



**WORLD BANK GROUP**

Finance & Markets

Financial Sector Advisory Center (FinSAC)

# UNDERSTANDING BANK RECOVERY AND RESOLUTION IN THE EU: A GUIDEBOOK TO THE BRRD

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## FOREWORD

When a company turns insolvent, it should exit the market in an orderly manner, and should not be allowed to destroy economic wealth on a continuing basis. This is a precondition of a functioning market economy, and should also apply to failing financial institutions. The financial crisis, however, demonstrated that, when it comes to creative destruction, banks are different. Failing financial institutions were kept on life support, and the hospital bills were sent to the taxpayer. This was done because Europe wanted to avoid the unpalatable alternative of witnessing a re-run of Lehman Brothers. Lehman showed that the insolvency of a large or interconnected financial institution can result in a full-blown meltdown of the entire industry. A lack of appropriate tools for the resolution of banks resulted in the necessity to resort to public funds to maintain financial stability.

Europe has shown its determination to remedy this unsatisfactory situation. The clear goal was that taxpayers should no longer be liable to bail out troubled institutions. In response to the crisis, the European legislator took the necessary steps and established a toolkit that allows the orderly resolution of banks without compromising financial stability, and without resorting to public funds. The Banking Recovery and Resolution Directive (BRRD) became one of the most important building blocks of the Banking Union.

New rules need to be analysed, interpreted and put into context. This guide will make an important contribution to connecting the theoretical underpinnings of the BRRD with its practical application. To ask questions is the first step to gaining knowledge. Therefore, every chapter of this Guidebook asks the key questions first. In this way, it guides readers through the complex issues and helps them to understand how the new recovery and resolution regime works. The Guidebook does not limit itself to merely describing the new regulatory framework. It also presents the first, and still developing, cases of application.

This Guidebook has benefited from the valuable contributions and insights of numerous experts. Its publication forms part of the research activities of the Financial Sector Advisory Center (FinSAC). FinSAC was established 2011 in Vienna with the financial support of the Austrian Ministry of Finance. The Program aims to provide financial sector reform advice and implementation assistance to client countries in the European and Central Asia region. The Center of Expertise is part of the World Bank Global Practice “Finance and Markets” and has managed to become a renowned regional “knowledge center” that specifically responds to client demand in matters pertaining to the financial sector, its supervision and its stability. The Guidebook provides an early stocktaking exercise of the new recovery and resolution tools. We hope it will be helpful in establishing a sound financial sector environment in which problem banks can be allowed to fail safely.

**Harald Waiglein**

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# INTRODUCTION

The 2007 financial crisis has exposed major weaknesses in global financial systems, including the threat to financial stability posed by banks that were too big, interconnected and complex to be closed or go bankrupt<sup>1</sup>. As a result, many banks have been rescued using public support, allowing for an uninterrupted provision of their services, but effectively shifting (most) of their losses to taxpayers instead of banks' owners or investors.

The political realities following the bail-out of banks called for game-changing regulation to reduce both the likelihood and the impact of failure. Together with higher capital and liquidity requirements, the enhancement of resolution regimes was a central element of the international regulatory response to increase banks' resilience. The Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions (KA), endorsed by the G20 in 2011, provide the new harmonized international standard for resolution regimes for financial institutions. The KA, although focused on global systemically important banks (G-SIBs), serve as guidance to jurisdictions that are adopting or amending national resolution regimes. The key objectives are relevant for domestic key players in the EU just as European legislation is relevant for FinSAC client countries which host EU banks (that may be significant in terms of the local market but small relative to the parent bank's operations).

Within the European Union (EU), more than 40 legislative and non-legislative measures were adopted in the wake of the financial crisis. The EU was a forerunner in implementing the KA especially in terms of the bail-in tool. A new framework for dealing with failing banks, the Bank Recovery and Resolution Directive (BRRD) was agreed in 2014, for national implementation as of January 2015. The BRRD translates the KA in the EU context and provides for a harmonized framework and enhanced cooperation for bank resolution in the EU. It builds on other EU legislation, such as the capital adequacy requirements for banks (CRR/CRD), the European Market Infrastructure Regulation (EMIR), the Deposit Guarantee Scheme Directive (DGSD), and EU state aid rules<sup>2</sup>, as a cornerstone and potential game-changer in creating a more stable and fairer banking system that serves the economy at large.

The BRRD regulates the different stages and elements of a problem bank's recovery and resolution process, including advanced planning and restructuring. It rests upon the following key elements:

- Recovery and resolution planning including the removal of obstacles to resolvability;
- An enhanced set of early intervention measures to foster forward looking supervision and crisis prevention;
- A harmonized set of resolution tools and powers to manage bank failure, aiming to ensure that losses are absorbed by shareholders and creditors while allowing the continuity of critical functions. The four main resolution tools are the:
  1. Bail-in tool: ensuring that losses are absorbed by shareholders and creditors.
  2. Sale of business tool: allowing the resolution authority to sell all or part of the failing bank to a private acquirer.

<sup>1</sup> Commonly referred to as the "too big to fail" problem.

<sup>2</sup> Other jurisdictions considering alignment with the EU resolution framework should take account of the full breadth of EU legislation.

3. Bridge institution tool: transferring the good assets and essential functions of the problem bank into a new temporary institution (bridge bank) with the aim of selling it.
  4. The asset separation tool: isolating the “bad” assets of the bank in an asset management vehicle for orderly wind down, if immediate liquidation is not justified in current market conditions.
- The limitation of government support, only foreseen as a last resort under special circumstances;
  - An ex-ante resolution funding sourced from bank contributions to ensure the implementation of resolution tools when preconditions are met;
  - An enhanced cooperation between Member States as well as with authorities in third countries in all phases of preparation, intervention and resolution (via resolution colleges).

Notably the BRRD resolution toolkit is applied only if justified by public interest i.e. to systemically important banks to ensure the continuation of their critical functions (see chapter 14); the BRRD does not regulate bankruptcy or insolvency law which remain in the national competence as an alternative to resolution or alongside resolution (to liquidate the rump left behind). When undertaking national reform of bank resolution frameworks it is advisable to allow some resolution powers and respective safeguards to also be applied for non-systemic banks. The sale of business tool and the bridge bank tool (to allow, for example, the transfer of several small banks into a bridge bank) should be available for non-public interest banks as part of a bank liquidation/bankruptcy regime.

### **The objectives and target audience for the BRRD Guidebook**

The BRRD is the outcome of a long negotiation process.<sup>3</sup> The new bank recovery and resolution framework has wide reaching implications, both within the EU but also for countries with banking relationships with the EU. This Guidebook aims to explain the scope, the principles, and the rationale of the BRRD<sup>4</sup> and related secondary legislation and guidance.<sup>5</sup> Expert contributors, including lawyers and academics, share in this Guidebook their experience of and insights to the BRRD negotiation process, recovery and resolution planning, adoption of resolution decisions and the negotiation of bail-in. The Guidebook also raises awareness of discretionary or non-regulated areas and provides some initial thoughts for further development and possible implementation challenges. These challenges include but are not limited to the management of potential conflict of interests, the application of the public interest test, the choice of resolution tools, and the interaction between cross-border regulations.

The Guidebook has been prepared by the World Bank Financial Sector Advisory Center (FinSAC), a dedicated technical unit of the Finance & Markets Global Practice that delivers policy and technical advice and analytical services to client countries in Europe and Central Asia (ECA) region.<sup>6</sup> The Guidebook aims to assist FinSAC’s client countries in the process of reforming and aligning their national resolution frameworks with international good practice and with the EU *acquis communautaire*. It outlines the main provisions, underlying concepts, and practical consequences of the new EU regime; assists with the identification of gaps and overlaps of existing resolution frameworks, taking into account regional characteristics; and highlights key implementation challenges. The Guidebook should not be

<sup>3</sup> After formal consensus was reached in 2014 political reluctance and technical uncertainties prevailed in several Member States. This delayed the implementation and triggered the referral of six Member States to the European Court of Justice for failing to transpose the BRRD into national law within the established timeframe.

<sup>4</sup> While the scope of the BRRD extends to big investment firms and banks, this Guidebook focuses on banks and does not address the peculiarities associated with investment firms.

<sup>5</sup> At the time of publication, around 40 standards and guidelines have been adopted by EBA and/or the European Commission

<sup>6</sup> FinSAC client countries include: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Kosovo, FYR Macedonia, Moldova, Montenegro, Poland, Romania, Serbia and Ukraine.



read as a legal interpretation of the BRRD, nor is it intended to promote the adoption of a particular approach or suggest that “one-size-fits-all”, but rather it outlines possible scenarios, and general considerations and factors to be addressed. In this way it seeks to be a useful tool for international financial institutions and countries in other parts of the world seeking closer cooperation with the EU or aiming to strengthen their understanding of the European framework.

