About resolution in brief

What is resolution?

Since the global financial crisis that began in 2007, it has become clear that the handling of troubled banks and other financial institutions will need more effective regulation.

In hopes of retaining stability in the financial system, curtailing additional downfalls of the real economy and protecting depositors, governments both in and outside Europe spent enormous amounts of taxpayer money during the crisis on sustaining their financial sectors and saving banks, which sometimes has led to excessive accumulation of sovereign debt. And where banks were left unrescued (as was the case with – for instance - Lehman Brothers), insolvency and the ensuing liquidation precipitated severe contagion across the financial system at large. In order to prevent this situation from reoccurring, an alternative to both fiscally expensive bank rescue plans and inefficient liquidations that put the financial system's stability at risk had to be found.

It was with this purpose in mind that the European Union has adopted the Bank Recovery and Resolution Directive (BRRD). Tools specified in the directive may help avoiding insolvencies or minimise pertaining negative consequences of them, which can be ensured by ensuring the continuity of systemically significant functions of the financial institution at hand. In particular, savings covered by the deposit guarantee scheme (up to EUR 100.000) shall enjoy full protection not only in terms of value, but also in terms of uninterrupted access to current accounts and deposits. Hungary's law on resolution, adopted in July 2014, stipulates the rules of resolution applicable to credit institutions and investment firms on the basis of said EU directive.

The underlying principle is that, rather than relying on taxpayer bailouts, shareholdwes and creditors should be first to bear the costs of handling financial institutions' distress. To ensure this — and thus protect taxpayers — the Resolution Fund was created, allowing for certain costs of resolution to be spread across the entire sector of credit institutions and investment firms, whereby the resulting burden sharing will also lead to market players taking responsibility for one another.

On the whole, resolution therefore represents a special insolvency proceeding aimed at the restructuring of an institution or group, while ensuring the continuity of its basic functions and retaining the stability of the system of financial intermediaries, restoring — whether wholly or in part — the viability of the institution or group concerned and protecting budgetary funds. With the rules of resolution in place, the failure of a troubled institution can be prevented from causing spillover effects or any other major adverse impacts to the system of financial intermediaries.

Instruments of resolution

In scenarios stipulated by law, the following tools of resolution will be at the Central Bank of Hungary's disposal:

a) sale of business: means the tool for effecting a transfer of shares issued by the institution under resolution — or some or all of its assets, liabilities, rights and obligations — to another, healthy market participant.

b) bridge institution tool: refers to the transfer of shares issued — or some or all of the assets, liabilities, rights and obligations held — by one or more institutions under resolution to a bridge institution.

c) asset separation: the Central Bank of Hungary may transfer the assets, liabilities, rights or obligations of an institution under resolution or a bridge institution to one or more asset management vehicles.

d) creditor bail-in: a resolution whereby uninsured creditors and bond holders agree to bear, after shareholders have been divested of their shares, the remaining burdens and to have their claims cancelled or converted into equity (and therefore becoming owners themselves). As a result, the institute will most likely be saved from liquidation and can safely resume normal operations and serve its clients.

Organisation for bank resolution in the MNB:

In Hungary, the law designates the Magyar Nemzeti Bank as the national resolution authority. Under the Organisational and Operational Rules of the Magyar Nemzeti Bank, - in line with the EU directive - the resolution function is structurally separated with the supervisory function and is under the direct control of the Deputy Governor responsible for monetary policy, financial stability and lending incentives.

[Contact the managers of Magyar Nemzeti Bank]

Contact the Resolution Directorate resolution@mnb.hu