has been enacted, resulting from the financial crisis which originated in 2007-2008. The aim of this legislation is to improve the banking supervision (as some drawbacks were observed both in the regulatory provisions and in the way the supervision had been conducted), to prevent contagion and spill-over effects among EU countries (due to growing banking and financial integration) and to weaken the link between banking stress and government finance (with a considerable impact observed in a few Member States during the last years).

The financial crisis has shown that past banking supervision, fully carried out under national responsibility, has not avoided the start of the crisis, in spite of some harmonised "safety" mechanisms (such as Basel II) which turned to be insufficient; it did not prevent, in particular, the collapse of some financial institutions as well as contagion and spill-over effects among EU countries.

In this context, the governments of many Member States have been obliged to undertake "bail-out" interventions which have had a considerable effect in terms of government deficit and debt.

In order to try to solve these shortcomings, the European Council decided in October 2012 to create a Banking Union, relying on 3 pillars:

- A **Single Supervision Mechanism**, compulsory for euro area members but open also to other Member States, with a dominant role for the ECB (directly for about 130 banks representing

[1] EU Parliament and Council Regulation 806/2014 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (hereafter named the Regulation) and EU Parliament and Council "Banking for Recovery and Resolution Directive" (BRRD) of 15 May 2014, to be transposed in national legislations before the end of 2014, for measures to be applied from 1st January 2015. Hereafter, referred to as the Directive.

a preponderant part of banks assets – 85 %, and deposits – 80 %) and an harmonised framework for all supervised institutions (the so called "single rulebook").[2]

- A **Single Resolution**[3] **Mechanism**[4] (SRM) with the creation of a Single Resolution Board (SRB) and a Single Resolution Fund (SRF) which has entered into force in 2016. A common framework for carrying out resolution activities has also been set up.[5]

- A **harmonised system of guarantee of the deposits** (notably, as far as the maximum amount and the delay for compensation are concerned). [6]

In a nutshell, the intention of the new legislative arrangements is as follows:

1) A shift from a "culture" of "bail-out", in which the burden of rescue of banks is largely borne by the community, to a "culture" of "bail-in", where shareholders and some "unsecured" creditors must first contribute (up to certain limits) to the absorption of losses and recapitalisation.

2) An attempt to minimise the impact on public finance or, at least, the occurrence of any financial intervention by government only as a last resort.

In the Regulation, article 14 mentions as one of the objectives (the 4th, in the order): "*to protect public funds by minimising reliance on extraordinary public financial support*."

The Regulation also mentions (article 8) that a resolution plan prepared by the SRB should not assume "*any extraordinary public financial support besides the use of the Fund*."

However, it must also be underlined that the Directive reads in article 56: "*government financial stabilisation tools shall be used as a last resort after having assessed and exploited the other resolution tools to the maximum extent practicable whilst maintaining financial stability, as determined by the competent ministry or the government after consulting the resolution authority*."

This guidance note focuses on the following points:

- the classification of the Single Resolution Board and of the Single Resolution Fund;

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[2] It must be stressed that the central body (the Single Supervisory Board) may at any moment "take the lead" for the control of any EU financial institution, should the national authority be considered as lacking of efficiency.

[3] Official definitions are: "*Resolution occurs at the point when the authorities determine that a bank is failing or likely to fail, that there is no other private sector intervention that can restore the institution back to viability within a short timeframe and that normal insolvency proceedings would cause financial instability*." And "*Resolution means the restructuring of a bank by a resolution authority, through the use of resolution tools, to ensure the continuity of its critical functions, preservation of financial stability and restoration of the viability of all or part of that institution, while the remaining parts are put into normal insolvency proceedings*."

[4] Established by the EU Parliament and Council Regulation 806/2014 of 15 July 2014.

[5] By the "*Banking for Recovery and Resolution Directive*" (BRRD) of 15 May 2014. The Directive also deals with the case of cross-border institutions, which are more and more frequent with the integration of banking and financial markets in the EU.

[6] By revision of the Directive 94/19 in 2010 and in 2014. At this stage, it is not yet envisaged to create a single mechanism, similar to the new schemes above, with a unique guarantee fund. National institutional arrangements can therefore differ (notably as far as the sector classification of deposit guarantee funds is concerned) but an important point is that the fund should always be in a position to ensure the legal compensation to which depositors are irrevocably entitled.

- the cases where the “resolution tools “could result in the creation of an entity which should be treated as a public defeasance structure to be classified within the government sector;

- the impact on government accounts of the entry into force of the Single Resolution Fund at the beginning of 2016;

- the relevance of the rules of the Manual on Government Deficit and Debt (MGDD), latest edition (2016), related to public defeasance structures in a resolution context.

Analysis of the situation

1) The relevance of MGDD rules related to public defeasance structures in a resolution context

From a national accounts point of view (see ESA 2010 20.46 and 20.248), as far as the existence of public defeasance structures is concerned, the main point is whether there could be future cases where the “*resolution tools”* could result in the creation of an entity which would have the features of a public defeasance structure to be classified within the government sector.

ESA 2010 in chapter 20 and the MGDD in chapter IV.5 "Financial defeasance", set the rules according to which an entity should be considered as a public defeasance structure to be classified in the government sector. In this context, it is important to stress beforehand that, on the basis of all the legislative documents mentioned above, there is no element which could lead to modify the methodological provisions included in the dedicated chapter IV.5 on defeasance in the MGDD, which therefore retain all their validity in this framework.

There is notably in the MGDD a clear definition of a defeasance structure[7] (see sub-section IV.5.2.1, the paragraph 9):

"A financial defeasance structure is an institutional unit, which has substantial problematic assets, whose principal activity is the resolution of these assets generally over an extended period and not the provision of financial intermediation services. Such an institutional unit is not a financial intermediary as defined in ESA 2010.

Some or all of the features on the following indicative list would provide evidence of the defeasance structure nature of a unit, since they would call into doubt that the institution could be classified as a financial intermediary:

- being closed to new deposit-taking, or partly open under restrictive conditions. This includes the ceasing of deposit-taking from the general public or specified and relatively large sub-groups thereof. In particular, deposit-taking from the government, or specific public corporations, would not be considered sufficient to conclude that the institution is engaging in financial intermediation;

[7] Although the term is not explicitly used in the recent legislative documents as such, it is clear that it is implicitly referred to and covered. For instance, the Regulation recital 69 mentions: ”*where the resolution tools have been used to transfer the systematically important services or viable business of an entity to a sound entity such as a private purchaser or a bridge entity, the residual part of the entity should be liquidated*.” The latter residual entity to be liquidated will hold by evidence problematic assets. It is also foreseen that a specific entity could be created for the liquidation of some assets over a given period of time (see article 42 in the BRRD).

