



University of St.Gallen

# Resolving small and medium-size banks: The role of bridge institutions

Siena, 8 May 2025

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From insight to impact.

# Agenda

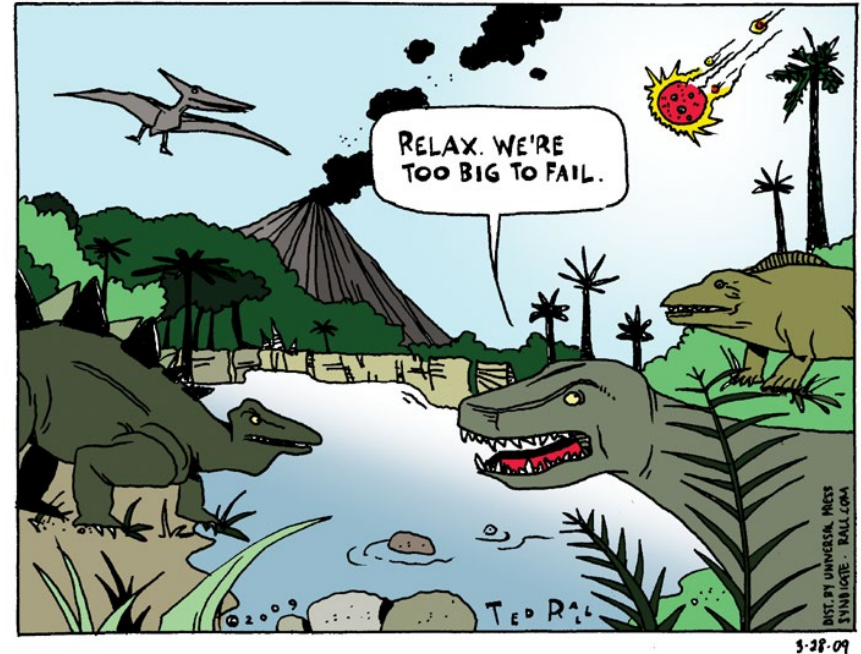
1. Why resolve small and medium-size banks?
2. What role for bridge institutions?
3. How to operationalize bride institutions?

Why resolve  
small and  
medium-size  
banks?



# Resolution as response to the global financial crisis 2007-2009

- (Large) Banks are different
  - Perform critical functions
  - Failure may have systemic repercussions
- (Corporate) Bankruptcy does not work
- Result: EUR 5.76 trillion in State aid for the bailout of the financial sector between 2008 and 2014
- “Never again”
  - Internationally: FSB Key Attributes
  - EU: BRRD, SRM-Regulation



# Four resolution tools

## Bail-in tool

- Write down of equity and write down and/or convert debt into new equity
- Open bank bail-in or in combination with transfer tools

## Sale of business tool

- Transfer of (parts of) the failed bank's business to a private acquirer (share deal or asset deal)
- Open, fair and transparent bidding process

## Bridge institution tool

- Conceptually a *temporary* solution (2 years + extensions)
- Operates as a licensed bank and maintains the transferred business until it is sold / wound down

## Asset separation tool

- Transfer of non-performing/illiquid assets of the failing bank to an asset management vehicle
- Cannot be applied as a stand-alone tool

# Small and medium-size banks

- They can be “**systemic in failure**” (FSB, 2024) → see Silicon Valley Bank in the U.S.
  - Failure may have large regional and/or sectoral impact
  - Have similar business models and may fail at the same time
- Resolution will often be **less costly and disruptive**, as it preserves the franchise value of the bank’s assets and its business relationships
- Predominantly **funded with retail and SME deposits**, on which losses should not be imposed
  - Have been managed under national regimes, often involving the use of taxpayer money
  - Need a dedicated resolution regime that accounts for their funding constraints → transfer tools, funded by Deposit Guarantee Schemes, if necessary

# Public interest assessment: *status quo*

- Bank Recovery and Resolution Directive (BRRD) and Single Resolution Mechanism Regulation (SRMR) are not restricted in principle to large and systemically relevant banks.
- BUT: conditions for resolution require that resolution action  
“is necessary for the achievement of and is proportionate to one or more of the resolution objectives ... and winding up of the institution under normal insolvency proceedings *would not meet those resolution objectives to the same extent.*” (Art. 32(5), subpara. 1, BRRD2)

“In a nutshell: resolution is for the few, not the many. For smaller, less significant banks, insolvency will be the procedure at play if and when they fail.”

