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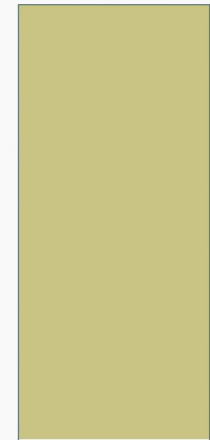
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No creditor worse off (NCWO): The (un)bearable *lightness* of EU's banking resolution regime

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1. PARETO RETRIEVED FOR BANKING RESOLUTION

- ❑ A matter of **collective action**: value share (preservation, and capture?) for transaction costs relief
- ❑ To prevent **individualistic behavior** (value destruction) in case of insolvency, creditors are treated in an equal stance way (*pari passu/par conditio creditorum*). Exceptions to the general rule are justified on the grounds of incentives for creditors to scout the common debtor performance.
- ❑ Pareto optimality in a Kaldor-Hicks frame: when someone is worse-off **must be compensated**.
- ❑ But the efficiency/fairness rule is misled: how to measure the improvement/impairment [**marginal conditions**]?

2. THE GONE-CONCERN VS GOING-CONCERN DILEMMA

- ❑ “Creditors should have a right to compensation where they do not receive at a minimum what they would have received **in a liquidation of the firm under the applicable insolvency regime** (no creditor worse off than in liquidation safeguard)” (2011 KA, para. 5.2).
- ❑ BRD, BRR and Spanish Act 11/2015: “a **winding up** under normal insolvency proceedings”. [But an insolvency proceeding does not necessarily involve the insolvent firm’s liquidation, at least totally].
- ❑ “Resolution of an institution which maintains it as a **going concern**” (BRD, Recital 8). “A failing institution should be maintained through the use of resolution tools as a **going concern**” (BRD, Recital 46).

3. THE VALUATION METHODOLOGY PROBLEM

- ❑ EC Delegated Regulations **2018/344** (*Valuation 3: NCWO*) and **2018/345** (*Valuations 1&2*).
- ❑ Valuation methods (“measurement basis”):
 - a) **Hold value**: for the assets to be retained
 - b) **Disposal value**: for the assets to be sold
 - c) **Franchise value** [going-concern value]: “the NPV of cash flows that can reasonably be expected to result from the maintenance and renewal of assets and liabilities or businesses and includes the impact of any business opportunities, as relevant, including *those stemming from the different resolution actions* that are assessed by the valuer”
- ❑ Art. 11.4(2) 2018/345: franchise/hold value cannot be applied when the **asset management vehicle**, **bridge institution** and **sale of business** resolution tools are enforced, even when they are conservation measures.

4. HIERARCHY OF LIABILITIES, ABSOLUTE PRIORITY AND INCENTIVES

- ❑ Absolute priority is given by EU resolution regime to banks' counterparties (other banks) operation liabilities (repos) and deposits, but the unprivileged/non-protected stakeholders **have no power/incentive to propose a deal** (as they are written down up-front).
- ❑ Going-concern valuation is fully consistent with a *dilution* response for existing shareholders and subordinated creditors: they receive a **provisional loss** with an opportunity to be compensated throughout the entity's restructuring process.
- ❑ Gone-concern valuation is a *tit-for-tat* response: unprivileged/non-protected stakeholders get an **up-front, non-recoupable loss**.
- ❑ The preventive reaction by shareholders and subordinated creditors to no deal/no compensation outcome is **a bank run** on their side. This will only foster the entity's meltdown.

5. PROVISIONAL CONCLUSIONS AND CONJECTURES

1. **Bail-in resolution is a monetary destruction mechanism** charging losses to banks' liabilities holders instead of depositors or other financial entities.
2. **Gone-concern valuation for non-protected security holders** is absolutely inconsistent with a value-conservation action implemented by the legally defined resolution tools.
3. **The entity's value preserved by resolution** accrues to those who purchase the entity's assets and business, and to other banks and depositors.
4. **EU banking resolution has nothing to do with banks' insolvency.** It is simply a way to control money supply and the number of operators in the industry.