

“Resolution and the role of the Single Resolution Board”

The Financial Crisis evidenced the need to progress towards a more harmonized system of financial supervision and resolution – particularly in the euro area, where the system of national banking supervision resulted in a misjudgement of risks for the system, with insufficient safety nets at European level to ensure the financial stability of the Member States participating in the Economic and Monetary Union (EMU).

To ensure that failing banks can be wound down in a predictable and efficient way without burdening European taxpayers, the European Union developed a common set of rules for all Member States: the CRD4 package, which introduces in particular tougher capital and liquidity requirements for banks in order to strengthen financial stability; and the Bank Recovery and Resolution Directive (BRRD), which creates a framework for financial distress to be overcome and for resolution authorities to intervene to avoid failure. In case of failure, the BRRD introduces the principle of bail-in – whereby banks' shareholders and creditors assume most of the burden – and national resolution funds.

Building on these two key pieces of legislation, the euro area countries agreed that further steps were needed within the EMU to reduce the link between banks and sovereigns. The project resulted in the creation of a new institutional system of banking supervision and resolution within a banking union, based on a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM).

Whereas the SSM became fully operational in November 2014, some of the elements of the SRM is not expected to be fully operational until January 2016. Besides, Commission proposals are expected for a European Deposit Insurance Scheme as well as for a potential framework for resolution of financial institutions other than banks by November 2015 and January 2016.

The new framework for resolution within the EU

The BRRD provides national authorities with more comprehensive and effective powers to deal with failing banks at national level, as well as cooperation arrangements to tackle cross-border banking failures. When a bank is considered to be failing or likely to fail, resolution authorities assess whether there is any potential private solution to restore the institution back to viability within a short timeframe, and whether normal insolvency proceedings would harm the public interest (by putting at risk financial stability or covered deposits, for example). If there is no private solution and resolution is considered of public interest, resolution would then be triggered. The resolution authority has four tools at its disposal: i) sale of business; ii) bridge bank; iii) asset separation; and iv) bail-in.

Shareholders and creditors are the first in line for assuming losses. Equity and debt representing at least 8% of the bank's balance sheet will have to be bailed-in (that is, the bank's creditors will see their debt written off without repayment or converted into equity) before resolution funds may be used in bail-in. In any case, resolution funds could assume only up to 5% of the losses. To ensure that a bank holds sufficient bail-inable liabilities when resolution is triggered, the resolution authority is also responsible for determining a minimum requirement for own funds and eligible liabilities in resolution (MREL).

Resolution funds will be set up at national level by every Member State over a 10-year period (by 31 December 2024), funded ex-ante with contributions from banks and investment firms in proportion to their liabilities and risk profile. The target funding level for each national fund amounts to at least 1% of covered deposits.

Ultimate responsibility for resolution is on national resolution authorities: public administrative authorities entrusted with administrative powers to prepare and manage resolutions.

The BRRD has already been transposed in 17 Member States, whereas 11 Member States (including France, Italy, Poland and the Netherlands) are still in the process to implement the rules into their national law¹.

Resolution in the context of the Banking Union

The Banking Union currently lies on three building blocks: (i) the Single Supervisory Mechanism (SSM), under which the European Central Bank (ECB) holds ultimate responsibility for banking supervision and assumes the direct supervision of the largest credit institutions in participating Member States; (ii) the **Single Resolution Mechanism (SRM)**, which is the structure responsible for planning the management of banking failures in an orderly manner, minimising the costs for taxpayers as well as for managing Single Resolution Fund (SRF), and (iii) a harmonised system of deposit guarantee schemes (DGS) at national level under the Deposit Guarantee Schemes Directive. A financial backstop (the direct recapitalisation tool of the European Stability Mechanism –ESM–) was also adopted in case privately-funded resources (bail-in, resolution fund, DGS) are not enough to ensure financial stability.

