EU Regulation

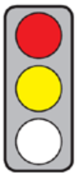
BANK RESOLUTION FOR THE SSM STATES (SRM)

cep**PolicyBrief** No. 2013-42 of 7 October 2013

KEY ISSUES

Objective of the Regulation: The Commission and a Board decide on bank resolution in the SSM zone. A Single Bank Resolution Fund will share the cost of the resolutions.

Affected parties: Banks, their owners, creditors, tax payers, resolution authorities.



Pro: Central resolution decisions may - theoretically - prevent distortion of competition.

Contra: (1) Since the Resolution Fund is dependent on financing from the ESM, competitive distortions cannot - in practice - be prevented.

(2) The Single Resolution Fund for all SSM States promotes Moral Hazard and passes on the risks and costs of resolution to all tax payers in the SSM zone.

(3) The Regulation cannot be based on the internal market competence (Art. 114 TFEU) but only on the flexibility clause (Art. 352 TFEU) which requires unanimity in the Council.

(4) It should be clearly stated that no Member State can be forced to share in the resolution costs, even where the Resolution Fund fails to achieve its target size. This would otherwise violate the conditions laid down by the Federal Constitutional Court.

CONTENT

Title

Proposal COM(2013) 520 of 10 July 2013 for a **Regulation** of the European Parliament and the Council establishing uniform rules and a uniform procedure **for** the resolution of credit institutions and certain investment firms in the framework of a **Single Resolution Mechanism and** a **Single Bank Resolution Fund** and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council

Note: The Regulation is based on the proposed Directive on Bank Recovery and Resolution [BRRD, COM (2012) 280]. For a better understanding of the material it is therefore worth looking at the cep**PolicyBriefs** to this proposal.

Brief Summary

- **Object, area of application and institutions involved**
  - The Regulation provides for uniform rules on the resolution of financial institutions (Single Resolution Mechanism, SRM; Art. 1).
  - The Regulation only applies to the following financial institutions (hereinafter: "banks") (Art. 1 and 2, see also cep**PolicyBrief** on ECB Banking Supervision):
    - all banks established in the EU states in which the ECB is to be responsible for banking supervision in the future (Single Supervisory Mechanism, SSM) (hereinafter: "SSM States"); these are all Euro Area, and all non-Euro Area Member States who have submitted voluntarily to ECB banking supervision;
    - the parent undertakings of such banks and investment companies that are subject to ECB banking supervision.

    In these cases, the present regulation adds to the proposed general Directive on bank resolution [COM (2012) 280; see cep**PolicyBrief**].
  - Resolution and how it is organised will be decided by the Commission and a Resolution Board - set up as an EU agency - based in Brussels (Art. 38 (1), Art. 44). In addition, an SSM-wide Single Bank Resolution Fund (hereinafter: "Resolution Fund") will be set up (Art. 64).
  - Neither the Commission nor the Board can require a SSM State to provide public financial support (Art. 6 (4)). Where, however, a decision of the Board "impinges on the fiscal responsibilities of that Member State" the State may require "a further deliberation" as long as the Resolution Fund still falls below the target funding level (Art. 51 (3)).
- **Resolution objectives and principles**
  - The objective of resolution is the maintenance of a bank's critical functions - such as payment transactions - whilst avoiding contagion and other adverse effects on the stability of the financial market. The use of public funds should be "minimised" and depositors protected. (Art. 12)
  - When it comes to a resolution, the shareholders bear first losses followed by the creditors (Art. 13 (1)).
- **Powers of the Commission: Decision on resolution and resolution tools**
  - The Commission decides whether to place a bank under resolution. It makes its decision on its own initiative, based on a recommendation of the Board or on a communication from the ECB or a national resolution authority. (Art. 16 (6))
  - The Commission sets out in a "resolution scheme", which resolution tools are to be applied and whether the Resolution Fund will be used (Art. 16 (6)).

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– The following resolution tools are available (Art. 21 - 24):
  - transfer of the shares, assets, rights or liabilities of a bank to a private purchaser or state-controlled bridge bank,
  - transfer of the assets, rights or liabilities of a bank to an asset management vehicle ("bad bank"),
  - writing down the bank's liabilities or converting them to equity ("bail-in").