### **Timing and the added value in developing new agendas**

The publication of this Guidebook is timely as the BRRD, though already more than a year old, introduces some challenging new concepts which will take time to operationalize and show effects. By way of example, the Single Resolution Board (SRB), which deals with the resolution of banks within the euro area, only became operational in January 2016 and is still in the process of drafting resolution plans and setting the minimum requirement for own funds and eligible liabilities (MREL) for the banks under its purview. The resolution planning process, including whether to follow single or multiple point of entry approaches, will fundamentally impact banks’ target set-ups in going concern, and affect subsidiaries of EU banking groups in FinSAC client countries. Furthermore, the development of a resolution framework is a dynamic process and adoption of the legal framework is only a starting point, though a strong one in terms of improving market discipline. The soundness of the resolution framework will depend on proper implementation of the powers and their actual use.<sup>7</sup>

In addition to explaining the legislation and the associated issues, the Guidebook raises awareness of discretionary or non-regulated areas and provides some initial thoughts for further development and possible implementation challenges. These challenges include but are not limited to:

- Establishment of an independent resolution authority often within the supervisory authority and the management of possible conflict of interests.
- Removal of impediments for resolution or liquidation and the recognition of resolution as a going concern task.
- Justifying resolution action under the public interest test rather than applying regular insolvency proceedings.
- The choice between resolution tools, the application of moratoria and a realistic “resolution valuation”. The lack of a clear creditor hierarchy for MREL holders and differences in national insolvency regulations in particular may increase the asymmetry among countries and even affect the calculation of the no creditor worse off than under liquidation (NCWO) safeguard test (thereby limiting the effectiveness of the bail-in tool).
- The operationalization of bail-in and contagion effects. For banks that depend heavily on deposit financing, or when bail-in affects retail investors (due to prior mis-selling and legacy problems), strict bail-in requirements could themselves become a source of financial instability if insufficient high-quality loss absorbing instruments are available. In addition, governance problems may arise when bondholders are bailed-in and become shareholders, particularly in countries where related parties constitute a high percentage of bondholders and issues concerning the fit and proper test for bank ownership come into play.
- The financing of resolution action and ensuring the liquidity of a problem bank and its long term viability (without public support). In that regard also the limitations of deposit guarantee schemes (DGS) should be acknowledged. The super preference attributed to DGS under the insolvency

<sup>7</sup> The FSB adopted the Key Attributes Assessment Methodology for the Banking Sector in October 2016 which set out the essential criteria to guide the assessment of the compliance of a jurisdiction’s bank resolution frameworks with the FSB’s ‘Key Attributes’.



ranking (above uninsured depositors), means their impact on resolution is likely to be marginal in cases where a very high recovery rate is expected and where the DGS role is essentially limited to acting as a liquidity provider under (hypothetical) liquidation.

- Cross-border cooperation and recognition of foreign resolution actions and bail-in instruments will be crucial to the success of resolution regimes. The new European framework promotes cross-border cooperation and information-sharing but is still largely based on cooperation (as opposed to centralization in the euro area). Cooperation could be hampered by differences in national implementation. Moreover, non-binding agreements and ex-ante understandings without legal enforcement mechanisms could create a false sense of security. For example, individual authorities may deviate from an agreed group cross-border resolution plan when the actual resolution scheme is decided.
- It is crucial to remember that any resolution regime can only achieve its purpose if banks are actually resolvable and if the costs associated with bank failure do not fall upon the public/taxpayer. The sovereign-bank nexus – namely, the mutual reinforcement and dependency between banks and governments that have impeded bank resolution in the past – is not per se broken by tools such as bail-in (although, depending on the liability holders, it should contribute to weakening the nexus as banks become more self-sufficient in resolving their financial difficulties).

### **Accompanying publication: “Bank Resolution and “bail-in” in the EU: Selected case studies pre and post BRRD”**

To better illustrate the complexities and challenges of failing banks, FinSAC have gathered a selection of case studies (attached to this Guidebook) which detail how some EU countries approached resolution in the wake of the financial crisis. Most of these cases took place before adoption of the BRRD and highlight the gradual transition from publicly funded bail-out to statutory private loss absorption outside liquidation (via bail-in). The case studies provide examples of different measures used to deal with distressed financial institutions, and mitigate the impact on financial stability. Some cases also discuss what might have been different had the BRRD framework already been in place.

### **Concluding remarks**

The BRRD (building upon the KA) creates a comprehensive and powerful framework for the resolution of financial institutions. It promotes a forward looking approach to supervision, with early and timely intervention measures, the removal of impediments to resolution under going concern ensuring that an entity is actually “resolvable”, when circumstances require. By making failure possible, the BRRD aims to reduce the need for public support, boosting sustainable market economies and creating positive effects for civil society. By removing the implicit government guarantee, it also helps to increase banks accountability towards their customers, clients and investors encouraging better risk management and financial strength. As such, the BRRD serves as a robust benchmark for accession countries and the wider ECA region.<sup>8</sup>

The Guidebook, together with the accompanying case studies, should help FinSAC client countries understand the resolution process and identify the impact that the BRRD will have on their own financial systems. In this respect, the FinSAC team of dedicated experts will continue to support its client countries to: i) assess local law for bank resolution against international good practice; ii) assist in the strategic analysis on the possible design and effects of new tools especially bail-in; iii) draft legal requirements for the revised banking recovery and resolution frameworks; iv) raise awareness and share knowledge of

<sup>8</sup> Most of FinSAC client countries host EU banks. These banks may in some case be significant in the local markets, even though they are small relative to the parent bank's operations

new tools and changes to the law amongst principal authorities; and v) test the new framework via crisis simulation exercises. The establishment and maintenance of resolution frameworks will be resource and cost intensive for both, banks and authorities, and the assignment of proper and qualified staffing to deal with the new framework a pre-requisite and a condition for success.

**Pamela Lintner**

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## OVERVIEW

The topics covered by this Guidebook are divided into six parts. This overview provides an outline of each part and chapter.

### Chapter Outline

#### The Background, Rationale and Institutional Set-up of Bank Resolution in the EU

- 1 **The BRRD as a response to the global financial crisis**  
Chapter 1 outlines the reasons behind the 2007/08 financial crisis and places the BRRD within the context of the broader regulatory response to the crisis.
- 2 **EU Banking Union and the BRRD**  
Regulatory answers to the financial turmoil in the European Union are described in chapter 2, putting the BRRD within perspective of the EU Banking Union. The Banking Union builds upon a centralized system for the euro area with banking supervision attributed to the European Central Bank (ECB) and a centralized resolution scheme with the Single Resolution Board (SRB) at its heart.
- 3 **An overview of the BRRD's scope, objectives, powers and tools**  
Chapter 3 outlines the scope, objectives and powers of the new resolution framework. It examines why normal insolvency proceedings are unsuitable for banks and what is so special about the new regulatory resolution schemes post-crisis.
- 4 **The maintenance of critical functions as a key resolution objective**  
The continuity of critical functions as a key resolution objective is examined in more detail in chapter 4. It describes the criteria for identifying and mapping critical banking functions to the real economy and financial markets.
- 5 **The resolution authority: governance, conflicts of interest and financing**  
Chapter 5 discusses which authority should be designated for taking resolution action and how to strike a balance between resolution and supervisory and other authorities in terms of cooperation and information-sharing, while at the same time ensuring their operational and functional independence. In cases where the resolution powers are vested in the same authority that is responsible for supervision, some minimum requirements for managing possible conflicts of interests are identified.

## Recovery Planning and Early Intervention

### 6 Recovery plans

The post crisis resolution framework requires banks to draw up recovery plans setting out measures that can be executed in the event of a deterioration of their financial situation in order to restore their viability and return to "business as usual."

Chapter 6 stresses the importance of recovery planning as a robust governance tool and outlines the practical aspects that authorities should take into account to assess the effectiveness of such plans.

### 7 Intra-group financial support agreements (IGFSAs)

Intra-group financial support agreements are a preventative tool recognized in the BRRD to strengthen the financial position of groups. They allow participating institutions that experience financial difficulties to receive financial support, for example in the form of loans, guarantees, or the provision of assets for use as collateral in transactions, from other participating entities – subject to approval by the supervisory authorities and the shareholders of each entity that is party to the agreement. Chapter 7 describes the conditions, safeguards and the limited regulatory incentives to enter into IGFSAs.

