

EBF Positioning on the Principles underlying the Single Resolution Mechanism

Key Points

- The EBF is supportive of the concept of Banking Union as a complement to EMU and in the spirit of promoting the single rulebook and its consistent application. The Banking Union framework needs to progress to overcome the present fragmentation of financial markets and help break the link between sovereigns and the banking sector. It should promote a level playing field as well as provide an efficient common crisis management framework for banks in countries participating in the Single Supervisory Mechanism.
- In addition, it should further alleviate contentious home-host issues in the recovery and resolution process within the participating Member States, as it would overrule national interests in cross-border bank failures. It should also facilitate the speed of cross-border resolutions which in turn may minimise the systemic impact and the cost of bank failures as well as the need for taxpayer support.
- The EBF in principle supports the creation of the Single Resolution Board (the Board) to plan and oversee banking resolutions. EBF Members believe that the Board should be given a strong legal basis, if deemed necessary by a treaty change.
- The Board should work in close contact with the European Central Bank (ECB) to monitor the health of banks in the Banking Union and develop resolution plans and minimise any duplication of data requests.
- The governance of the SRM needs to be solid from the start. It should be upfront clear what the roles and responsibilities of the stakeholders in resolution and supervision are with the basic principle that duplication of responsibilities should be avoided.
- The current proposal for the SRM should be also underpinned by a harmonised framework for Bank Recovery and Resolution (BRRD) at the EU level which addresses the basic framework for the resolution of banks. The EBF urges EU policymakers to finalise the negotiations of the BRRD without delay.
- The Board should ensure that effective and binding cross-border decisions on bank resolution are taken in an appropriate timeframe for managing a crisis, with sufficient powers and resources to ensure these decisions are executed in a consistent manner. The ultimate decision maker in the SRM should be independent, but accountable through democratic oversight and answerable to legal proceedings and rights of appeal.
- A key precondition for the creation of the SRM is that it should not be burdened with legacy costs. Banks should therefore be given a financial health check (i.e. their balance sheet should be assessed)

by the ECB prior to their admission, if the ECB has not recently already performed such a test. Legacy asset shortfalls in the banking sector should be dealt with on a national basis.

- EBF Members agree that the SRM should be supported by a credible bail-in regime and resolution financing arrangements, in the form of a Single Resolution Fund (SRF)¹. However, while several EBF Members are concerned that the SRF is not feasible in the short term, all EBF Members agree that significant preconditions need to be fulfilled before the SRF can start operating. Most important is an assessment of the balance sheets of all the SSM banks.
- While the SRM should be supported by the SRF, the EBF firmly believes that the principle tool for absorbing losses and recapitalising restructured banks is bail-in and not the SRF. The level of outstanding senior unsecured long-term debt currently held by banks - around €1.1 trillion - is 20 times the size proposed for the SRF. Bail-in would absorb all or most of the cost of a bank failure in most circumstances.
- The purpose of the SRF is not and should never be recapitalisation - as such the size of the SRF should be limited in line with a targeted purpose to provide financing to meet operational costs of resolution. Its use should be subject to well-specified preconditions and safeguards to avoid moral hazard.
- When the SRF is created, this should be done in a way that minimises the impact by ensuring: no duplication of contributions by banks; phasing out national resolution funds; contributions are risk-based and vary in proportion to the likelihood of failure and are to be capped; the target level is built up over a reasonable timeframe (at least 15 years) and subject to strict annual affordability limits.
- The entry into force of the BRRD and of the SRM Regulation should be closely aligned, in order to avoid the double duty to set up national resolution funds next to the SRF and the administrative burden to merge them into one single fund. Alternatively, the entry into force of the national resolution funds foreseen by the BRRD should be delayed.
- The SRF should make extensive use of payment commitments which are fully backed by collateral of low risk assets unencumbered by any third party rights and alternative financing arrangements in order to limit the impact on the EU banks' capacity to back the real economy.