- being closed to new lending, or partly open under restrictive conditions. The extending of loans which relate to the management of existing assets would not be sufficient to conclude that the institution is engaging in financial intermediation;

- strong externally imposed restrictions from competing on banking and financial markets;

- in most cases, a foreseen limited lifetime linked to the progressive liquidation of the assets by recovery or sales on the market."

Although better supervisions and/or early interventions by a resolution authority should minimise the risk of creation of such an entity, the legislative documents mentions that entities having clear features of financial defeasance structures may be part of a resolution plan.

In addition, the MGDD clearly states in paragraph 11:

"When there is evidence that government is assuming all or the majority of the risks and rewards associated with the activities of a government-controlled defeasance structure, as described above, this structure is classified in the general government sector, whatever its legal status. For instance, government is committed to cover the majority of the expected losses from the assets, through providing guarantees on the financing of the entity holding the problematic assets and the guarantee fee is not in line with the risks involved, or that the main source of financing is from the public sector. The entity should be classified in the general government sector either from its creation ….."

The holding or not of a banking licence is not mentioned neither in ESA 2010 nor in the MGDD among the features which could be relevant for the classification of such units and it is therefore to be considered as not relevant in this respect[8].

Although efforts have been carried out from a legal point of view, via the above mentioned Regulation and Directive, in order to reduce the likelihood that government could be involved and/or own such defeasance structures, it is evident that, in some cases, this could still be the case, as evidenced by the fact that it is still explicitly mentioned in the above mentioned legal documents that government could be involved. The fact that it could be a rare event is of no interest from a methodological point of view and from the point of view of the application of national accounts rules. The existing rules of the MGDD shall therefore continue to apply fully in such cases.

It must be also underlined that, as far as the legal status of any entity under resolutions is concerned, this is not an element which should be relevant for the application of the classification rules which have been agreed in the MGDD. Therefore, as in the past, the fact that an entity, which would match the criteria stated in the MGDD as to be included within the government sector, would keep its banking licence during a progressive winding up process (and therefore be on the official "list" of MFIs) is not to be taken into account for national accounts sector classification.

[8] On the contrary, the MGDD specifies (page 57) that "*a unit which would not place itself at risk, even if it held a banking license, cannot be considered as a financial intermediary*", as well as that (page 68) entities having the features of captives financial institutions controlled by government should be classified in government and not in S.12 "*even in cases they would hold a banking license and would be included in the MFI list held by the ECB*". The parallelism with the case of financial defeasance structures owned by government is evident.

Additionally, the fact that the debt of such defeasance structures would not an incontrovertible commitment of government, in as much as the obligation does not exceed the realisable value of the asset, would not preclude classifying the entity inside government, and recognising the debt as Maastricht debt. Given basic ESA rules, any entity public controlled and carrying nonmarket activity should be classified inside government. Their debts are thus Maastricht debt, despite the fact that their reimbursement is strictly conditional to the sufficiency of assets and/or of future cash flow. Defeasance structures are, in this respect, no different.

In reality, defeasance structures are merely entities hosting portfolio of assets that are essentially property of government in as much as government (and its associated arms: guarantee funds, resolution funds, etc.) provided help by way of purchasing these assets at an inflated prices (directly, or indirectly), in a clearly non-commercial way. Such portfolio of assets exposes the holders to risks and rewards, on a net basis, i.e. net of any liabilities assumed, following the waterfall implied in the rescue scheme.

As such, government is genuinely exposed to risks and rewards on the defeasance structure. The existence of risks to government does not require any risk for a future outflow of resource of other government unit. The risks exist from the possibility of a lower return of resources than implied by the fair value of the assets transferred at time of transfer.

2) The classification of the SRB and of the SRF

As far as the classification of the SRB and SRF is concerned, the Regulation states in its article 42 that "*the Board shall be a Union agency with a specific structure corresponding to its tasks. It shall have legal personality*."

The Board (SRB) will have its seat in Brussels, will be independent from the Member States and will have its own staff and its autonomous budget, fed by special contributions levied for covering the administrative expenditure of the Board. The SRB has started its activity at the beginning of 2015 in order to prepare the entry into force of the Single Resolution Mechanism at the beginning of 2016.

As far as the decisions making process is concerned, there will be five full-time members (including the Chair) and a member appointed by each participating Member States, representing the national resolution authorities. However, it is mentioned in article 47 of the Regulation that the Board shall act independently and according to the general interest. Members are not supposed to receive instructions from their national government in order to "protect" or "favour" any financial institution. It is foreseen that decisions will be taken either by a plenary session or by an executive session (where only the permanent members of the Board will participate).

The process of decision for resolution plans is rather complex but it can be concluded that the Board will have the power of initiative and that the Council will not be able to dictate any measure. The Council and the Commission may "object" to the plan presented by the SRB (and only under some pre-determined circumstances), but only the Commission will have the right to amend it. In this case, the Council will have the right to agree or not with the amendment proposed by the Commission. If the Council will agree with the Commission, the SRB will then have to accept the amended plan.

It is also stated (article 18 of the Regulation) that "*where the Council objects to the placing of an institution under resolution on the ground that the public interest criterion referred to in paragraph 1c is not fulfilled {by reference to objectives of a resolution plan} the relevant entity shall be wound up in an orderly manner in accordance with the applicable national law*."

Eurostat considers that the SRB should be classified within the sector S.2122. The Fund (SRF), on the contrary, will have no legal status and has been set up as a "financial arrangement". The Regulation stipulates (article 75) that "*the Board will administer the Fund in accordance with this Regulation"*. The Regulation on the SRM even specifies that "*the owner of the Fund shall be the Board*". It is clear that the Fund will not have the features of an institutional unit, and should therefore be classified together with the unit controlling it, i.e. the SRB.

The activation of the Fund (unique for the countries participating to the SRM[9]) will only be decided by the Board. The latter has also the power to set the ex-ante contributions (levied by national governments but to be automatically and integrally transferred to the Fund), the possible ex-post contributions and the possibility to enter in some financial arrangements (which may include the European Stability Mechanism (ESM)), if needed.

The action of the Board will be obviously constrained by some legal provisions, such as a "target level" to be reached in a few years (probably 8 years)[10], a restriction of extra-contributions to three times the annual amount of contribution, etc. In this context, however, it is important to stress that no other entity will have the power to interfere in this decision making process.

Although there will be a transition period, this has been set to only 8 years, which means that, in 2024, the Fund will be fully operational for any resolution activity (needing the use of the Fund[11]) for any unit, whatever its territorial location.

Before that moment (in 2024), the contributions levied in each country will be allocated to "national compartments"[12]. In this respect, there has been a double debate on the progressive mutualisation of the compartments (to reach the situation described above), and on the specific powers of each country in relation to each own national compartment.