### 8 Early intervention measures (EIM)

While recovery planning is in the hands of the banks, supervisory authorities are empowered to take early intervention measures to ensure that financial difficulties are addressed as soon as they arise. Chapter 8 explains the importance of early intervention measures by supervisors in cooperation with resolution authorities when there is a significant deterioration in an institution's financial condition and when it does not meet or is likely to be in breach of regulatory requirements including capital requirements.

### 9 Precautionary Public Support – Exceptional Public Recapitalization of a Solvent Bank

Chapter 9 elaborates how government support, for example in the form of precautionary recapitalization, can be provided to an otherwise solvent bank without taking resolution action while complying with the EU state aid requirements.

## Resolution Planning

### 10a Resolution plans

How to prepare for taking resolution action in case of need is described in chapter 10a. Resolution authorities are required to draw up resolution plans laying out how to deal with a failing bank which is no longer viable and specifying the application of possible resolution tools and ways to ensure the continuity of critical functions.

### 10b Resolvability assessment

Planning for resolution includes the assessment of whether a bank is actually resolvable via liquidation (as the default option) or via resolution under the so called "resolvability assessment". This is outlined in chapter 10b. If authorities identify obstacles to resolvability in the course of this planning process they can require a bank to change its legal or operational structures to ensure that it can be resolved with the available tools in a way that does not compromise critical functions, threaten financial stability, or involve costs to the taxpayer.

### 11 The minimum requirement for own funds and eligible liabilities (MREL)

Resolution planning further involves the definition of MREL i.e. the loss absorbing capacity each bank must have to facilitate bail-in in the form of high quality instruments

which, when triggered, would not create contagion or negative effects in the real economy. The MREL is a new regulatory ratio conceptually similar to the total loss-absorbing capacity (TLAC) requirement of the Financial Stability Board, both of which are outlined in chapter 11.

### **Preparation and Conditions for Taking Resolution Action**

#### **12 Valuation in advance of resolution (ex-ante)**

The independent valuation of a bank's assets and liabilities plays a key role in the different stages of the resolution process as outlined in Chapter 12. The first step is for the resolution authority to decide whether a bank is failing or likely to fail (FOLTF) after resolution is triggered by the supervisory authority. In a second step a "resolution valuation" informs the selection of the most appropriate resolution tools and ensures that any losses on the assets are fully recognized at the point of resolution to define the adequate amount of bail-in and transfer prices. In addition an estimate on the losses under hypothetical liquidation is to be provided in light of the NCWOL test. The chapter stresses challenges of ensuring timely valuation and highlights differences from book values and also from pure accounting and prudential values.

#### **13 Write-down or conversion of capital (WDCC) instruments**

Chapter 13 describes the power to write down or convert capital instruments (WDCC), which can be applied by the resolution or supervisory authority outside resolution at the point of non-viability without the need for a public interest test. In addition, the chapter describes how the use of CoCo Bonds i.e. contingent convertible bonds can act as a loss-absorber outside the legal BRRD framework.

#### **14 Conditions for taking resolution action and the adoption of a resolution scheme**

Resolution takes place if the preventive and early intervention measures or WDCC outside resolution fail to restore the bank (though there is no condition of prior EIM intervention). Liquidation under national insolvency proceedings is the standard procedure for a failing bank and taking resolution action must be justified in the public interest. Chapter 14 elaborates on the responsibilities and conditions for taking resolution action and the BRRD's rather wide discretion in defining public interest. It also outlines the process for adopting a group resolution scheme under the BRRD as well as under the single resolution mechanism of the euro area.

### **Resolution Tools and Legal Safeguards**

Chapters 15 to 20 describe the minimum set of resolution tools provided for under the BRRD and elaborate on matters to be considered when deciding on the choice of resolution tools, all of which can be applied without the consent of owners and creditors. No ranking of the best resolution tool is stipulated as the application of resolution tools is strongly related to the resolution strategy developed on a case by case basis.

#### **15 The bail-in tool**

Bail-in allows a reduction in the liability side of the bank to close the asset-liability gap. It implies the write-down or dilution of equity or other instruments of ownership and the recapitalization of the entity emerging from resolution via write down and conversion of creditors. Bail-in can either be applied on a stand-alone basis (open bank bail-in tool, e.g. where complexity and interconnectedness make it impossible to apply a transfer

tool or where in light of TBTF and/or competition aspects a transfer is not feasible) or in combination with other resolution tools. Chapter 15 elaborates on the scope of bail-in, possible exclusions, cross-border issues as well as the prior 8 % requirement before the use of public support and the Resolution fund is allowed.

#### 16 The sale of business tool

The BRDD does not single out a preferred resolution option. However, resolution by way of a transfer to a private acquirer (sale of business tool) might often be a favored resolution option, if a purchaser can be found (possibly in combination with loss absorbance via bail-in). Chapter 16 describes the different phase of a sales process and the challenges in applying a standardized transparent marketing process.

#### 17 The bridge institution tool (Bridge Bank)

Chapter 17 explains the use of a Bridge Bank as a temporary institution allowing the continued provision of essential services by a failing bank without the need for bail-out by public funds. This gives authorities time to find a buyer, reorganize the bank, or wind down parts of its business in an orderly manner. The remaining part of the old bank with the "bad" or non-essential functions will regularly be liquidated under normal national insolvency proceedings.

#### 18 The asset separation tool/asset management vehicle (AMV)

The asset separation tool cleans the balance sheet of a bank. In order to prevent this tool from being used solely as a state aid measure, the framework prescribes that it may be used only in conjunction with another tool (Bridge Bank, sale of business or write-down). Chapter 18 elaborates on the justifying conditions for the creation of an AMV, as well as on the challenges of managing one.

#### 19 The government stabilization tool and public support

Though the key objective of new resolution tools is the protection of public funds, the BRRD does not fully prohibit the use of public money, as outlined in Chapter 19. Instead it controls and limits its use to a tool of last resort that should only be used in exceptional circumstances of systemic crises and after all resolution tools and resolution financing schemes have been exhausted. In these cases prior 8 % bail-in of shareholders and creditors will be required.

#### 20 Valuation ex-post resolution – no creditor worse off than under liquidation (NCWOL)

The interference in the property rights of shareholders and creditors that the new resolution tools entail must be justified by the overriding need to intervene in the "public interest". Legal safeguards ensure that resolution tools are not improperly used. The key safeguard and benchmark in justifying the application of statutory power by the resolution authority is the comparison of actual losses under resolution with losses under a hypothetical liquidation; the so called "no creditor worse off than under liquidation" (NCWOL) principle. Chapter 20 describes the key elements of this fiduciary ex-post insolvency valuation and refers to first experiences gained under the Austrian and Danish resolution cases.

### Resolution Financing and Judicial Review

#### 21a Resolution financing

Chapter 21a deals with the setting up of ex-ante resolution financing arrangements through contributions from banks that are proportionate to their liabilities and risk

profiles in each Member State and the Single Resolution Fund for the euro area members. The funds are exclusively used for supporting orderly reorganization and resolution but not to bail out and recapitalize a failing bank. In general (in)direct loss-absorption is only allowed after 8 % bail-in by shareholders and creditors.

#### 21b The resolution fund

Chapter 21b outlines the purpose, structure and use of the resolution fund and alternative financing resources, also touching upon financing in cross-border resolutions. Banks and investment firms that are within the scope of the BRRD, and branches of third-country banks and investment firms established in a Member State, are obliged to contribute to national resolution funds. Within the euro area, from 2016, these are replaced by the Single Resolution Fund, part of the Single Resolution Mechanism (see chapter 2).

#### 22 Use of deposit guarantee schemes for resolution

The compulsory contribution to, and conditions for using, Deposit Guarantee Schemes (DGS) money for resolution purposes are elaborated in chapter 22.

#### 23 Judicial Review of Resolution Action

Chapter 23 describes and elaborates on the judicial review of resolution action under the BRRD, which, in line with international best practice, is mainly administrative based and the role of the judiciary is largely limited to an ex-post assessment.

### Annexes

#### 1 Crisis management and communications

Maintaining public confidence in financial stability is an essential part of handling troubled banks and the application of resolution tools. Annex 1 considers the key elements of an effective communication strategy which should be developed as part of resolution planning and elaborated as necessary during application of resolution tools.

#### 2 List of national options

Annex 2 gives an overview of the national options provided for in the BRRD.