Preferred timing of implementation

Europe needs a harmonised framework for Bank Recovery and Resolution as soon as possible, so that the tools and powers exist for any bank in the EU to be wound down if needed. This should include strong cross-border provisions to ensure the integrity of the single market. The BRRD therefore must be agreed as soon as possible.

The creation of the SRM at the European level is a crucial element of the design of the European Banking Union. The ECB needs a credible counterparty in crisis situations in order to be credible as the single supervisor. What is feasible in the short-term is clearly a matter for debate. However, there is much more consensus on what is desirable in the long term.

¹ The Federation of Finnish Financial Services does not support the creation of a Single Resolution Fund.

Given that the SSM and SRM will determine the supervisory landscape of the Banking Union area in the years to come and will impact banks' strategies directly, the EBF favours quality over speed in the transition to the SRM. At the very least, the SRM should start only after a balance sheet review on all participating banks has been completed. Legacy issues should then be addressed nationally before banks can enter the SRM. Against that background, the EBF feels it is crucial that the SSM and the BRRD are finalised and operational before implementing the SRM.

Clarity on roles of authorities involved

Before the SRM is to become operational the roles, relationships and responsibilities between all the stakeholders in resolution and supervision should be clear. All legal provisions on these governance relationships need to be clarified. It should be upfront clear where the responsibilities end and start of every authority involved, with the basic principle that duplication of responsibilities should be avoided. This will contribute to the speed and effectiveness of the resolution process. The governance should be underpinned by an effective procedure for appeal against resolution decisions (going and gone concern) for institutions under supervision and for other stakeholders (for example investors and creditors).

Design of the Single Resolution Board

While a case can be made for and against various options around the current proposal for a Single Resolution Mechanism, EBF Members agree that the Board should fulfill the following criteria regarding its legal identity, operational requirements, governance and decision-making process, and its powers:

- The Board should be fully independent from e.g. supervisory interests and political influence;
- There should be clear separation of competencies between supervisors and the Board;
- The Board must have the necessary expertise on bank restructuring and insolvency and be highly professional in its conduct;
- It should have a governance system with a carefully balanced and effective representation of national participants and European stakeholders taking into consideration the financial stability within Banking Union and its Members' jurisdictions as well as the wider European Single Market;
- It should be fully accountable to the European Parliament and the European Council and subject to judicial review and the right to appeal.

With regard to banks having a right to appeal against Board decisions, there needs to be an effective and swift mechanism to provide legal protection. In some Member States there is an administrative procedure. The proposal for the SRM should dictate the administrative rules of procedure the Board should follow when dealing directly with banks including:

- holding hearings with the bank before an early intervention or a resolution measure is imposed on it;
- providing the justification, form and timetable of its decisions;
- setting the official language to be used by the SRM or the right to inspect files.

Administrative rules of procedure should be included in the proposed regulation along the lines of those laid down in the area of state aid and antitrust law (see Council Regulation (EC) no. 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty and

Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty).

Finally, the Board should have the capacity to deal with any bank – even large and complex banking groups - and be able to take swift, impartial and binding decisions over the following resolution aspects of SSM supervised banks:

- Recovery and resolution planning;
- Intra-group support agreements;
- Resolution triggers;
- Minimum requirements for bail-in;
- Joint financing arrangements.

The benefit of a supranational resolution authority would be that it is not subject to national bias to ring-fence assets during a crisis and can act in the interest of the wider European Single Market and economy while also avoiding pressure of local or foreign creditors and depositors.

Scope of the SRM

The EBF supports the inclusion of all banks which are based in countries participating in the SSM, whether directly or indirectly supervised by the ECB.

The SRM scope of entities should at a minimum fully correspond to those banks under direct ECB supervision. However, small- and medium-sized banks should not be ruled out of scope as in a crisis small bank failures can become a systemic risk as well.

If a two tier approach is adopted as in the SSM – i.e. if banks not under direct ECB supervision (but within its scope) fall under the scope of the National Resolution Authorities – the Board should always have the final word in resolution in a similar way as the ECB is the final decision-maker in supervisory issues.