► **Board: Staff members, meetings and independence**

– The Board is composed of an Executive Director, a Deputy Executive Director and 244 members of staff (Art. 39 (1) and (2), Annex). The Council appoints the Directors after hearing the EP (Art. 52 (5)).
– The Board meets in "executive sessions" and in "plenary sessions".
– Executive sessions lay down the details of the resolution (see below). Participants are (Art. 49-51):
  - four permanent members - Executive Director, his/her Deputy and one representative each from the Commission and the ECB -,
  - one representative from each national resolution authority of the SSM States in which the bank under resolution has its head office or has subsidiaries or branches.

  The four permanent members and the resolution authority of the state in which the bank has its head office have one vote each. All other resolution authorities share one vote. Decisions are made by simple majority.
– The plenary sessions decide - generally by simple majority - on the work programme and budget of the Board. The participants, who have one vote each, are the four permanent members and one representative of each of the resolution authorities of the SSM States. (Art. 39 (1), Art. 45, Art. 46, Art. 48 (1))
– All Board members act "independently and in the general interest". The four permanent members neither seek nor take instructions from the Commission or the Member States. (Art. 43)
– The Council and the European Parliament may request the Executive Director to attend a hearing. National parliaments may "invite" the Executive Director to participate in an "exchange of views". (Art. 41, Art. 42)

► **Powers of the "Executive Session" in the run-up to a possible bank resolution**

– The executive session assesses whether a bank is resolvable without the use of public funds - besides the Resolution Fund. If this is not possible, it can impose wide-ranging measures on a bank such as requiring it to cease a specific activity. (Art. 8)
– It draws up resolution plans for all banks in the SSM States (Art. 7). Simplified obligations or exemptions are possible, especially for small banks and banks with an institutional protection scheme - such as trustee savings banks or cooperative banks (Art. 9).
– It determines, for each bank, the level of own funds they have to maintain and the level of liabilities required for the bail-in tool. In this regard, it takes account, inter alia, of the size of the bank and the extent to which the deposit guarantee scheme "could" contribute to financing resolution. (Art. 10)

► **Powers of the "executive session" in relation to the actual organisation and financing of a resolution**

– The executive session decides, by way of a "resolution scheme", in particular (Art. 16 (8), Art. 20-24),
  - which shares, assets, rights and liabilities are to be transferred to a private purchaser, a bridge bank or a bad bank,
  - the extent to which a bail-in will be implemented, which liabilities will be exempt from the bail-in and which creditors, on the basis of this exemption, will have to bear more losses than at first envisaged,
  - the extent to which the Resolution Fund will be used; the requirement for this is a decision by the Commission that it does not constitute unlawful state aid (Art. 16 (8) and (10)).
– The national resolution authorities must implement the "resolution scheme". If they fail to do so, or do so insufficiently, the Board can issue instructions to the bank under resolution. (Art. 26 (2))

► **Resolution Fund**

– A Single Bank Resolution Fund will be set up for the SSM States which will be owned by the Board. The fund will be financed by the banks of the SSM States. After ten years it must have available at least 1% of the amount of deposits which are covered by deposit guarantee schemes. (Art. 64 (1) and (3), Art. 65 (1))
– A bank's contribution to the fund is determined according to the banks total liabilities and risk profile. It will be raised at least annually. (Art. 66 (1) and (2))
– The Board may decide that the fund (Art. 67 (1), Art. 68, Art. 69)
  - can raise additional contributions retroactively if the financial means are insufficient (in the plenary session),
  - can apply for loans or other aids - such as from the ECB, the European Stability Mechanism (ESM), Member States, banks or other capital market players - if its financial means are "not immediately accessible" or are insufficient (in the executive session),
  - can apply for loans from the national resolution funds of non-SSM States if financial means are still insufficient (in the plenary session).
– The fund may be used, in particular, for capitalising bad banks or bridge bank. A direct recapitalisation or assumption of the losses of a bank by the fund is not permitted. (Art. 71)
– In principle, the Resolution Fund's level of participation is not limited. If the Board excludes certain liabilities from a bail-in, the deployment of the Resolution Fund to make up for the resulting lack of finance is limited to 5% of the bank's total liabilities. Furthermore, the remaining bail-in must cover at least 8% of the bank's liabilities. (Art. 24 (6) and (7))

– The Board must invest the amounts held in the fund in obligations of the SSM States or intergovernmental organisations, or in "highly liquid" assets of "high" credit worthiness (Art. 70 (3)).