A specific Intergovernmental Agreement (IGA)[13], decided that the mutualised part will be 40 % of the total the first year (2017), reaching 60 % of the total the second year (2018) and will then progressively increase by 6.75 % each year until 2024 (in a previous version, it was equal to only 10 % each year over 10 years). This means that, after two years, the majority of the resources in the compartments could be used for any country and not strictly on a national basis. It is not excluded at present, moreover, that the process of mutualisation could be accelerated, after the third year.

[9] 26 EU Member States have agreed on the transfer of contributions to the SRF. There are some specific rules for the Member States for which the currency is not the euro.

[10] This target could be adjusted. It is understood as only as a minimum.

[11] A relevant example is when the bail-in (capped at 8 % of total liabilities of an institution) is not sufficient. In this case, the Fund may contribute up to 5 %.

[12] To be precise, these compartments will still be identified after that date but their use will be undifferentiated.

[13] Available at: http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208457%202014%20INIT.

Neither the Regulation nor the IGA specify the nature or the status of the compartments. It is not possible to consider that the financial assets in each compartment will be a sort of deposit which the country could be able to withdraw at will, or even at some notice. Government could not invoke budgetary problems (or any other reason) for using the national compartment under any circumstances. The transfer of the contributions from the country to the SRF is irrevocable and the use of the contributions will be exclusively dedicated to resolution activities.

In this framework, a key point is the degree of decision powers which a country will hold on its own compartment during the transition period.

Here, it is important to underline that countries will not be able to use the resources raised from the financial institutions located in their territory exclusively for resolutions activities undertaken at their national level, in the framework of decisions taken by their national resolution authority.

As a matter of fact, it was agreed that the resources of the Fund will be used for resolution intervention as follows:

- at first, the Fund will draw on the compartment of the "contracting parties" involved (i.e. the home country of an institution and the host countries for branches/affiliates);

- should this not be enough, the Fund will have recourse to the financial means available in the mutual part of all the other countries;

- then, if it will still need resources, it will use the remaining resources in the national compartments of the other countries which have not yet been mutualised;

- should that again not be enough, the Board may decide to levy extraordinary ex post contributions in the countries involved (home and host);

- successively, the Board may decide on borrowings which will have to be reimbursed by extraordinary ex-post contributions.[14]

Finally, only as a last measure, transfers (which will have the nature of loans) between compartments which have not yet been mutualised may be implemented.

This will happen at the request of the countries where a resolution activity is taking place; such "loans" should be "reimbursed" by future extraordinary ex-post contributions.

The countries which are not involved in the resolution process, will have the right to object, under short deadlines, only in specific cases, such as when a resolution activity in their own country might take place in the near term (to be agreed by the Board), if the "additional mutualisation" should take more than 25 % of what is in the non-yet mutualised compartment, or if there are reasonable doubts on whether the requiring party(ies) would be able to replenish in the future the national part to be used.

The IGA, mentions in article 7 (6) that "*The Board shall specify general criteria determining the conditions upon which the temporary transfer of financial means among compartments envisaged in this Article shall take place*."

[14] It is at this stage that the ESM might be involved.

Based on all the above, Eurostat has concluded that there is no reason to foresee any specific treatment for resources allocated to national compartments, notably when not yet mutualised. Even if not all the resources will be fully available for the Board at inception, the restrictions are nevertheless partial and, in addition, deemed to progressively diminish.

As far as the classification of the SRB is concerned, it should be classified in the sector "Institutions and bodies of the European Union" (S.212), as a government entity and not as a financial corporation. This is because:

- The SRB will be entitled to levy contributions and will have the power to set their level – which is normally a power exclusive to government entities;

- The banking union is set up in the context of the existing EU institutions and bodies, which form sector S.212;

- The SRB will be close to the Commission and the Council, as the SRB cannot decide by itself a resolution plan (which may imply to use the resources of the SRF). Although the SRB will have the mission to elaborate resolution plans, the Commission will have the power to object (within 12 or 24 hours) on some aspects, and if it does so, the SRB will be obliged to revise the plan. Moreover, in some specific cases (for instance where the liquidation of an entity is foreseen) the Council can adopt the objections of the Commission (but not propose an alternative plan). This means that the SRB cannot be considered as a unit having a complete autonomy of decision.

3) **The issue of support from general government**

As previously mentioned, the new legislation will not exclude the possible intervention by government, with a possible impact on their deficit and/or debt, even if a better supervision, early interventions by a resolution authority and the use of some "resolution tools" would normally minimise the likelihood of such interventions.

The new legislation would still allow the creation of entities with the features of financial defeasance structures. This could be observed, amongst other, in 3 cases:

a) The Council may reject the launch of a resolution process (for MS participating to the SRM) and, in this case, the "extinction" of the financial unit which has not been considered as being in a position to reach in the future an acceptable degree of solvency (structurally viable) may imply the establishment of a public defeasance structure. This would be notably the case if the unit at stress would be a public financial institution. In this case, the SRB or the national resolution authority (NRA) would not be involved (see below).

b) The support to some significant ("systemic") financial institutions may need such a considerable amount of resources, under different resolution tools, that the SRF or national resolution funds would be unable to provide[15], even by way of their own borrowing. In such situations, it may be

[15] As stated above, during the transition period the resources of the SRF would be progressively constituted. Is some problems were to occur during the very first years, the capacity of intervention of the SRB and the NRA could be insufficient if the problems would not be limited to small or medium size entities.

decided to transfer some problematic assets to a special public structure as a way not to wind up the existing unit.

c) The Directive clearly mentions that government could take control of a unit under resolution. It is also stipulated that this must be temporary, with a view to transfer the ownership of the unit to the private sector, as soon as possible. But it might be that a part of the unit would not be viable and that, in this case, the non-transferable assets might be managed by a defeasance structure.

d) Resolution activities for the smaller and less significant banks might be undertaken under the exclusive decision making power of national resolution authorities, and involve the use of public assets.

As a consequence, the methodological provisions included in ESA 2010 and in the dedicated chapter IV.5 "Financial defeasance" in the MGDD must be considered as still relevant and fully applicable also in the general framework of resolution of credit institutions. Their application must not be considered as purely hypothetical but fully possible, in view of the entering into force of the Single Resolution Mechanism.

4) The absence of a dichotomy between the SRM and the BRRD

It is important to stress that the new set up cannot be considered as a case of a dichotomy between one set of rules for the SRM world (the euro area as well as other countries participating in the banking union) where control in some circumstances would lie with the SRB, and another set of rules for the Bank Recovery and Resolution Directive (BRRD) world (for non-participating EU countries) where relevant control would lie with the national resolution authorities. While the SRB will be responsible (with the co-operation and assistance of the national resolution authorities) for the resolution planning for the major banks in the euro area, the national authorities will remain largely independently responsible for the resolution planning for the smaller and less significant banks. This is explicitly set out in Article 7 of the SRM Regulation. These national resolution authorities might of course be part of general government.