Need for Resolution Financing Arrangements within the SRM

Bail-in as the main loss absorbing tool

The EBF supports the need for resolution financing to support the Single Resolution Mechanism. The cost of resolution should be primarily covered with the bail-in tool, i.e. using money from owners and creditors. In the Banking Union, this form of financing should be supplemented by a Single Resolution Fund (SRF), to provide credibility and “break the vicious circle between banks and sovereign debt”.² The SRF should only contribute to the financing of resolution once the bail-in tool has been applied, as established in the BRRD. However, several EBF Members believe that the SRF is not feasible in the short term, while all Members agree that significant preconditions need to be fulfilled before the SRF can start operating.

² The Federation of Finnish Financial Services does not support the creation of a Single Resolution Fund.

Preconditions for the SRF

The preconditions for the SRF include arrangements for phase-out of national resolution funds and dealing fully with the legacy assets. The introduction of a joint liability is at present particularly challenging as there are significant differences in the financial health of individual countries' banks and in legacy costs. This creates different starting points for Member Countries to build-up common resolution funding by its banks. Furthermore, any joint liability in the financing of resolution without proper safeguards is highly problematic because it involves moral hazard.

To decrease moral hazard, it is of primary importance to all EBF Members that the liabilities of bank owners and creditors are explicitly specified in crisis management regulations, and that these regulations are also uniformly applied in all situations. In this respect the BRRD should avoid any significant national discretion, e.g. the flexibility to apply exclusions from bail-in for any eligible liabilities, and the option in Article 31 (7) of the BRRD proposal for Member States to create and use additional resolution tools should be removed.

A key precondition for the creation of the SRM is that it should not be burdened with legacy costs. Banks should therefore be given a financial health check (i.e. their balance sheet should be assessed) by the ECB prior to their admission, if the ECB has not recently already performed such a test. Legacy asset shortfalls in the banking sector should be dealt with on a national basis.

In addition, EBF members fear that national resolution funds will be retained in parallel to setting up a Single Resolution Fund as there is not a binding request for participating Member States to close down national funds thus potentially resulting in a double payment for those banks. Therefore, previous and current contributions of banks to the national resolution funds should qualify and be transferred to the SRF.

When it is decided to create a SRF (or any other form of financing arrangement with joint liabilities) it would have to:

- Be ensured that the SSM is fully operational,
- Be preceded by a operational and harmonised resolution framework enshrined in the BRRD and which include a workable and credible bail-in regime,
- Be preceded by a comprehensive asset quality and balance sheet review of each bank to ensure an equal footing between participating banks. Legacy asset problems should be clearly identified and their solution maintained strictly under national responsibility,
- Not require multiple contribution from banks into national funds and the SRF,
- Limit the annual contributions for pre- and post-funding with appropriate caps,
- Provide safeguards against moral hazard in the use of the SRF,
- Be ensured that the management of the SRF is independent in its investment policy and in its verifications and decisions regarding the fulfilment of all requirements before any payment or contribution by the SRF can be made.

SRF Target level

With regard to the target size of resolution financing arrangements – be they national or commonly held - a thorough economic impact assessment and affordability study should be conducted to assess the most

appropriate size of the fund. The EBF believes that because of the new bail-in tool the size of the fund can be limited to a figure much lower than currently proposed and sees that a significant timeframe of at least 15 years is needed to build up these funds. EBF Members are of the strong conviction that the target level of the fund should be set taking into account the strengthened prudential framework, the crisis prevention role of Recovery and Resolution Plans and accompanying far-reaching powers of supervisory authorities, higher capital buffers of Basel III, the early intervention regime and broad loss absorbing capacity of bail-in. Together all these measures will reduce the probability of a bank failing and increase the loss absorbency available if it is needed.

Also, more emphasis should be given to ex-post financing, payment commitments which are fully backed by collateral of low risk assets unencumbered by any third party rights and alternative financing arrangements.

On the latter, the EBF welcomes the agreement that the ESM could provide such an alternative back-up financing arrangement to Eurozone banks, but notes that a solution needs to be found for banks in non-Eurozone countries that might join the SSM.