- **Deposit guarantee schemes**
  – The national deposit guarantee schemes of the SSM States affected by a resolution, may be drawn upon, where required, up to the amount which they would have had to pay as compensation for covered deposits if the bank had been liquidated in normal insolvency proceedings (Art. 73 (1)).
  – If a deposit guarantee scheme does not have the resources for this, it may be lent funds by the Resolution Fund (Art. 73 (4)). This requires a two-thirds majority in the plenary session (Art. 46 (1) c, Art. 48 (1)).
- **Coming into force**
  – Contributions from banks to the Resolution Fund are due as of the date on which the Regulation comes into force (Art. 88).
  – The Resolution Board begins work on 1 January 2015 and may use the Resolution Fund as of that date. Creditors will only be able take part in a bank resolution as from 2018 ("bail-in"). (Art. 88 sub-paragraphs 2 and 3 in conjunction with Art. 85)

Statement on Subsidiarity by the Commission

Only action at European level can ensure "minimal spill-over effects" from bank resolutions. In addition, bank resolutions can be carried out at the "least cost" and competitive distortions avoided.

Policy Context

The Regulation is part of the European legislation to create a "Banking Union" which includes the following legislative proposals: In June 2012, the Commission submitted a proposal for a Directive on bank recovery and resolution [BRRD, COM (2012) 280, see cep**PolicyBrief**]. The Council and the EP want to achieve agreement on this in 2013. As from Autumn 2014, banking supervision in the Euro Zone will be centralised at the European Central Bank (SSM, see cep**PolicyBrief**]. In addition, there is political agreement that, after banking supervision by the ECB has been established, the ESM shall be able to recapitalise banks directly, that is to say without having to go via national budgets.

Legislative Procedure

10 July 2013	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Leading Directorate General	DG Internal Market
Leading Committee of the EP:	Economic and Monetary Affairs, Rapporteur: Elisa Ferreira (S&D Group, PT)
Leading Federal Ministry:	Finance Ministry
Leading Committee of the BT:	Finance
Decision mode in the Council:	Qualified majority (Adoption by a majority of the Member States and with 260 of 352 votes; Germany: 29 votes)

Formalities:

Legislative competence:	Art. 114 TFEU
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Legislative procedure:	Art. 294 TFEU (Ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

The Regulation far exceeds the rules on bank recovery and resolution (BRRD, cf. cep**PolicyBriefs**) in two respects. Firstly: Decisions on resolutions are to be made centrally by the Commission and the Board rather than by a national resolution authority.

Centralised resolution decisions may prevent competitive distortions which arise where national resolution authorities subject creditors to different levels of loss absorption, **but** this advantage **only** takes effect **if the SSM Resolution Fund has sufficient financial means** to avoid, in particular, the involvement of the ESM**. The involvement of the ESM requires unanimity** on the part of all ESM States **so one state can make its consent dependent on being put in a more advantageous position.** This prevents the Commission and the Board from being able to act with competitive neutrality.

In the case of cross-border resolutions a fight over distribution, between the participating states, is inevitable; they will all try to minimise the burden on their own taxpayers. To reach a reasonable solution in this matter, the voting rights in the executive session should not, as is proposed, be rigidly allocated, but should correspond to the bank's volume of business in the participating states.