#### 3 Overview on State aid and Bank Resolution

# LIST OF ABBREVIATIONS

AMV	Asset management vehicle
AT1	Additional Tier 1 capital
Atlas	Shareholder of last resort
AQR	Asset Quality Review
BAMC	Slovenian Bank Asset Management Company
BES	Banco Espírito Santo S.A.
BIS	Bank for International Settlements
BoE	Bank of England
BOC	Bank of Cyprus
BRRD	Bank Recovery and Resolution Directive
CCPs	Central Counterparties
CDS	Credit default swaps
CET1	Common Equity Tier 1 Capital
CJEU	Court of Justice of the European Union
CoCo Bonds	Contingent Convertible Bond
CRA	Credit Rating Agencies
CRD IV/CRR	The EU Capital Requirements Directive (CRD IV) and Regulation (CRR)
CSDs	Central Securities Depositories
DGS	Deposit Guarantee Schemes
DGSD	EU Deposit Guarantee Schemes Directive
DIA	Deposit Insurance Agency
DIF	Depositors Insurance Fund
DNB	Central Bank of the Netherlands
EBA	European Banking Authority
ECB	European Central Bank
EDIS	European Deposit Insurance Scheme
EIM	Early Intervention Measures
ELA	Emergency Liquidity Assistance
EMU	Economic and Monetary Union
ESM	European Stability Mechanism
EU	European Union
EUR	Euro
FOLTF	Failing or Likely to Fail
FROB	Spanish Fund for Orderly Bank Restructuring
FSB	Financial Stability Board
FSC	Danish Financial Stability Company
GACS	Italian guarantee scheme on non-performing loans
GDP	Gross Domestic Product
G-SIB	Global Systemically Important Banks
G-SIFI	Global Systemically Important (Financial) Institutions
HaaSanG	The Austrian Federal Act on Restructuring Measures for Hypo-Alpe-Adria-Bank International AG
IADI	International Association of Deposit Insurers



IGFSA	Intra Group Financial Support Agreement
IMF	International Monetary Fund
IPO	Initial Public Offering
IPS	Institutional Protection Schemes
ISDA	International Swaps and Derivatives Association
IT	Information Technology
JST	Joint Supervisory Teams
LCR	Liquidity Coverage Ratio
LT2	Lower Tier 2 Capital
M&A	Mergers and Acquisitions
MiFID	EU Markets in Financial Instruments Directive
MPE	Multiple Points of Entry
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
MoF	Ministry of Finance
NCWOL	No Creditor Worse Off than in Liquidation
NCA	National Competent Authorities (National Supervisory Authorities)
NDA	Non-disclosure Agreement
NPL	Non-performing Loans
NRA	National Resolution Authorities
NSFR	Net Stable Funding Ratio
O-SII	Other Systemically Important Institution
PONV	Point of Non-viability
PRA	Prudential Regulation Authority
RTS	Regulatory technical standards
RWA	Risk-weighted Assets
SLE	Subordinated Liability Exercises
SPE	Single Point of Entry
SPV	Special Purpose Vehicle
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
T2	Tier 2 Capital
TBTF	Too Big to Fail Institutions
TLAC	Total Loss-Absorbing Capacity
WDCC	Write down or conversion of capital

# BACKGROUND, RATIONALE AND INSTITUTIONAL SET-UP OF BANK RESOLUTION IN THE EUROPEAN UNION

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## CHAPTER 1: THE BRRD AS A RESPONSE TO THE GLOBAL FINANCIAL CRISIS

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By Anastasia Gromova-Schneider

### KEY QUESTIONS

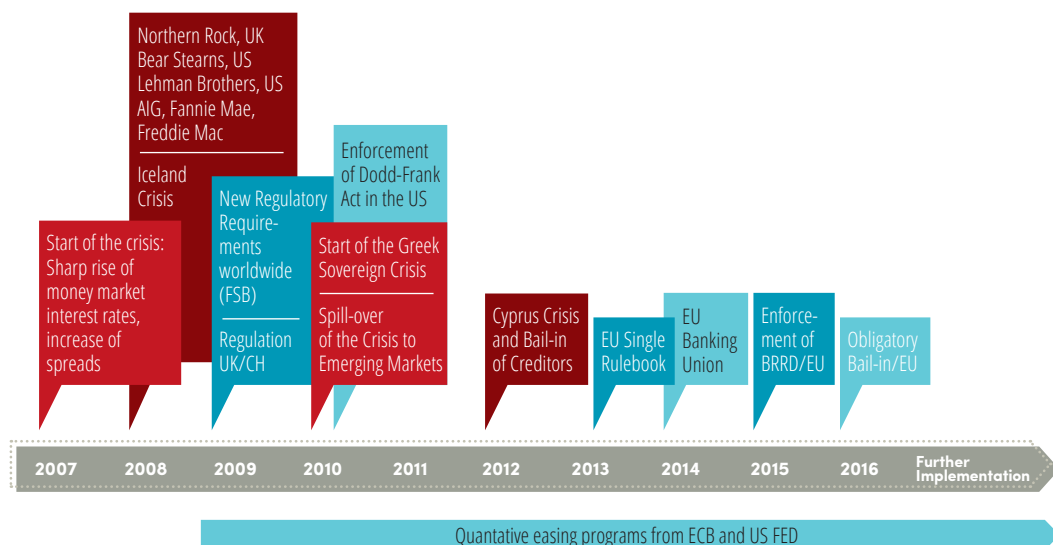
- What led to governments intervening to stabilize markets during the 2007–2009 global financial crisis?
- Why did the euro area crisis follow the global financial crisis?
- What lessons were learnt from the crises?
- How does regulatory reform address issues of “too big/too interconnected to fail”?

The BRRD is to be read as a response to the global financial crisis in the context of the broader regulatory post crisis framework.

### **The BRRD as a Response to the Financial Crisis**

The global financial crisis, which began in 2007–2009, is still being digested by many economies. It revealed a lack of clarity about how to react to a distressed banking sector, and serious shortcomings in the tools available to deal with failing banks without interrupting the provision of systemically critical functions to customers and the economy at large. Much work has been done nationally and internationally since then to develop comprehensive bank recovery and resolution regimes, including the [2010 Dodd-Frank Act](#) in the US and the [European Union's Bank Recovery and Resolution Directive \(BRRD\)](#), adopted in 2014. The new post-crisis resolution framework essentially aims to regulate how banks should be organized and what instruments should be in place to preserve overall financial stability while reducing the costs of a failed systemically important bank for sovereigns and tax-payers.

## Financial Crisis – A Brief History of the BRRD Background



<b>LIQUIDITY CRISIS</b>	Limited interbank borrowings, credit crunch
<b>VOLATILE STOCK MARKETS</b>	Constant uncertainties of values
<b>BANK AND SOVEREIGN CRISIS</b>	Economic downturn and low growth
<b>CREDIT CRUNCH</b>	Limited access to funds and therefore limited investments

### COSTS OF THE CRISIS (2007–2009)

Nationalization of Banks*	<b>29</b>
Gross restructuring support for countries concerned*	In % of GDP <b>0,7-7,7</b>
Liquidity support*	%-points <b>1,1-18,3</b>
Asset purchases and guarantees*	In % of GDP <b>0,2-13,4</b>

Other measures taken included guarantees for liabilities and bail-in of creditors (Cyprus)

### Boom and Bust in the Financial Sector

The global financial crisis followed an economic boom phase. Deregulation and innovation massively transformed the financial system in the late 20th century. The boom phase was characterized by accelerating housing market prices and financial innovation in the form of asset securitization, including the development of a complex derivative instruments market. Derivatives rose from 2.5 times world GDP in 1998 to 12 times world GDP on the eve of the crisis, while primary securities remained broadly stable over the same period at around two times GDP.<sup>1</sup> This boom phase was facilitated, if not encouraged, by insufficiently stringent regulation of financial institutions; government policies to increase home-ownership; expansionary monetary policies; and global imbalances. All of these contributed to an asset price bubble and then to the bubble bursting, beginning with the US subprime mortgage market in 2007. What began on a local level in the US with failing institutions like Bear Stearns, and in the UK with Northern Rock, quickly spread globally due to the high interconnectivity of the financial sector and had very strong effects across the globe including in Europe.<sup>2</sup> Reactions to the losses (notably through mortgage defaults), and opaqueness regarding the quality of banks' balance sheets worldwide led to a shortage of liquidity in the interbank market, an increase in counterparty risk, and a credit crunch in the global economy as banks stopped lending. The insecurity of market participants after the default of Lehman brothers in September 2008 – as a result of huge losses accrued in lower-rated mortgage-backed securities – can be considered the start of the financial crisis.

Governments globally undertook massive fiscal interventions to restore financial stability and keep the markets calm, preventing potential system-wide financial and economic meltdown.