Within the SRM, the **Single Resolution Board (SRB)** acts as the resolution authority for banks in participating Member States. As such, it is responsible for assessing their resolvability, drawing up and updating the resolution plans, planning and drafting all decisions relating to resolution, and managing the SRF - a common pool of money that replaces national resolution funds for Member States participating in the banking union.

Once completed, the SRF will have around € 55 billion raised through contributions from all banks in the participating Member States over a period of eight years from 31 January 2016². Furthermore, the ESM can also be used for directly financing the recapitalisation of banks from the beginning in 2016, once a full bail-in has been applied and only if the Member State where the bank is headquartered also contributes to the recapitalisation.

¹ EC Financial Services: Commission requests 11 Member States to apply EU rules on Bank Recovery and Resolution http://europa.eu/rapid/press-release_IP-15-5057_en.htm

² Intergovernmental Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund https://www.parlament.gv.at/PAKT/VHG/XXV/I/I_0072/Z/imfname_429388.pdf

The role of the SRB

The SRM Regulation confers to the SRB the role of central decision-making body in resolution, responsible for coordinating and giving instructions to the network of national resolution authorities (NRAs) in participating Member States. As such, the SRB is responsible for drawing up resolution plans and drafting all decisions relating to resolution (forming the resolution scheme), and is directly in charge of the most significant banking groups. Final adoption of the resolution scheme however remains a responsibility of the European Commission for legal reasons.

Although the SRB was created in the beginning of 2015, it will not assume its full powers until January 2016. In the meantime, the SRB's mandate is limited to resolution planning (including resolvability assessment and removing impediments to resolution) and setting up its structure and internal procedures. These arrangements include:

- **Preparing a Cooperation Framework** in collaboration with NRAs, to identify the ways in which the SRB and the NRAs will cooperate for the successful functioning of the SRM. In addition, the SRB is preparing two other cooperation agreements: one with the ECB (supervisory authority) and the European Commission (since all decisions taken by the SRB must be endorsed by the College of Commissioners), to ensure consistency, cooperation and coordination between the respective roles and tasks. In addition to these agreements with EU institutions, the SRB is preparing cooperation arrangements with the relevant resolution authorities of non-participating Member States and third countries.
- **Preparing a Resolution Planning Manual** for NRAs specifying the criteria for drafting, updating and assessing resolution plans – covering information requirements and guidance on how to assess the information received by banking groups, as well as the methods, procedures and approaches for consolidating and assessing the information and analysis on credit institutions. Nevertheless, during 2015 the SRB has already begun its resolution planning activities in collaboration with the NRAs, the ECB, the Commission and other international stakeholders – specially, the Financial Stability Board (FSB), which is leading a comparative assessment exercise on the impediments to resolvability of global systemically important banks (G-SIBs). Moreover, the SRB has also identified the 143 banking groups for which it will have direct resolution responsibility from 2016, and is working on transitional resolution plans for those 43 banks (among which are 9 G-SIBs) which have been identified as priorities.
- **Determining minimum requirements for own funds and eligible liabilities (MREL).** The definition of the amount, composition and allocation of the MREL is one of the most challenging cornerstones of the new resolution framework, and one of the elements that has a deeper impact on the funding of credit institutions. The SRB must work on enhancing the information-sharing with the ECB to adapt the information obtained through the current reporting system (focused on the accounting and prudential aggregates) to the needs for resolution purposes (more focused on the banks' liability structure). Besides, decisions on the MREL quantity and allocation among subsidiaries is tightly linked to business models, as well as to the different resolution strategy (multiple point of entry vs. single point of entry), including potential legal constraints. Last but not least, European G-SIBs will be required to comply with the FSB TLAC requirement, and the SRB has announced its willingness to ensure consistency, and not duplication, between the TLAC and MREL ratios.
- **Preparing a Crisis Management Manual** which compiles past experience and best practices of national authorities. The manual would serve as a guideline for the steps to be taken from the early intervention stage (a phase when the ECB detects strong financial distress, but before the problems become critical and resolution is required) to the execution of resolution, including the drawing up of the resolution scheme.
- **Setting-up of the Single Resolution Fund (SRF).** In 2015, the sole responsibility for the contribution collection is on the NRAs. The resources of national resolution funds will then be transferred to the SRF in January 2016 – subject to the timely ratification of an intergovernmental agreement on this matter still pending to be ratified in most participating Member States.