Secondly: **The Single Resolution Fund for all SSM States** leads - unlike national resolution funds in the non-SSM States - to the resolution of one bank having to be financed by the banks of all the other SSM States. This **promotes Moral Hazard** among the participating states because all SSM States still have - despite central banking supervision by the ECB - substantial scope to shape their own national financial centres, and can, for example, use corporation tax to inflate their financial sectors. Thus they generally bear part of the responsibility for high bank resolution costs. **Therefore, a national resolution fund should also be set up in** each of **the SSM States.** Where its means are insufficient to resolve a bank, the SSM State concerned should bear the cost. If the burden is too great, the national resolution fund can apply for a loan from the ESM.
Although the Single Resolution Fund receives contributions from all banks in all the SSM States, it will not, for some considerable time, have sufficient means at its disposal to actually finance resolutions. It will therefore have to apply for ESM loans.
The Single Resolution Fund therefore **passes on the risk and cost of resolution to all taxpayers in the SSM zone**. It will primarily be the taxpayers in the country concerned who will profit from this situation.
Another problem is the fact that the Executive Session - in which, moreover, the states where the bank under resolution is not active cannot take part - decides on the level of finance to be made available from the Resolution Fund. It can therefore predetermine the necessity of an ESM loan. Although, technically, all ESM states - in Germany with participation of the Bundestag - have to agree, a rejection would give rise to excessive disruption.

Legal Assessment

Legislative Competency

The Regulation cannot be based on the internal market competence (Art. 114 TFEU) put forward by the Commission **because the Regulation only applies to SSM States and** participation of all Member States in the SSM seems politically impossible. The common resolution regime only strengthens the internal market in certain locations. It **therefore** in fact **causes a split in the internal market.**
Although EU agencies can be set up on the basis of the internal market competence (ECJ, Case C-217/04, ENISA of 2 May 2006), replacing Member State authorities with EU agencies could go beyond mere harmonisation and would not therefore be covered by the internal market competence (Closing Submissions of Advocate General Jääskinen in Case C-270/12, VK/Council and Parliament of 12 September 2013).
Having uniform rules on resolution for the SSM States increases financial stability. **The Regulation can** therefore **be based on the Flexibility Clause (Art. 352 TFEU) which, however, requires the unanimity of the Council.**

Subsidiarity

Unproblematic in view of the high level of integration that exists in the EU banking sector.

Proportionality

A Single Resolution Fund for all SSM States is not necessary to avoid competitive distortions. It is sufficient to have national resolution funds that are able fall back on the ESM.

Compatibility with EU Law in other Respects

According to the Meroni doctrine of the ECJ (Case C-9/56 and C-10/56 of 13 June 1958), discretionary decisions are reserved to EU organs and may not be delegated to a "external bodies" such as a resolution board. However, since it is now possible, following the Lisbon Treaty, to bring an action against the decisions of EU agencies, the ECJ is likely to move away from this decision (Closing Submissions of the Advocate General Jääskinen in Case C-270/12, VK/Council and Parliament of 12 September 2013).
Decisions by authorities on bank resolutions, like any other exercise of state power, require democratic legitimacy. In this respect, the following applies: the greater the effect of the intervention, the greater the ability to exercise control needs to be. With respect to intervention such as that of a bank resolution, the proposed reporting obligations and rights to submit questions are insufficient.

Impact on German Law

The Bundestag cannot "without prior constitutive consent, transfer its budgetary responsibilities by way of vague budgetary authorisations to other bodies" particularly if this "may lead to unmanageable burdens with significant budgetary consequences" (BVerfG, 2 BvR 987/10 of 7 September 2011, par. 125).
A clear statement is required that no SSM State can be forced to share in the resolution costs, even where the Resolution Fund fails to achieve its target size. Otherwise there would be a violation of the conditions laid down by the Federal Constitutional Court.
Under current law, the ESM can only give financial aid to ESM States. For loans to the Resolution Fund, the ESM Treaty, and thus also the German implementing legislation, have to be modified.

Conclusion

Since the Resolution Fund will be dependent on financing from the ESM, the Commission and the Board cannot implement resolutions in a way which is competitively neutral. The Single Resolution Fund for all SSM States promotes Moral Hazard and passes on the resolution risks and costs to all tax payers in the SSM zone. The Regulation cannot be based on the internal market competence (Art. 114 TFEU) but only on the flexibility clause (Art. 352 TFEU) which requires unanimity in the Council. It should be clearly stated that no Member State can be forced to share in the resolution costs, even where the Resolution Fund fails to achieve its target size. Otherwise there would be a violation of the conditions laid down by the Federal Constitutional Court.