Professor, thank you very much for your quick response.

As provided by the recent Euro Summit agreement, which has been ratified by the Greek Parliament (Law 4334/2015), today the parliament will vote on the transposition of the Directive 2014/59/EU concerning the "Recovery and resolution of credit institutions and investment firms", widely known as BRRD.

Could you briefly describe what is this Directive about?

The Banking Recovery and Resolution Directive is a cross-border EU piece of legislation aiming to establish a pan-European regime to deal with failing banks.

The "recovery" aspect of the Directive aims at restoring the confidence and viability of a bank when it is faced with a distress scenario or a difficult financial position.

Resolution is the term that is used for the liquidation of a bank. When a bank has reached a situation when it is not viable anymore, you have to resolve the bank in an orderly manner to minimize costs, disruption and contagion.

These are the two main aspects being addressed by the BRR Directive, in other words, how to prevent a crisis and how to deal with it in an orderly manner in case it happens.

Why is there such a rush to adopt the BRRD?

Right now the whole Greek banking system is in distress. This directive precisely tries to reverse the situation, and if not possible it tells you how to orderly liquidate the banks and minimize the negative effects of it.

If you ask me it is very timely and probably should have already been adopted. In some jurisdictions, like the UK, many of the tools incorporate in the Directive were already incorporated prior to the transposition of the Directive. It is a great addition, particularly for a country with a fragile banking sector like Greece. It is of utmost importance.

We keep reading about "bail in" and "haircut". Could you explain these terms in simple words?

Bail in and haircut are two different things which are not very simple to explain without getting into technicalities.
Bail in and haircut are two different things.
One of the pillars of the BRRD is that it tries to reflect the sentiment of what has been the post credit crunch scenario, particularly after the collapse of Lehman Brothers in the US and the bail-out of several banks. In the aftermath of the extensive use of taxpayers money to assist the banks in distress, many people started questioning the whole rationale of using taxpayers' money to support bankers get out of trouble due to their risky practices. Therefore, instead of using taxpayers money, banks should be in a position to sustain an external shock without having to resort to taxpayers money (i.e. to find their own way out of the distress scenario).

Although banks have no financial means when in distress, banks still have two types of creditors: those that hold a claim because the banks have issued debt in the capital markets, like bonds, and the depositors. When you deposit money in the bank it means that you are lending money the money stops being yours. It is a loan that you grant to the bank but it has special characteristics: the bank has to repay upon demand within banking hours in a branch of the bank.

Both, depositors and bondholders, have claims against the bank. In a nutshell, the rationale of bail-in aims at using bondholders' money to save the bank by reducing the total amount of debt and increasing equity.

Haircut on the other hand is the jargon used to refer to face value reduction. In this case, a reduction on the amount deposited in the bank. Haircut is not a tool as bail-in but a consequence. Bail-in is a tool which is embedded in the Directive stating that when a bank is facing difficulties before using taxpayers' money, we should use shareholders money to save the bank. Then, eventually, depositors might lose some money. The first ones to lose would be the shareholders, then bondholders and eventually depositors (above the EUR100,000 deposit guarantee scheme established in Directive 94/19/EC)

Can you expand more on the concept of the haircut?

If you do not have enough money to save the bank. It is like in a corporate restructuring. The banks tell the creditors (depositors), that they cannot pay what they owe—for example, instead of paying back 150 it will only pay 75. The bank imposes through an administrative procedure (bank resolution) a face value reduction on your deposits, i.e. a haircut.

There are two great truths that depositors usually are not aware of: (1) that the moment that they have done a deposit it is not their money anymore, it is the bank's money; and, (2) depositors believe that they are protected and they are only partially protected (if there is a deposit protection scheme and the system is pre-funded). In most jurisdictions there is deposit insurance/deposit protection guarantee scheme. Public, private, implicit, or explicit, most countries have it. In Greece is there is a Fund [INCLUDE NAME].

Technically, according to Directive 94/19/EC deposits are protected up to EUR 100,000. After the crisis, the EU is moving towards a banking union. The banking union has 3 pillars: (1) common supervision performed by the ECB; (2) common resolution as adopted in the BRRD; and, (3) a common deposit guarantee scheme for all EU members. This last one is not yet in place. Then, the problem is each domestic Fund has to protect depositors. How much money does the Greek fund has? In the end of the day it is a simple equation. What happens if the fund does not have sufficient money? Then it should take money from the Central Bank to cover the shortfall but what would happen if the Central bank does not have money?

What do you think about capital controls?

Perhaps one of the best things that could have happened to Greece, because banks stopped bleeding (losing money). It depends on your point of view, if you look at the big picture it should have been imposed a long time ago but no politician wants to adopt it because it will make them quite unpopular. During the last 2-3 years, the Greek banking system has been bleeding out (money going to Luxemburg, Italy, etc.) The amount of withdrawals was immense lately, so capital controls were necessary. Needless to say, people would not like capital controls because they cannot do what they want with their money but it is best for the common interest under these circumstances and it is a completely justified choice by the government (stability of the banking system as a whole).

How do you get out of this difficult situation?

Capital controls will last for a while (if not look at Iceland or Cyprus). There is a need to build confidence on the banking system before capital controls can be lifted.