5) The issue of control in the context of resolution activities

Resolution authorities are entitled with some powers in order to carry out the resolution process. This is both the case for the national resolution authorities (NRA) and the Single Resolution Board, as the latter will not intervene in all cases, even under the SRM.[16] The Regulation and the Directive include clear provisions on the share of responsibilities between NRAs and the SRB.

In the Directive (the Regulation refers explicitly to the Directive on the following points), there are 3 possible forms of control:

First, the resolution authorities (RA), which include both the Single Resolution Board as well as national resolution authorities, are entitled to specific powers which are referred as to "resolution

[16] However, if resources of the SRF will be used, the SRB would have the last say on the resolution actions. This would not be the case if the Member State would not ask to use the resources of the SRF.

powers" in article 63; they can override the power of the shareholders if the latter are reluctant to implement some measures, but this covers only the resolution actions which are detailed in the Directive ("tools"). The exercise of these powers must be proportionate and will be adjusted to each case.

Second, article 35 mentions that the RA may also appoint a special manager who would have the task to implement the resolution measures decided by the RA. This would be however only for a temporary period. Once the resolution measures are completed, such powers would be no longer needed.

Additionally, as mentioned in article 72, the RA may also "*operate and conduct the activities and services of the institution under resolution*". In such case the voting rights linked to the shares or other ownership instruments, would not be exercised. This, however, will happen only during the period of implementation of resolution measures (i.e. the different tools listed in the legal documents).

This would however strictly be on a case-by-case basis and it is also mentioned that the RA may take specific resolution action through "executive orders", without exercising formal control over the institution under resolution.

Should the RA exercise some form of control (although it will remain to be seen the exact terms and features of its control), it might be considered whether the unit under resolution would still be part of the public sector as long as the resolution actions would not have been concluded, something which is foreseen to happen on a rather short period (normally only up to a maximum of two years). Eurostat considers that also during the above short period, the unit should not be excluded from the public entities register. The public control might only be "suspended" temporarily (if at all) but not definitively transferred.

Moreover, it is to be underlined that a national resolution authority exercising control on an entity under resolution could be classified in general government. This is not excluded in article 3 of the Directive.

Finally, the new legislation has foreseen that, in the context of the resolution actions, two new special bodies could be set up (articles 40-42).

One is a bridge bank, to which the "viable" activity of the institution under resolution (and notably its "critical functions") will be transferred, which means that the residual entity will become a non-viable entity which will disappear in the future (see below).[17]

The other is an asset management vehicle (AMV) with the aim to receive some assets of poor or bad quality (and notably not directly related to the implementation of "critical functions"); in this case the residual entity should be considered as viable in the future while the AMV should have only a limited lifetime.

[17] It might be the case that, at the start of the resolution process, the residual entities could be still considered as MFIs, holding a banking licence but this should be for very short time as, by definition, they would have to stop exerting "critical functions". Moreover, the holding of a banking licence would not influence their classification.

In both cases (the residual entity and the AMV), the entity will be partially or totally publicly owned, as private investors would most likely not invest into an AMV. The specific cases of the classification of the residual entity and of the AMV are discussed below.

6) The relevance of control in a process of liquidation

The issue of control in a liquidation process needs to be further examined. It has been argued that, as in some circumstances the SRB will take "control" of an entity, it will not be possible for an entity to be part of the general government sector, because the entity would not be a government controlled (public) unit. This needs careful reflection.

First of all, it will be necessary to see how this "control" will be made in practice, but even more fundamentally, when it comes to the classification of financial defeasance structures, in a situation where the entity has to be wound up and the (bad) assets progressively sold, it seems far more relevant to consider the degree of risk the government assumes in the process. As made clear in ESA 2010 20.248, in those cases where a unit's only task is to assume the management of the bailout, the unit should be classified in the government sector… "*units that purchase financial assets from distressed financial corporations with the objective of selling them in an orderly manner cannot be considered financial intermediaries because they do not place themselves at risk. They are classified in the general government sector*".

ESA 2010 20.46, at the same time, makes explicit that a defeasance structure or a "bad bank" "*shall be classified according to the degree of risks it assumes, considering the degree of financial support from government… if the defeasance structure does not place itself at risk, it is classified to the general government sector*". It is therefore evident that when dealing with entities having the features of financial defeasance structures, the main criteria to be taken into account as far as their classification is concerned, is whether government assumes most of the risks and rewards[18].

The Manual on Government Deficit and Debt recognises all the above fully and specifies (sub-section IV.5.2.2, paragraph 14) that if a unit in financial distress is put into liquidation … "*this unit in liquidation (which can also be a residual part of financial institution in distress which has been restructured) has to be classified inside general government if government is, de jure or de facto, controlling the liquidation process (for instance through its dominant influence on a creditors' committee) and/or it is expecting to bear a majority of the expected losses from the liquidation due to its significant claims on the unit (taking into account its ranking among creditors) and/or due to support granted in the context of the management of the bail-out*". The MGDD adds further that "*the fact that the control has been withdrawn from the previous owners is not as such sufficient to be automatically classified in the sector of the liquidator or the creditors (possibly belonging to different sectors). Thus, the unit must remain in the financial sector or, as mentioned above, be reclassified in the general government sector*".

When the defeasance structure is in the hands of a liquidator, the control criteria becomes generally uncertain or irrelevant. The liquidator does not exercise control in the meaning of ESA, or even

[18] The risk could be limited to the equity of government but could also be higher.

business accounting. Under IFRS or IPSAS, control is explicitly referred to as "control for a benefit". A liquidator controls the liquidation, but for the benefits of others. He is a mere agent. As a result, when drawing his/her IFRS balance sheet, the liquidator excludes the assets and liabilities of the entities he/she liquidates. He is just like the manager of mutual funds, who, whilst controlling the investment of the funds, is not deemed to control the mutual fund itself. All these act as trustees.

7) Resolution tools and classification of units within the government sector

The innovative aspects of the BRRD and of the Regulation, as far as resolution is concerned, are that they contain a list of actions that the resolution authorities may carry out, under their respective field of competence. These are referred to as “resolution tools”. Not all of them are relevant from a statistical (government accounts) point of view, such as the minimum requirement for own funds, the eligibly of liabilities, the writing down and conversion of capital instruments and other actions which are grouped about the generic term of “early intervention”.

From a national accounting point of view, the key point is to ascertain whether entities with the features of public defeasance structures could be created in the context of the application of different resolution tools.

An important point to stress, in this context, is that the resolution authorities may assume some powers in a financial institution, above the shareholders, as far as some specific decisions are concerned. Nowhere is it mentioned in the relevant legal acts that this should not be applicable to an institution controlled by government, such as a public financial corporation.