### Massive Fiscal Interventions Restored Financial Stability and Calmed the Markets

Massive fiscal interventions were undertaken by governments worldwide to restore financial stability and keep the markets calm, avoiding what otherwise could have become a system-wide financial and economic meltdown. The exceptional economic and financial instability and unpredictable contagion risks triggered fast and decisive action by sovereigns and central banks. Reserve banks' quantitative easing programs pumped billions of liquidity into banks. Central banks' claims on financial institutions increased between 1.1 %–18.3 % worldwide<sup>3</sup> in 2007–2009 through measures that included weaker collateral requirements, the purchase of asset-backed securities, and the introduction of non-conventional liquidity facilities. But despite these measures, banks continued to fail and required capital injections to restore market confidence. Globally,

<sup>1</sup> Adrian Blundell-Wignall, Solving the Financial and Sovereign Debt Crisis in Europe, OECD Journal: Financial Market Trends, 2011 – issue 2

<sup>2</sup> For example on the interconnectedness of US banks to Europe in the case of CDS derivatives see OECD Journal: Financial Market Trends, 2011 – issue 2, page 12

<sup>3</sup> Data retrieved from "[Resolution of Banking Crisis: The Good, the Bad, and the Ugly](#)" by Luc Laeven and Fabian Valencia, IMF Working Paper 2012"

29 banks (considered of domestic systemic importance) were nationalized between 2007 and 2009 and between 2.7 %–21.1 % of GDP was spent on restructuring costs, asset purchases and guarantees.<sup>4</sup>

In Europe, the European Commission authorized total aid of EUR 3,892.6 billion (29.8 % of EU GDP in 2013) for guarantees on liabilities between 2008 and 2014. The outstanding amount peaked in 2009 at EUR 835.8 billion (6.39 % of EU 2013 GDP), and has since decreased to 352.3 billion in 2013 (2.7 % of EU 2013 GDP). An additional EUR 448 billion (3.4 % of EU 2013 GDP) was spent on the public recapitalization of banks between 2008 and 2013.<sup>5</sup> One of the hardest hit European countries was Iceland, a small state based on area, population and real economy, with a large financial sector that was too big to save, though the domestic parts of it were nationalized.

### The Euro Area Debt Crisis

As the crisis advanced, its effects spilled over from banks to the real economy. The sovereign and banking crises exacerbated each other especially in Europe, shown most clearly by the Greek sovereign crisis in 2009. The European (sovereign) debt crisis, also referred to as the “euro area” or “euro zone” crisis, made apparent the fragility of monetary union under crisis conditions and the lack of macroeconomic tools for effective intervention. The cross-border exposure of some big European Union (EU) banks to sovereign debt in weaker (peripheral) European economies was quite significant in some countries. The main problem, however, was found in the nexus between (domestic) bank risk and sovereign risk.<sup>6</sup> The share of euro area sovereign bonds in total bank assets in the euro area increased over the past five years by one-third, from 4 % to 5.3 %.

Several euro area Member States (Cyprus, Greece, Ireland, Portugal, Spain) were unable to repay or refinance their government debt and/or to bail out their “national” banks without assistance from the European Central Bank (ECB), or the International Monetary Fund (IMF). The European Stability Mechanism (ESM) was created as a special vehicle to provide direct financial assistance – prohibited under the EU Treaty at that point in time – to euro area Member States experiencing financing difficulties<sup>7</sup>, issuing debt instruments in order to finance loans and other forms of financial

The sovereign and banking crises exacerbated each other, especially in Europe.

The European Stability Mechanism (ESM) was created as a special vehicle to provide direct financial assistance to euro area Member States experiencing financing difficulties.

<sup>4</sup> Ibid.

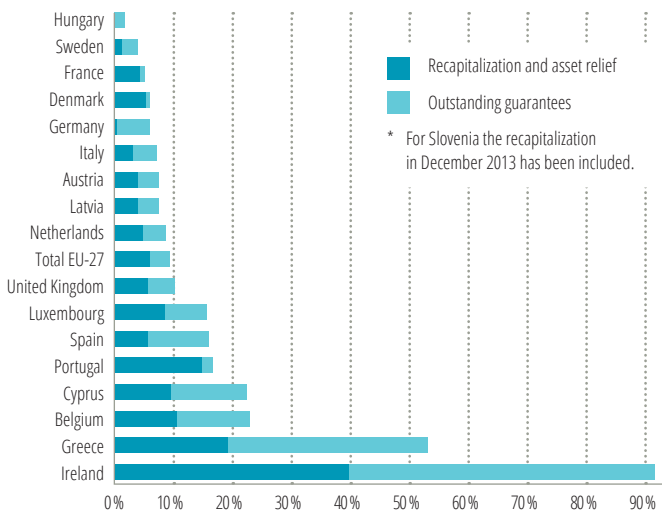
<sup>5</sup> EU Commission website: [http://ec.europa.eu/competition/state\\_aid/scoreboard/financial\\_economic\\_crisis\\_aid\\_en.html](http://ec.europa.eu/competition/state_aid/scoreboard/financial_economic_crisis_aid_en.html)

<sup>6</sup> Adrian Blundell-Wignall, Solving the Financial and Sovereign Debt Crisis in Europe, OECD Journal: Financial Market Trends, 2011 – issue 2

<sup>7</sup> [Article 136 of the Treaty on the Functioning of the European Union \(TFEU\)](#) was amended accordingly and the European Stability Mechanism (ESM) was created. The ESM is an intergovernmental organization under public international law created in 2012 as a special vehicle to provide direct financial assistance to euro area Member States experiencing financing difficulties. The ESM may recapitalize banks directly only if private investors have been bailed-in under the BRRD. The total amount of ESM resources is limited to EUR 60 billion.

assistance. In exceptional circumstances, the ESM may directly recapitalize financial institutions as an instrument of last resort when bail-in and contributions from the resolution funds are insufficient (see chapter 21a on resolution financing). Although significantly affected by the crisis, euro area debt to GDP ratio stood at 85 %<sup>8</sup> of GDP at year end 2015 (65 % in 2007<sup>9</sup>), compared to 103 % in the US (which was also around 64 % in 2007).

**State aid approved to financial institutions in the period 2008–2012**  
(in % GDP 2012)\*



The FSB developed the ‘Key Attributes’ as the international standard for the resolution of institutions deemed “too big” or “too interconnected” to be allowed to fail because of their potential systemic impact.

**Regulatory Response**

The financial crisis highlighted a lack of effective means of dealing with institutions deemed “too big” or “too interconnected” to be allowed to fail because of their potential systemic impact. In 2008, the G20 called for strengthened cooperation on crisis prevention, management and resolution to permit an orderly resolution, including of large complex institutions, without public bail-out. Regulators reacted by developing new policies and strengthening regulations at the international and national level worldwide. In 2009, the Financial Stability Forum published high-level principles for cross-border cooperation on crisis management. This work was continued by its successor body, the Financial Stability Board (FSB), which developed the “Key Attributes of Effective Resolution Regimes for Financial Institutions” as the international umbrella standard for resolution regimes covering financial institutions of all types that could be systemic in failure. The Key Attributes were published in October 2011 and extended to financial market infrastructures and insurers in 2014.

<sup>8</sup> <http://ec.europa.eu/eurostat/documents/2995521/7235991/2-21042016-AP-EN.pdf>, 6.7.2016

<sup>9</sup> The Maastricht Treaty limits the debt ratio to 60 % GDP.

The Bank for International Settlements (BIS) published recommendations for supervisors to strengthen cooperation in cross-border bank resolution in 2010, stressing the need to help support market discipline by encouraging counterparties to focus more closely on the financial risk of an institution and help protect institutions from the moral hazard that arises through relying on public support. The IMF and the World Bank co-published a report on the legal, institutional and regulatory framework for bank insolvency in 2009. Furthermore, Basel III as the cornerstone of post-crisis reforms aims to strengthen minimum standards of resilience so that financial firms are less likely to fail, and to reduce the impact on the financial system and the economy in case a firm does fail. The main changes under the Basel III requirements relate to: i) an increase in the quality and level of capital; ii) the enhancement of risk capital; iii) the inclusion of a leverage ratio requirement; iv) the introduction of capital buffers to mitigate various sources of systemic risk (macro-prudential dimension); v) the mitigation of liquidity risk through a liquidity coverage ratio (LCR) and a net stable funding ratio (NSFR); and vi) enhancements to the “securitization model”.