Elke König (2020)

- Example: Veneto banks (2017) → too small to meet the PIA, too big to be liquidated

# Public interest assessment: proposal for reform

- A reformed PIA would require that resolution action:  
“is necessary for the achievement of, and is proportionate to, one or more of the resolution objectives ... and where winding up of the institution under normal insolvency proceedings *would not meet those resolution objectives more effectively.*” (Art. 32(5), subpara. 1, BRRD3)
- Essentially reversal of burden of proof (Asimakopoulos & Tröger, 2024): resolution for the many, insolvency for the few?
- The pending reform will likely increase the remit of resolution, even though there is lack of political agreement as to how much

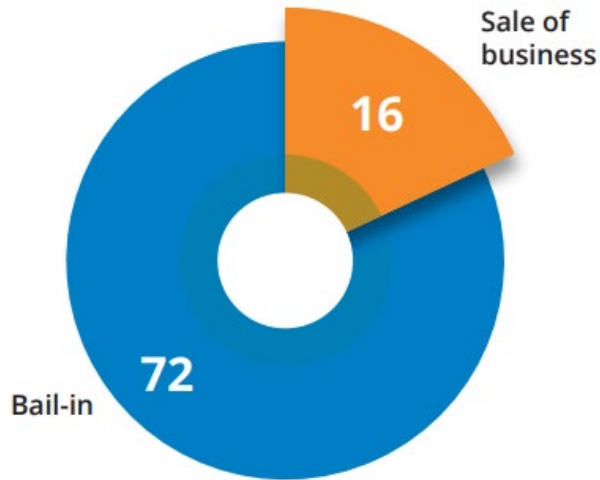


What role for  
bridge  
institutions?



# Resolution planning by the Single Resolution Board

**Figure 3.** Preferred resolution tool



“Sale of business is the most frequent tool envisaged as a variant to open bank bail-in, whereas a bridge institution is often used as **a variant to sale of business**, in combination with bail-in.”

SRB, Resolvability of Banking Union Banks: 2022, Sept. 2023

# Resolution practice: transfers, transfers, transfers

## **Banco Popular (2017)**

- Sold to Banco Santander in a share deal
- The resolution plan of Banco Popular had identified open bank bail-in as the preferred resolution strategy (no variant strategy planned yet)

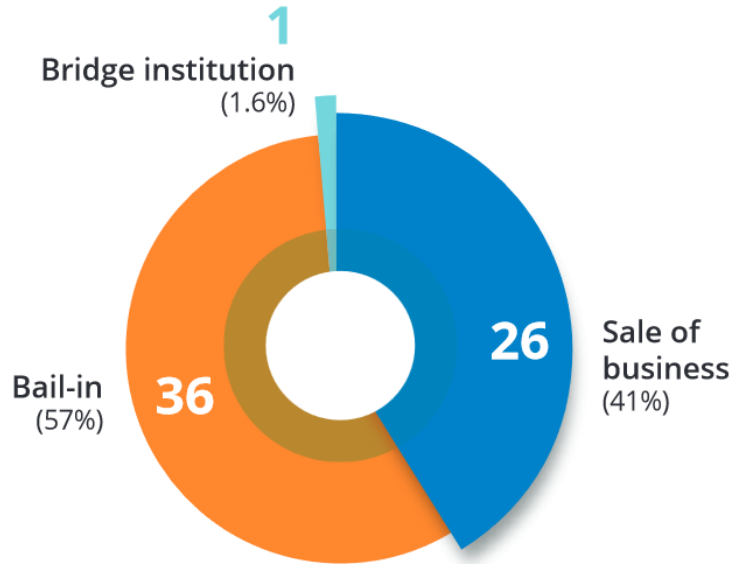
## **Sberbank (2022)**

- Croatian and Slovenian subsidiaries of Sberbank AG (Austrian parent) sold to Hrvatska Poštanska Banka d.d. (Croatian Postbank) and Nova ljubljanska banka d.d. (NLB d.d.)
- The resolution plans of both subsidiaries had identified open bank-bail in (applied at the Austrian parent) as the preferred resolution strategy

## **Similarly: Credit Suisse (2023)**

- Merged with UBS *to avoid entry into resolution*
- Resolution plan of the group had foreseen open bank bail-in at the single point of entry

# Resolution planning by the National Resolution Authorities



“[I]n comparison with [significant institutions], a higher proportion of plans had a preference for transfer tools, with about 40% based on a sale-of-business (primarily as a share deal ...).”