Moreover, it is to be underlined that if it was decided that a (failing) public unit should not enter into a resolution process, for various reasons, then it would automatically be liquidated. Such unit would certainly hold problematic assets and, as a consequence, the MGDD rules related to public defeasance structures will be applicable. It would be irrelevant to assess the degree of likelihood of such cases to happen. What is obvious is that, however, the new legislation will not forbid or prevent the appearance of public defeasance structures.

The fact that the resolution authorities will have certain powers would not prevent the reclassification of the unit with the features of a public financial defeasance structure, inside government. It must be underlined in this respect that the powers of the resolution authorities are strictly defined and only temporary. An exit from resolution must take place rather quickly, for better or for worse. Moreover, it is not clear to what extent these authorities would direct a progressive liquidation process, after they have taken a decision to wind up an entity. In this respect, what matters is that the risk on the problematic assets would be borne by government.

In this context, it is interesting to review the different "resolution tools" which are offered to the resolution authorities which could have an effect on the sector classification of units.

a) Sale of business tool

In this case, it is imposed to the unit to sell some assets or even a whole activity, including what is called in the Directive and in the Regulation “critical functions”.

The definition in the BRRD could be seen as rather vague: “*activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services*

that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations."

Government could still purchase some business (assets) and the normal Eurostat rules should be applied, related to the price of the transaction, if not conducted at market/fair value.

As a consequence, after the sales, the "residual" entity, largely holding assets which could not be sold, will have to be wound up. It could meet in this context the criteria as to be considered a public defeasance structure, as defined in the MGDD.

b) Bridge institution tool and residual entity

In this case, a part of the assets and liabilities of the unit are transferred to an institution, created on purpose, which is called a "bridge institution" because it will have to implement a restructuring plan, in order to ensure recovery during a transition period, and on which some resolution measures will be imposed. For instance, the bail-in could take place at this stage.

Normally, the ownership of this bridge institution could be various but it is specified that there should be a public (partially at least) ownership (see BRRD article 40(2)).[19]

Thus, government may be the owner of the bridge institution and it may have also provided some guarantees. However, it is to be underlined that the original entity should still exist and would show residual assets and liabilities which would not have be transferred to the bridge institution because they would be a burden for the Bridge Institution and would surely compromise its recovery.

This institution will more likely have to be wound up, as it could be assumed that it would hold problematic assets (most likely these would be a majority of its assets as, contrarily to some past examples, the resolution authorities would be reluctant to leave some good assets in it). In addition, the "active" part of the ancient unit (facing market competition) will be logically transferred to the bridge institution.

Eurostat considers that, in this case, the sector classification of the residual entity must be closely examined.

The residual entity will not by default be classified in the financial sector, even in those cases in which it will retain the banking licence it originally had. If the MGDD rules will show that it is in substance a defeasance structure controlled by government, the unit will be included in the government sector (S.13). As soon as the main function of the residual entity would be the liquidation of the assets and no longer the "critical function" (such as receiving deposits[20]), with the

[19] Note that the term "public" is not defined in the BRRD and the Regulation. It does not exactly cover the public sector as defined in national accounts.

[20] The simple management of deposits would not be in accordance to ESA 2010 2.75, which specifies that the business of a deposit-taking corporation consists in "*receiving deposits*"… "*and, for their own account, to grant loans and/or to make investments in securities*". The management or mere holding of deposits and loans cannot be equivalent to the provision "for their own account" nor to the provision "receiving". Receiving deposits means an active behaviour of the unit. For this reason, a residual entity which may be engaged in the simple management of deposits and loans cannot be allocated to the deposit-taking corporations except the central bank sector (S.122). It must be ascertained what is the principal activity of the entity and if this presents in substance the features of a financial defeasance structure.

entity holding a majority of bad or problematic assets not kept by or not transferred to the viable entity, the residual entity must be considered as a defeasance structure.

Nowhere in the relevant legal acts is specified that government could not be the owner of this residual entity and not be at risk. In addition, government might have some creditor's interest and/or would like to protect some other creditors. As a reminder, control should be assessed by additional criteria than the mere ownership or voting rights.

Moreover, as far as the outcome of the bridge institution (classified as a financial institution) is concerned, it is to be stressed that the resolution authorities will have to take a decision after a given period. There may be a merging with another entity, an exit from the resolution authority's control, and a sale to a third party.

It is not excluded that, at one point in time, if the recovery will not be possible, the bridge institution itself could be liquidated, after having implemented other tools so that it would be left with rather problematic assets, implying again an examination of its sector classification if government was controlling it, as stated above.

c) Asset separation tool

In this case, a specific "asset management vehicle" (AMV), which would not be a credit institution, would be set up.

In the specific case of the AMV, article 42 of the BRRD mentions as follows:

"Asset separation tool

1. In order to give effect to the asset separation tool, Member States shall ensure that resolution authorities have the power to transfer assets, rights or liabilities of an institution under resolution or a bridge institution to one or more asset management vehicles.

Subject to Article 85, the transfer referred to in the first subparagraph may take place without obtaining the consent of the shareholders of the institutions under resolution or any third party other than the bridge institution, and without complying with any procedural requirements under company or securities law.

2. For the purposes of the asset separation tool, an asset management vehicle shall be a legal person that meets all of the following requirements:

(a) it is wholly or partially owned by one or more public authorities who may include the resolution authority or the resolution financing arrangement and is controlled by the resolution authority;

(b) it has been created for the purpose of receiving some or all of the assets, rights and liabilities of one or more institutions under resolution or a bridge institution.

3. The asset management vehicle shall manage the assets transferred to it with a view to maximising their value through eventual sale or orderly wind down.

4. Member States shall ensure that the operation of an asset management vehicle respects the following provisions:

(a) the contents of the asset management vehicle's constitutional documents are approved by the resolution authority;

(b) subject to the asset management vehicle's ownership structure, the resolution authority either appoints or approves the vehicle's management body;

(c) the resolution authority approves the remuneration of the members of the management body and determines their appropriate responsibilities;

(d) the resolution authority approves the strategy and risk profile of the asset management vehicle."

So the BRRD specifies in article 42 that, first, there must be public ownership (see above) and, second, that the AMV "*has been created for the purpose of receiving some or all of the assets, rights and liabilities of one or more institutions under resolution or a bridge institution*." It is also specified that the asset management vehicle shall manage the assets transferred to it" *with a view to maximising their value through eventual sale or orderly wind down*."

It must be pointed out that the legislation is silent about the length of the period when the powers of the resolution authority will be effective, so it is not known whether such powers will be effective over the whole life of the entity or not.

The scope of an AMV is strictly linked and restricted to the progressive liquidation of the assets and, even if the Resolution authority (the SRB for sizeable financial institutions and the NRA for small ones) may exercise some powers in the process, it will not bear extensive risks and get any reward in the process of liquidation, which is an essential criteria for Eurostat.