### European Response

Within the context of the European integration process, the financial crisis made particularly apparent the previously tolerated discrepancy between the freedom to provide services within an integrated market, national supervision, and the unsolved problem of burden-sharing. The crisis showed that the EU had to improve the European-wide system for coordination and cooperation in the management of cross-border banks. A system based on ad hoc coordination was insufficient in an integrated market and even more within a common currency. European legislators summed this up in the recitals of the SRM Regulation as follows: “Interbank markets have become less liquid and cross-border bank activities are decreasing due to fear of contagion, lack of confidence in other national banking systems, and in the ability of Member States to support banks.”

Switzerland and the UK were forerunners in the adoption of national resolution schemes. Within the euro area a new Banking Union was created, responsible for the centralized oversight and resolution of banks under a set of fully harmonized laws, regulations, and practices ([see chapter 2](#) on Banking Union). The BRRD was developed as a common framework for bank resolution across all EU Member States. It gives authorities additional powers to develop a future framework for the banking industry and has been designed to better prepare for and resist shocks leading to the implementation of bail-in instruments ([see chapter 11](#) on MREL) and to ensure resolvability across national borders (at least within the European Union), regardless of size and structure. Broadly speaking the BRRD regulates four key elements: i) the preparation and prevention of resolution via recovery and resolution planning; ii) the taking of early intervention measure by the supervisor; iii) the application of resolution tools and powers

Basel III was the cornerstone of the post-crisis banking reform along with new banking resolution rules.

The BRRD creates a common framework for bank resolution across all EU Member States.

Its key elements are

- recovery and resolution planning
- enhanced set of early intervention measures by the supervisor
- strong set of resolution tools and powers in the case of an actual bank failure
- cooperation and coordination between national authorities.



in the case of an actual bank failure; and last but not least iv) the cooperation and coordination between national authorities

The European Commission in the BRRD impact assessment has calculated that whilst the increased costs to financial institutions may have a negative impact on GDP, the improved financial stability of the sector and reduced likelihood of system crises and risks to taxpayers' money to recapitalize failing banks would have a much larger positive impact on GDP. Also the FSB's assessment on the impact of implementing the new standard on Total Loss Absorbing Capacity (TLAC, [see chapter 11](#)) at global level concluded that even under the most conservative assumptions macroeconomic benefits of introducing TLAC (+15/20 bps of annual GDP) would exceed costs (-15 bps).

### Relevant documents

- [Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No: 111-203 \(07/21/2010\)](#). An Act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bail-outs, to protect consumers from abusive financial services practices, and for other purposes.
- [EC Commission, State Aid Scoreboard 2015 – Aid in the context of financial and economic crisis](#)
- [EC, Impact Assessment, Accompanying the BRRD legislative proposal, SWD\(2012\) 166 final](#)
- [FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions, 2014 \(2011\)](#)
- [FSB, Summary of Findings from the TLAC Impact Assessment Studies, 2015](#)
- [BIS, Report and Recommendations of the Cross-border Bank Resolution Group, March 2010](#)
- [IMF, World Bank Group \(WBG\), An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency, 2009](#)
- [IMF, Cross-Border Bank Resolution: Recent Developments, 2014](#)
- [UNCITRAL, Documents published by the Working Group V on Insolvency Law](#)
- [Henri Maurer and Patrick Grussenmeyer, ECB, Statistics Paper Series, Financial assistance measures in the euro area from 2008 to 2013: statistical framework and fiscal impact:](#)
- [Basel Committee on Banking Supervision, Finalizing post-crisis reforms: an update, A report to G20 Leaders, November 2015](#)

# CHAPTER 2:

# THE EU BANKING UNION

# AND THE BRRD

By Pamela Lintner and Lira Qefalia

## KEY QUESTIONS

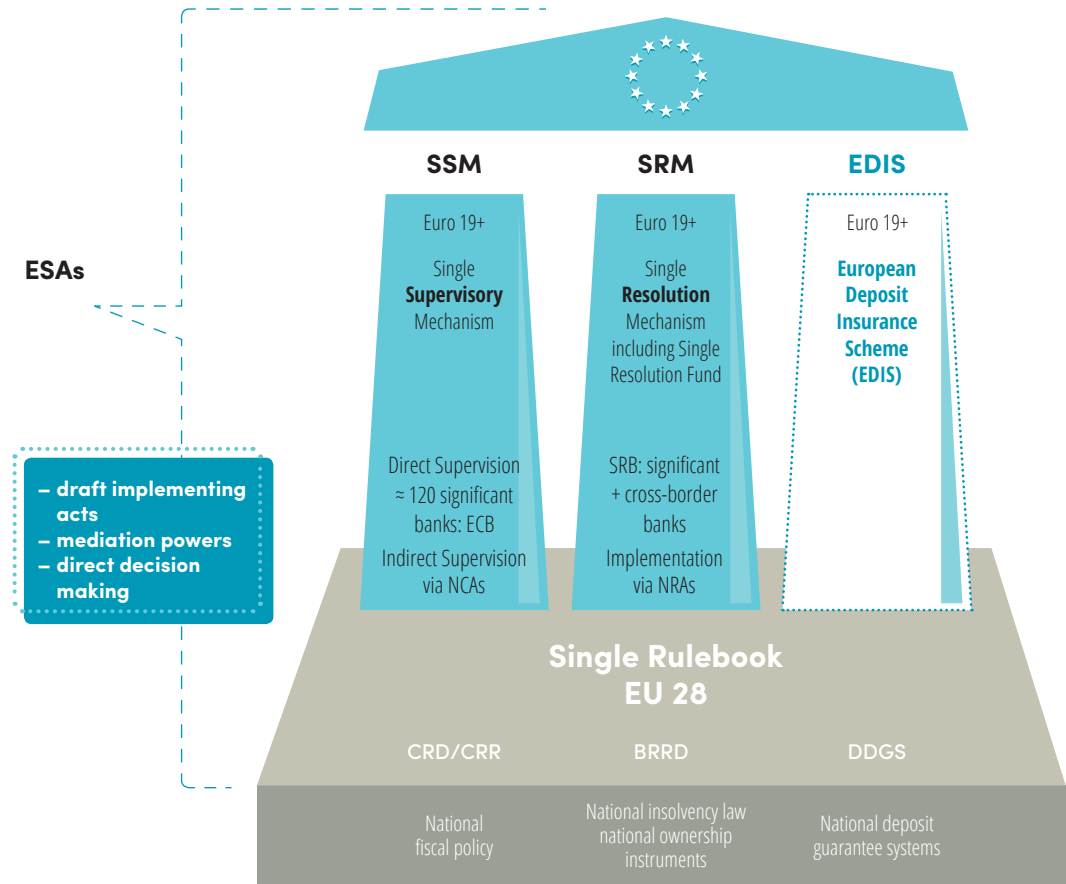
- What is Banking Union and who is involved?
- What responsibilities are left for the national authorities?
- What are the competencies of the European Central Bank (ECB) as a supervisor and of the Single Resolution Board (SRB)?
- What is the Single Rulebook?

The financial crisis demonstrated severe shortcomings in the institutional framework of the European Union (EU) in general, and in the Economic and Monetary Union (EMU) in particular. During the crisis there was limited cross-border cooperation in financial supervision and crisis management, and no rules for common burden-sharing were stipulated. A negative feedback loop between banks and sovereigns, i.e. the link between sovereign debt and bank debt, impaired a coordinated centralized response to the financial crisis in the EU. Member States largely addressed the systemic fragility of their banking systems through national policy tools. The crisis revealed evidence that national authorities had strong incentives to protect and act in the interests of their national markets.<sup>1</sup> The increasing risk of fragmentation in the EU banking market risked undermining the single market for financial services and impairing the effective transmission of monetary policy to the real economy throughout the euro area. The European Commission has since 2010 proposed nearly 30 sets of rules to ensure a safer, sounder and more stable EU financial sector. The Single Rulebook, with the CRD/CRR for supervision and the BRRD for resolution as its key elements, was introduced to ensure a single set of rules across the Single Market. On the basis of the Single Rulebook, Banking Union with centralized supervisory and resolution powers was created for those countries which share the euro. Its aim was for deeper integration to restore confidence in the euro and as part of a longer term vision of further economic and fiscal integration.

Banking Union was introduced to create a safer, sounder and more stable EU financial sector.

<sup>1</sup> COM (2013) 520 final Rc 5: “national supervisors have strong incentives to minimize the potential impact of bank crises on their national economies by adopting unilateral action to ring-fence banking operations”.