- **Preparing the management of the SRF from 2016.** For this purpose, the SRB must look for potential external financing sources in case of insufficient funds in the SRF during the 8-year build-up period until it is fully-fledged. The SRB is particularly working on a potential bridge financing arrangement with Member States (i.e., public credit lines). Moreover, the SRB must assume the investment strategy of the SRF. The European Commission is expected to present a proposal for a delegated act in this regard in autumn 2015.

Five Presidents' Report

As a follow-up to the implementation of the SSM and the SRM, in June 2015 the presidents of the European Commission, the European Parliament, the European Council, the European Central Bank and the Eurogroup presented a report on the next steps to complete the EMU.

The Five Presidents' Report³ underlines the need of completing the Banking Union, and points at three missing elements on which swift action is needed:

- The full transposition of the BRRD by all Member States.
- Reaching a swift agreement on the bridge financing mechanism for the SRF before January 2016.
- Setting up a credible common backstop for the SRF during the transition period until the fund is fully fledged. In this regard, the document proposes a credit line from the ESM to the SRF, so that the arrangement ensures that public assistance is recouped by means of ex post levies on the financial industry.
- Agreeing, before June 2017, on a European Deposit Insurance Scheme (EDIS) to increase the resilience of national deposit guarantee schemes (against future crisis and to strengthen confidence in the safety of bank deposits, irrespective of the Member State in which a bank operates. This element would represent the third essential pillar of the banking union, providing a common system of deposit guarantee for participating member states (as

originally envisaged in the banking union project). A Commission proposal in this regard is expected by the end of November.

Non-bank resolution

As with banks, normal insolvency proceedings may be ineffective in dealing with the failure of other financial institutions (such as clearing and settlement companies, asset manager or insurers), in particular those which develop critical functions which, if not maintained, represent a risk of serious disruption to the wider financial system and the economy in general.

In October 2010, the Commission decided to explore whether the recovery and resolution regime for banks should be extended to other financial institutions (beyond banks), to counter the potential threat of their failure. Following a public consultation in 2012, in its Work Programme for 2015 the Commission identified central counterparties (CCPs) as the sector for which a recovery and resolution framework may be necessary. A legislative proposal is expected by January 2016⁴.

Conclusion

Following the financial crisis, the European framework of financial supervision and crisis management was enhanced with a common set of rules (the CRR/CRD4 and the BRRD) aimed at strengthening financial stability, managing future failures in an orderly way and minimising the cost of a banking crisis for the taxpayers. In the Eurozone, the framework was underpinned with the creation of the SSM and the SRM, thus ensuring that the bulk of the instruments needed to deal with future banking crisis in cross-border banks within the banking union was available for public authorities. However, the timely implementation of the new framework remains a challenge, and the debate on further elements (such as a European Deposit Insurance Scheme within the banking union or the creation of an EU framework for non-bank resolution) are still in an early stage and will require a deep analysis to assess their implications in economic, fiscal and political terms.

³ European Commission. Roadmap for a framework for resolution of financial institutions other than Banks. http://ec.europa.eu/smart-regulation/impact/planned_ia/docs/2015_fisma_029_cwp_ccp_resolution_of_non_bank_resolution_en.pdf

⁴ European Commission. Roadmap for a framework for resolution of financial institutions other than Banks. http://ec.europa.eu/smart-regulation/impact/planned_ia/docs/2015_fisma_029_cwp_ccp_resolution_of_non_bank_resolution_en.pdf

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Secretariat or the Chair of the Financial Industry Committee.

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