Moreover, it is not clear whether the RA would finance the AMV, as their aim is to ensure the continuity of the "critical functions", which by definition will not be in the residual entity to be liquidated, and they must be in a position to get back the amounts put in the viable entity, beyond the "bail-in" level, as clearly stated in the legislation.[21]

An important point is that there will be, during the resolution process, a "link" between the entities under resolution and the AMV, as stated in the following articles:

"9. Resolution authorities may transfer assets, rights or liabilities from the institution under resolution to one or more asset management vehicles on more than one occasion and transfer assets, rights or liabilities back from one or more asset management vehicles to the institution under resolution provided that the conditions specified in paragraph 10 are met.

The institution under resolution shall be obliged to take back any such assets, rights or liabilities.

10. Resolution authorities may transfer rights, assets or liabilities back from the asset management vehicle to the institution under resolution in one of the following circumstances:

(a) the possibility that the specific rights, assets or liabilities might be transferred back is stated expressly in the instrument by which the transfer was made;

(b) the specific rights, assets or liabilities do not in fact fall within the classes of, or meet the conditions for transfer of, rights, assets or liabilities specified in the instrument by which the transfer was made.

[21] There is of course no "doctrine" yet set up by the SRB on this point. Therefore, it is not possible at this stage to estimate the likelihood of such situation.

In either of the cases referred in points (a) and (b), the transfer back may be made within any period, and shall comply with any other conditions, stated in that instrument for the relevant purpose."

Thus, it is clear that the “interest” of RAs in this specific AMV entity is confined to the resolution process.

The RAs would have no vocation to manage over a long time an entity under liquidation, once they would consider that there is no longer a threat on financial stability due to a financial institution in distress.

From the examination of its nature, it is clear that the AMV, set up in a resolution process, has all the features of a defeasance structure, as defined in ESA 2010 and the MGDD. This unit is only deemed to "manage" the bad assets (i.e. to progressively sell (realise) them) which cannot be kept by the viable entity which the resolution process aims to bring back to a normal unsustainable profitability and solvency situation. According to the BRRD, the AMV is owned by a public authority (ies), notion which has not been precisely defined in the BRDD. It may effectively be a Resolution Authority or government or, in theory, even a public unit outside government.

Eurostat considers that, in this respect, government support, although exceptional and temporary (as you would in any case expect in the context of an entity to be progressively wound up and extinguished, where support cannot obviously be on a regular and permanent basis, might be enough for government for being the entity bearing most of the expected losses. The possible government commitment to cover losses (bearing most of the risks incurred on the bad assets), which would result from the insufficient proceeds from the monetisation/realisation of the transferred assets in comparison with the value of the liabilities to be repaid, is therefore a key issue to be taken into account for the classification of the AMV.

This vehicle could be largely owned by government, as it is difficult to imagine that private investors would accept to bear the risks of the liquidation process. If it is the case, it should be classified in the government sector (S.13) according to ESA 2010 and MGDD rules.

Normally, the resolution authorities may use resources from the Fund, but it is clearly stipulated that they must be in a position to recuperate, as much as possible, the resources used in the resolution process in such a case. Therefore, they could provide temporary loans, but they will not bear the risks of the liquidation.

Therefore, in most cases, this vehicle (the AMV) should be classified within the government sector. It must again be stressed that the fact that the resolution authorities might control the liquidation process (in terms that are rather imprecise) would not change the nature of the risks (and possibly rewards) borne by government in this case.

However, it might be the case that such vehicle would be owned only by private shareholders without any risk borne by government. In this context, any involvement of government (under the form of some guarantee or direct lending) should nevertheless be closely checked.

d) Bail-in tool

As already mentioned, this is a new feature in the recent legislation. Both the Directive and the Regulation describe the process in detail. The aim is to restore the solvency of an institution in

trouble, which necessarily implies a reinforcement of the equity of the unit, by absorption of the losses and recapitalisation to a level which makes it viable.

The provisions are rather complex (notably as far as the involved creditors are concerned) and there may be derogations for some small institutions. In addition, the 8 % limit (see footnote 12), may not be reached for various reasons (the amount of unsecured liabilities may be small or the losses too significant).

For its part, the use of the Fund is normally capped at 5 % of the liabilities. But, it is foreseen that "*in extraordinary circumstances*", alternative financing sources could be used. Although the issue is not further explained, it shows that the new legislation allows some flexibility. What matters here is that this it will not be under the control of government.

Could nevertheless resources from government be requested in this case? This should not be excluded and it might notably be the case when sizeable banks are concerned (these are defined as "systemic important financial institutions") which may have a strong impact in terms of financial stability (in the context of the "too big to fail" issue). This would not mean that shareholders and unsecured creditors would not be asked to do their part, but it could be insufficient to save the bank. The provision of resources from government shall be examined according to rules.

Still, as the purpose of bail-in is to ensure on-going activities related to critical functions, it is normally only after the use of other tools, as mentioned above, that a public defeasance structure could appear and thus would trigger a change in classification, into the government sector.

e) Public equity support tool and temporary public ownership tool

Government financial stabilisation tools are included in the "tool kit" of the BRRD (articles 56, 57 and 58) but they are not mentioned, even implicitly, in the Regulation.

It is understood that the SRB, as an EU agency, cannot interfere with the sovereignty of the Member States when, at the national level, government takes the decision to support the entity by providing equity or by placing it under temporary public ownership.

Such tools can only be applied to **institutions failing or likely to fail** and provided that certain conditions as defined in article 56 are met. According to article 56 of the Directive, such government financial stabilisation tools shall be used as a last resort after having assessed and exploited the other resolution tools to the maximum extent practicable whilst maintaining financial stability.

The exact circumstances for the application of government financial stabilisation tools are however not fully clear. It is also not clear whether such government tools would be applicable to all financial institutions (including important banks) or whether the SRB could perhaps oppose them. Regardless of these two facts concerning the practical application of the government support tools, some conclusions can be drawn concerning the potential impact on government finance.

In the BRRD, the difference between the two government stabilisation tools (public equity and temporary public ownership) seems to be that in one case government would take a minority stake, while in the other it will acquire a majority one. It should be noted that the term "public" could be seen ambiguous as it is nowhere mentioned whether it should be a government unit or a unit included in the public sector.

Concerning the public equity support tool, article 57 mentions that "*Member States shall ensure…that such institutions or entities subject to public equity support tool in accordance with this Article are managed on a commercial and professional basis*" and also that the equity held "*is transferred to the private sector as soon as commercial and financial circumstances allow*."

Regarding the temporary public ownership tool, in article 58 there is the same reference to "*commercial and professional basis*", while there should be also a transfer of the entity to the private sector "*as soon as commercial and financial circumstances allow*."

From the above, it could be deduced that the support by government would not, at least in a first stage, lead to a direct reclassification of the unit within the government sector.