The European Banking Union



### The Single Rulebook

The Single Rulebook is the term used for the set of legislative texts that all financial institutions in the EU must comply with and on which Banking Union depends. The BRRD is one part of this Single Rulebook and, together with new rules on capital and liquidity requirements (CRD IV and CRR) and on deposit guarantee schemes (DGS), it ensures a unified regulatory framework. The Single Rulebook consists of a series of level 1 legislation adopted by the EU Parliament and the Council of the European Union (the Council), complemented by level 2 delegated legislation and implementing acts prepared and drafted by the European Banking Authority (EBA) and adopted by the European Commission in cooperation with Member States Committees. These Regulations are directly applicable and do not need to be transposed in national law. These legislative measures are further complemented by EBA “soft law” guidance.

The Single Rulebook forms the harmonized prudential rules that all financial institutions in the EU must comply with.

### Foundations of Banking Union

In June 2012, EU Heads of State and Government agreed to create a Banking Union, completing the EMU by providing for the centralized application of EU-wide rules for banks in the euro area. The Banking Union guarantees the harmonized application of European regulation through the creation of centralized Supervision and Resolution Powers (SSM and SRM). The Banking Union creates common instruments for micro and macro prudential supervision, crisis management and bank resolution applicable to all countries in the euro area (non-euro area countries may also join). It consists of three main elements/pillars:

- the Single Supervisory Mechanism (SSM) with the European Central Bank (ECB) as a centralized supranational supervisor;
- the Single Resolution Mechanism (SRM) with the Single Resolution Board (SRB) responsible for managing banks in case of failure; and
- a European deposit guarantee scheme, which is not yet centralized but is based on the same harmonized principles as for all EU Member States.

Banking Union creates a centralized framework of banking supervision, crisis management, and bank resolution applicable to all countries in the euro area.

### Single Supervisory Mechanism (SSM)

The SSM delivers prudential supervision led by the European Central Bank (ECB) as the supervisor of financial institutions in the euro area, together with the national supervisory authorities of the participating member states (i.e. all euro area member states and those who choose to participate by “opting-in”). Around 129 “significant” banks are under the ECB’s direct supervision, representing approximately 82 % of euro area bank assets. National Competent Authorities (NCAs/supervisory authorities) remain primarily responsible for the supervision of “less significant”, i.e. smaller, banks in close cooperation with the ECB (indirect supervision). In practical terms the ECB has to apply divergent national laws implementing CRD IV. It operates via Joint Supervisory Teams (JSTs) comprising ECB staff and relevant national supervisors. The JSTs foster a common supervisory culture and promote consistent supervisory practices and approaches. They carry out ongoing supervision of significant banks, in particular the

Under the SSM the ECB directly supervises the largest banks in the euro area, while the national supervisors continue to monitor the remaining banks via indirect ECB supervision.

Supervisory Review and Evaluation Process (SREPs) supervisory examination programs, and they are responsible for coordination with on-site inspection teams.

Before formally taking on its responsibilities in November 2014, the ECB conducted a “comprehensive assessment”, including an Asset Quality Review (AQR) and stress tests, of banks that would fall under its remit. Of the 130 banks assessed, 25 banks were found to have a capital shortfall.

Bank resolution is managed by the Single Resolution Board (SRB), which decides on the application of resolution tools and the use of the Single Resolution Fund (SRF).

### **Single Resolution Mechanism (SRM)**

Banks cannot be completely protected against failure, even with strong supervision and the use of early intervention tools. The second pillar of Banking Union, the Single Resolution Mechanism (SRM), allows their resolution to be managed effectively, with the aim of reducing costs to taxpayers and minimizing any negative effects to the real economy at the European level.

Bank resolution within the euro area is managed by the Single Resolution Board (SRB), which is responsible for resolution planning and decides on the application of resolution tools as well as on the use of the Single Resolution Fund (SRF), financed by the banking industry and owned by the SRB. Both the SRB and the SRF became fully operational in January 2016 ([See chapter 21b](#) on the gradual building up of the SRF via national compartments until 2024).

The SRM applies – in parallel to the SSM – to all banks in the euro area, and in addition to cross-border banks (around 15 have been identified by the SRB). ECB actions and powers in its capacity as the single supervisor and SRB actions under the SRM are intertwined and partially mutually dependent. While the ECB is the main authority empowered to decide if a bank is considered FOLTF (as a rule, [see chapter 14](#)), it is up to the SRB to trigger the resolution procedure and assess if the conditions for resolution are fulfilled. Moreover, the ECB is represented in a non-voting capacity on the SRB Board.

The SRM creates a uniform institutional framework for the application of the BRRD, including a SRF, for participating Member States. Resolution decisions are taken – for the largest institutions and cross-border banks – by the SRB. The application of specific resolution tools to deal with a failing institution, the “resolution scheme”, is decided by the SRB in a rather complex voting procedure between the Member States, with veto powers by the European Commission and the Council ([see chapter 14](#)).

The SRM Regulation is complementary to the BRRD, and not a replacement or substitute. Proper and comprehensive transposition of the BRRD by each Member State establishing a national resolution authority (NRA) that is powerful and capable of acting is essential. The SRB can apply its own tools

and powers under the SRM Regulation (which is directly applicable in all Member States). The SRB's resolution scheme decisions are as a rule directed towards NRAs, for their enforcement under national law. Only exceptionally, if the NRA fails to comply with the SRB's decisions, may the SRB address orders directly to the bank under resolution. NRAs within the euro area are responsible for the resolution of national banks not covered by the SRB (small, non-cross-border banks with no use of the SRF).

### European Deposit Insurance Scheme

Unlike the first two pillars of Banking Union, the third pillar is (so far) not based on a centralized system shifting competencies and powers to the European level but relies on the traditional concept of rule harmonization to ensure a common scope and level of deposit insurance (deposits up to EUR 100.000 are insured per person per bank). To complete the Banking Union the European Commission adopted a legislative proposal for a "European Deposit Insurance Scheme" (EDIS) in November 2015. This is now under negotiation in the EU Parliament and the Council. EDIS would be based on the creation of a European Deposit Insurance Fund, managed by the SRB, which would become fully operational by 2024. It aims to create a centralized euro area-wide deposit insurance scheme, which would comprise national deposit guarantee schemes plus a European deposit insurance fund built gradually over eight years. It would have the typical Banking Union construction: a Single Rulebook in the form of the existing DGS Directive and its national implementing laws and standards for all Member States, complemented by EDIS which would be mandatory for euro area Member States and open to non-euro area Member States wishing to participate.

EDIS would gradually build up and pool available funds for payout events at the central level over time without requiring an overall increase in banks' contributions. EDIS is planned to be developed in three sequential stages: i) a re-insurance scheme for the first three years, providing liquidity assistance and limited loss absorbance of the national schemes; ii) a co-insurance scheme for four years until 2024 under which EDIS would absorb a progressively larger share of losses of the national schemes; and iii) in the final stage, EDIS would fully insure deposits and would cover all liquidity needs and losses in the event of a pay-out or resolution procedure and protect deposits below EUR 100,000. National DGSs would remain in place even after 2024 to administer pay-out events and to act as a contact points for depositors and banks.

European deposit insurance is currently based on harmonized rules applied in 28 Member States. EDIS would, if adopted by the EU Parliament and the Council in future, ensure a centralized deposit guarantee system for euro area Member States.

### Relevant documents

- [Directive 2014/49/EU on Deposit Guarantee Schemes](#)
- [Communication from the Commission – A Roadmap towards a Banking Union \(COM/2012/0510 final\)](#)
- [European Court of Auditors: European banking supervision taking shape – EBA and its changing context No 05/2014](#)

- [ECB, Guide to Banking Supervision, September 2014](#)
- [Regulation \(EU\) No 806/2014](#) 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 Resolution Fund and amending Regulation (EU) No 1093/2010
- [Proposal for a Regulation amending Regulation \(EU\) 806/2014 in order to establish a European Deposit Insurance Scheme \(COM/2015/586 final\)](#)
- [Regulation \(EU\) No 1022/2013](#) establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank
- [Commission Delegated Regulation \(EU\) 2016/1075](#) supplementing Directive 2014/59/EU with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges



# CHAPTER 3:

## THE BRRD – AN OVERVIEW OF ITS SCOPE, OBJECTIVES, POWERS AND TOOLS

By Dominik Freudenthaler

### KEY QUESTIONS

- Which entities fall within the scope of the recovery and resolution regime?
- What is the difference between bank resolution and regular insolvency proceedings?
- What general powers does the BRRD provide?
- What is the relationship between resolution powers and resolution tools?
- What types and forms of a moratorium are allowed under the BRRD? Is it a resolution tool?