SRB, Resolvability of Banking Union Banks: 2021, Sept. 2022, pp. 40/41

# Bridge institution tool provides for optionality

## **Compared to the sale of business tool:**

- does not depend on the immediate availability of a suitable buyer
  - + enhances the bidding process
- buys time in situations of general market stress

## **Compared to open bank bail-in:**

- allows for carve-out of the viable business from the “rest” of the failed bank
- might be more effective in reestablishing market confidence

# Caveat of sale of business: willingness and suitability of buyers

## Willingness of buyers

- Buyers cannot be forced
- Will depend on (a) the franchise value of the transferred business, (b) the nature of its financial problems, and (c) the market environment

## Suitability of buyers

- Resolution authority
  - Transfer must best achieve the resolution objectives → financial and operational capabilities
  - Marketing requirement → highest offer
- Supervisory authority
  - Share deals: assessment of qualifying holding → viability of the resulting group
- Competition authority
  - Merger control → no significant impediments to competition in the relevant markets

Resolution authorities can pre-select potential buyers, but whether they are readily available on the “resolution weekend” remains uncertain.

How to  
operationalize  
bridge  
institutions?



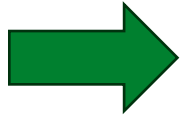
# Operational challenges

## “Melting ice cube problem”

Customers and counterparties will question whether to continue business with a bridge institution that has a highly uncertain future.

→ Runs may continue on the bridge institution (SVB, Signature Bank)

- U.S.: sale of at least the deposit franchise as quickly as possible (FDIC Acting Chairman Travis Hill)
- EU: attempt to restructure and sell at the highest price possible



Bridge institutions in the EU are licensed banks that have to meet prudential requirements



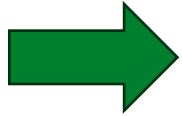
# Bridge institution funding

- Setting perimeter of transferred assets and liabilities (deposits, critical functions)  
→ reveals the “**funding gap**”
- Need for a “**safety margin**” beyond that *prima facie* gap (asset overhang)
  - Significant uncertainty related to the valuation of the transferred assets at the time of the transfer
  - Funding needs are likely higher for a bridge institution than for sale of business (stigma, uncertainty about ultimate solution)
- **Sources of funding** to fill the gap:
  - MREL-eligible instruments left behind in residual entity
  - Contribution by Deposit Guarantee Scheme

} + Single Resolution Fund, if necessary

# Bridge institution funding (cont.)

- Deposit Guarantee Scheme contribution is key for **small and medium-size banks** that tend to have difficulties in issuing sufficient MREL-eligible instruments
- BUT: Limited ability of Deposit Guarantee Schemes to contribute to the funding of resolution (Mecatti, 2022; Restoy et al, 2020)
- Reform proposal:
  - Replace existing super-preference for covered deposits with a general (single-tier) depositor preference?
  - Allow for a more flexible application of the least-cost test



DGS reform is instrumental for the operationalization of the bridge institution tool for small and medium-size banks

# Ownership and control

- In the past: **public ownership** of bridge institutions

“[The bridge institution] is wholly or partially owned by one or more public authorities which may include the resolution authority or the resolution financing arrangement and is controlled by the resolution authority” (Art. 40(2)(a) BRRD)

  - Resolution authority / resolution financing arrangements subscribes to newly-issued shares of the bridge institution
  - Bears the full risk of a sale below the nominal value of these shares
- Reform proposal: fully **private ownership** is possible, if the capital is provided through the conversion of liabilities into new shares
  - Private shareholders bear the full risk of a sale below the conversion rate

# Ownership and control (cont.)

- But: their **rights of control** over the bridge institution are excluded to the benefit of the resolution authority!  
“... the application of the bail-in tool for the purpose [of recapitalizing a bridge institution] shall not interfere with the ability of the resolution authority to control the bridge institution.” (Art. 40(2)(b), subpara. 2, BRRD3)
- Is that legally feasible? For how long?
- Will it increase the “melting ice cube problem”?

# Thank you.

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