However, it could be finally decided in a second stage to put the unit under liquidation. In this case, the situation should be re-assessed and the sector classification of the entity reconsidered.

If, in the context of the new legislation, government would be obliged to step in the capital of the unit, this would be an indicator that the fundamental situation of the bank is compromised, as "normal" resolution tools were not envisaged or turned out to be inefficient. The assets of the entity could be largely of bad quality.

Clearly, one should closely consider in this possible second stage the sector classification of the unit, which according to national accounts rules could have to be included in the government sector.

Notwithstanding the sector classification of the entity, the usual rules for capital injections as defined in ESA 2010 and the MGDD should be applied, possibly leading to the recording of deficit increasing capital transfers.

f) Extraordinary public financial support in solvent institutions

In the framework of BRRD, any bank that requires "extraordinary public financial support" is considered to be failing and therefore subject to the BRRD resolution rules, including the potential write-down or conversion of relevant capital instruments.

However, if public money is used to help a solvent bank to fill a capital shortfall revealed by the ECB's stress test or by an equivalent exercise (for example to preserve financial stability), then an exemption would apply. Thus, a solvent institution that receives public funds to address a capital shortfall based on a stress test scenario, would not trigger resolution, but a State Aid case.

Article 32 (d) of the Directive defines a series of extraordinary measures of public support (state guarantees, equity injections of own funds or purchase of capital instruments) that shall be limited to address capital shortfalls of **solvent institutions** established in stress tests, asset quality reviews or equivalent exercises conducted by the ECB, the EBA or national authorities, where applicable.

The cumulative conditions for the extraordinary recapitalisation with public funds are as follows:

a) the bank shall be solvent,

b) the injection of funds shall be of precautionary and temporary nature and shall be proportionate to remedy the consequences of the serious disturbance and preserve financial stability,

c) it shall not be used to offset losses that the institution has incurred or is likely to incur in the near future and

d) last but not least, the transaction shall be approved under the union State Aid framework (so after application of burden-sharing)

As in case e) above, the extraordinary support by government might not, at least in a first stage, lead to a direct reclassification of the unit within the government sector. However, independently of the sector classification of the unit, the usual rules for capital injections as defined in ESA 2010 and the MGDD should be applied, possibly leading to the recording of deficit-increasing capital transfers.

The general principle of reporting economic substance over legal form stated in ESA 2010 20.164 should be applied. It would be necessary to consider which role the government is playing in the transaction and apply a recording that recognises the economic substance of the transaction if this differs from its legal form.

8) Transfer of contributions

The Regulation mentions in recital 108 that "*Where participating Member States have already established national resolution financing arrangements, they should be able to provide that the national resolution financing arrangements use their available financial means, collected from entities in the past by way of ex-ante contributions, to compensate entities for the ex-ante contributions which those entities should pay into the Fund. Such restitution should be without prejudice to the obligations of Member States under Directive 2014/49/EU*".

However, in the IGA, recital 12 states: "*National laws and regulations implementing the BRR Directive, including those related to the establishment of national financing arrangements, start to apply as from 1 January 2015. The provisions concerning the establishment of the Fund under the SRM Regulation will be, in principle, applicable as from 1 January 2016. As a consequence, the Contracting Parties will raise contributions earmarked to the national resolution financing arrangement they are to establish up to the date of application of the SRM Regulation, at which date they will start raising the contributions earmarked to the Fund. In order to reinforce the financial capacity of the Fund as of its inception, the Contracting Parties commit to transfer to the Fund the contributions they have raised by virtue of the BRR Directive up to the date of application of the SRM Regulation*".

From the two above mentioned documents, it is clear that the possible restitution to banks will cover only contributions which could have been raised before the 1st of January 2015, if any.

For the already raised contributions to be transferred to the Fund, this will cover only the contributions raised by the NRA in 2015 and not in previous years, provided that they have not been used in resolution activities. However, as already stated, it is important to underline that the

Member States do not hold a claim on the Fund, equivalent to the contributions they have accumulated[22].

Therefore, the transfer of the already existing contributions from the national resolution funds to the single resolution fund must be considered as an unrequited transaction. It should therefore be treated as capital transfer expenditure with an impact on government net lending/borrowing (B.9).

It might be argued that, at least to a certain extent and during the transitional period, these resources could be used in case a unit should be considered under resolution in the territory of the MS. However, this event would be only contingent and the use of the Fund in a territory does not only depend on the contributions raised on this territory (it is to be remembered that only the Board will be able to decide on the use of the Fund and no MSs will have full control on their compartment, not even for the not-yet mutualised one).

However, a point would need specific attention. The IGA mentions "*contributions earmarked to the national financing arrangement*." It is not specified that it should be a government unit which will have to raise the contributions as the IGA, similarly to the Regulation, does not deal with issues concerning sector classification and legal status of entities. The IGA also mentions that these contributions have been raised by the "*Contracting parties*" which are clearly the governments of the participating Member States. As the payments are compulsory and unrequited, in order to be considered as transactions they must have the nature of taxes paid to national governments or supra-national government-like institutions..

In the MGDD, in chapter I.5, paragraph 14 states that "*the levies paid by the relevant financial institutions to the protection funds are classified as taxes*" (D.29). Therefore even if the transfer of the contributions will not be provided directly by a government unit, there will be a clear case for rerouting.

Therefore, the transfer of the contributions raised in 2015 should not depend on the sector classification of the national resolution fund (which will be replaced by the SRF in 2016) as the nature of the transaction from general government to the SRB is the same irrespective of the sector classification of the national resolution fund. All contributions raised in 2015 will have to be transferred to the SRB.

If the national resolution fund is not classified within the government sector (i.e. the corresponding assets are not on government's balance sheet) the accumulated contributions raised in 2015 should be first transferred to government (by other change in volume - uncompensated seizures (K.4), assuming that any national entity not classified to general government is not under the economic

[22] It is not mentioned in the regulation or in the IGA what could happen if one MS would decide to quit the SRM, except for MS which currency is not the euro. However, in the "Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund" (dated 14 May 2014), it is mentioned that for the countries whose currency is not the euro, "in case of termination of close cooperation with the ECB, contributions transferred by the contracting party concerned by termination are recouped in accordance with Article 4(3) of the SRM Regulation", and will cover both the mutualised and the not mutualised parts of the compartments, net of any use for resolution actions in the MS. In case of multi-national development banks there may also exist possibilities to withdraw capital, nevertheless, in the case of concessional lending, these are classified as capital transfers.

ownership of general government and as such, this has to be treated as a case of nationalisation of assets in accordance with ESA 2010 20.214-20.216), and then transferred to the SRF (by capital transfer). This treatment leaves government net worth unchanged[23].

From 2016 onwards, the national resolution funds will no longer receive the contributions from national financial institutions (D.29). The contributions by domestic S.122 units will be recorded directly as other taxes on production (D.29) in the SRB/SRF (S.2122).

CONCLUSION

To summarise, two categories of institutions result from resolution activities:

- viable institutions which will continue to be financial intermediary (classified in S.122);

-non-viable institutions, holding rather bad assets, which have to be extinguished (liquidated) progressively with the sale/realisation of the assets; these are referred as the" residual entity to be wound up"[24] but are called “defeasance structure” in ESA 2010 and in the MGDD. They will be classified either inside government or as financial auxiliaries, depending on control and risks and rewards criteria.

The extinction process may take various forms, although it is expected that in most cases it will follow the normal national insolvency normal procedures, except for the special case of the AMV.

In this context, it might be the case that, at the start of the process, the residual entities could be still considered as MFIs[25], holding a banking licence. This however will be irrelevant for their classification in national accounts. As soon as the main function of an entity will become the liquidation of its assets, most of which are bad or problematic assets, it will be considered as a defeasance structure. The current rules of the MGDD fully apply in the context of the establishment of the SRM.

In any case, due to uncertainty on the extent to which resolution authorities might exercise their powers in concrete cases and the possible different interventions by the resolution authorities and

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[23] The sector classification of national resolution funds will be the subject of a separate note. Levies by national resolution funds on financial corporations are to be classified as taxes (D.29) to general government, with a corresponding D.75 flows to the fund.

[24] In the case of the tool “sale of assets”, the residual entity may be viable or not viable.

[25] It is to be recalled that ESA 2010 defines MFIs as “deposit-taking” and not as “deposit-holding” (even less if as a result of a winding-down process). Moreover, in the new SSM/SRM framework, the existence of a banking license will not in any case ensure that the holding of a banking license always coincides with the task of financial intermediation, as defined in ESA 2010. Pursuant to the SSM Regulation (Council Regulation (EU) No 1024/2013), Article 14 (6), the power to withdraw a banking license is restricted with a view to considerations related to the implementation process of a resolution or for financial stability reasons: “*as long as national authorities remain competent to resolve credit institutions, in cases where they consider that the withdrawal of the authorisation would prejudice the adequate implementation of or actions necessary for resolution or to maintain financial stability, thy shall duly notify their objection to the ECB explaining in detail the procedure that a withdrawal would cause. In those cases, the ECB shall abstain from proceeding to the withdrawal for a period mutually agreed with the national authorities*.” Therefore, it is obvious that in any case the existence of a banking license as such would not warrant the ESA 2010 characteristic of a financial intermediary.

general government during a resolution process, it would be difficult to draw up a complete taxonomy of all possible eventualities, and case-by-case assessments and decisions cannot be avoided. The table below however shows, under normal circumstances, the criteria which will be followed to classify entities resulting from resolution activities in national accounts and the expected classification of such entities.

BANK RESOLUTION: SECTOR CLASSIFICATION OF ENTITIES IN NATIONAL ACCOUNTS

(BANK RECOVERY AND RESOLURION DIRECTIVE 2014/59/EU – SINGLE RESOLUTION MECHANISM REGULATION 2014/806/EU)

	Tool	Description	State	Features of a defeasance structure (MGDD IV.5) (1)	Gov. ownership/ risks and rewards	Sector classi-fication	Impact of transactions on government deficit and debt
Not likely to fail	**Early intervention measures**	*By supervisory authority – various changes related to the management of the entity may be required.* *Directive articles 29-30*	***Viable***	***NO***	***YES if Public bank***	***S.122***	***Possible capital injection for covering losses***
	Liquidation	*Decision of the Council not to start a resolution process.* *Regulation article 18.8*	***Not viable***	***YES***	***YES***	***S.13***	***Transfer of assets and liabilities with possible capital transfers***
				YES	***NO***	***S.126***	***Possible (e.g. loans or guarantees by government)***
	Bridge institution	*One part of the bank (MFI activities) is transferred to a new entity owned by "public authorities" and must be sold to the private sector in rather next future. Possible liquidation in some cases at the end of the resolution*	***Viable***	***NO***	***NO***	***S.122***	
			Residual (or BB) not	***YES***			

Failing or likely to fail		(2 years). The "residual" entity holds bad assets and must be wound up.	***viable***		***YES***	***S.13***	***Transfer of assets and liabilities with possible capital transfers***
		Directive articles 40-41		***YES***	***NO***	***S.126***	***Possible (e.g. loans or guarantees by government)***
	Sale of business	*The MFI-type activities are sold to an acquirer, which is not a bridge institution, under the close control of the resolution authority*	***Residual not viable***	***YES***	***YES***	***S.13***	***Transfer and assets and liabilities with possible capital transfers***
		The residual entity may be viable or non-viable. *Directive articles 38-39*		***YES***	***NO***	***S.126***	***Possible (e.g. loans or guarantees by government)***
			Residual viable	***NO***	***NO***	***S.122***	***NO***
	Asset separation	*New unit set up by resolution authority. It is not a credit institution (amongst other, no banking licence). Referred to as "asset management vehicle". It acquires problematic assets of banks in the view of proceeding to an orderly liquidation.*	***Not viable***	***YES***	***YES***	***S.13***	***Transfer of assets and liability with possible capital transfers***
		Directive article 42		***YES***	***NO***	***S.126***	***Possible (e.g. loans or guarantees by government)***
	Bail-in	*Coverage of losses by shareholders and unsecured creditors (up to 8 % of liabilities) in order to ensure a continuous activity. Resolution Fund may intervene up to 5 % (possible exceptions).* *Directive articles 43-44*	***Viable***	***NO***	***NO***	***S.122***	***Capital transfers where government covers losses, as equity holder or unsecured creditor***

	Public equity support	*Capital injection in equity (minority shareholder) by government in exceptional cases (size, systemic crisis, etc.). Equity to be resold in next future. Liquidation not excluded if unsuccessful recovery.* *Directive article 57*	***Viable***	***NO***	***NO***	***S.122***	***Capital transfer where equity injection*** ***covers accumulated losses*** ***+ possible impact of defeasance***
			Not viable	***YES***	***YES*** ***NO***	***S.13*** ***S126***	***Transfer of assets and liability with possible capital transfers*** ***Possible (e.g. loans or guarantees by government)***
	Temporary public ownership	*Capital injection in equity (majority shareholder) by government. In exceptional cases (size, systemic crisis, etc.); Equity to be resold in next future. Liquidation not excluded if unsuccessful recovery.* *Directive article 58*	***Viable***	***NO***	***NO***	***S.122***	***Capital transfer where equity injection covers accumulated losses***
			Not viable	***YES***	***YES***	***S.13***	***Transfer of assets and liability with possible capital transfers***

(1) Entity to be wound up, holding a majority of bad assets to be liquidated