[ART. 1, 31, 34, 63 BRRD](#)

### Scope

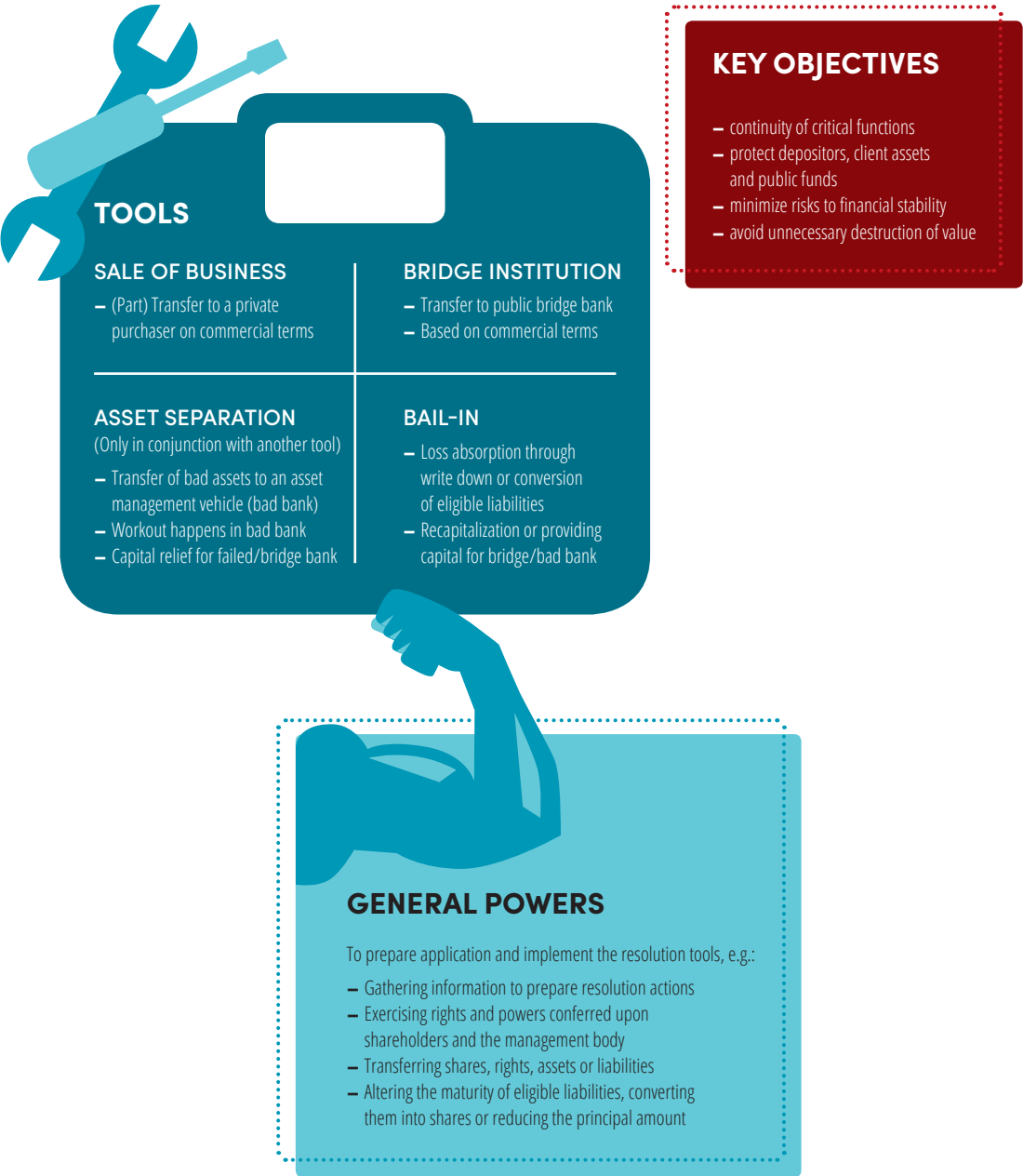
The BRRD takes account of the recommendations of the Financial Stability Board (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions ([see chapter 1](#)), and is aligned with the regulatory framework of the EU for financial institutions. The BRRD's scope includes those institutions that are subject to the prudential supervision and regulatory capital requirements provisions in the EU Capital Requirements Directive (CRD IV); that is, "credit institutions" and "big" investment firms with an initial capital above EUR 730,000 (jointly "institutions") and financial holding companies established in the EU. It also applies to "financial institutions" as defined in the Capital Requirements Regulation (CRR) that are subsidiaries of institutions or holding companies when they are supervised on a consolidated basis.

The BRRD's scope includes "credit institutions" and "big" investment firms (with initial capital > EUR 730,000 and financial holding companies established in the EU) as well as "financial institutions" as defined in the CRR that are subsidiaries of institutions or holding companies when they are supervised on a consolidated basis.

The BRRD will additionally have indirect effects on many more EU entities and group members, including branches outside the EU, even though they may not fall directly within the scope of the legislation.

Unlike the Key Attributes, the BRRD is not applicable to financial market infrastructures like Central Counterparty Clearing Houses (CCPs) and

Resolution Tools



Central Securities Depositories (CSDs), nor to insurance companies. The European Commission has, however, published a roadmap for future EU legislative initiatives to establish a framework for the resolution of non-bank financial institutions which will take account of sector-specific considerations.

Finally, it is important to stress that the BRRD is a Directive of minimum harmonization. Consequently, Member States must implement the minimum harmonized set of resolution tools and powers of the BRRD into national law, but may choose to go beyond these. In doing so, Member States are able to introduce additional tools at national level to deal with crises, as long as they are compatible with the resolution objectives and principles set out in the BRRD, other EU legislation, and the EU state aid rules.

### Objectives

The overarching objective of the BRRD resolution regime is to make sure a bank can be resolved swiftly with minimal risk to financial stability. This should be achieved without negative impacts on the real economy and without the need to spend taxpayer money to stabilize a failing bank (bail-in instead of bail-out). Resolution objectives are much broader than the objectives of regular insolvency proceedings, which commonly focus on the interests of creditors and to maximize the value of the insolvency estate. The BRRD resolution regime aims to ensure overall financial stability, ending the nexus between bank risk and sovereign risk. BRRD objectives are explicitly defined in law as:

- ensuring the continuity of critical functions;
- avoiding significant adverse effects on the financial system;
- protecting public funds by minimizing reliance on extraordinary public financial support for failing banks;
- protecting insured depositors; and
- protecting client funds and client assets.

These resolution objectives are of equal significance, and resolution authorities have to balance them as appropriate to the nature and circumstances of each case. To achieve these objectives, the BRRD broadly speaking regulates four key elements: i) the preparation and prevention of resolution via recovery and resolution planning; ii) the taking of early intervention measure by the supervisor; iii) the application of resolution tools and powers in the case of an actual bank failure; and last but not least iv) the cooperation and coordination between national authorities.

### Liquidation vs Resolution

The key advantage of a resolution is that it allows for some continuity and the maintenance of a bank's critical functions. If a bank goes into liquidation, all liabilities (except those exempted from the insolvency estate) fall due and the insolvency estate is protected by the imposition of a collective

Resolution objectives are much broader than the objectives of regular insolvency proceedings and aim to ensure an orderly resolution of failing banks while safeguarding financial stability and with minimum impact on the real economy and taxpayers' money.

In contrast to liquidation, resolution allows the maintenance of a bank's critical functions and not all liabilities fall due automatically.

stay of creditor action (no further enforcement by individual creditors). A trustee is appointed to dispose of the assets and distribute the proceeds among the creditors. The rationale in insolvency is that all creditors (with some exceptions such as secured creditors) should be treated the same and receive their pro rata share of the estate. However, this can result in stress, interruptions, and contagion risks for financial systems. The "fire sale" that liquidation entails may also be detrimental to the interests of creditors. In terms of financial stability, as seen during the last financial crisis, the application of bank insolvency rules has proven inadequate and politically unacceptable. Although covered depositors would be reimbursed by deposit guarantee schemes, the risk of wider contagion was, in most cases, deemed too great, especially for large and complex "too big to fail" institutions (TBTF). Thus, public funds were used to keep struggling banks open. In contrast to liquidation, not all liabilities fall due automatically if a bank is placed under resolution. The resolution authority should be able to cope with the crisis by allocating incurred losses among creditors and restructuring the institution while maintaining uninterrupted access to deposits and critical functions. Covered depositors have continuous access to their deposits (instead of reimbursement). In return for ensuring uninterrupted access to deposits, the deposit guarantee scheme is, under certain circumstances, liable to make in lieu contributions in the context of resolution ([see chapter 22](#)).

Unlike under insolvency proceedings, the BRRD explicitly stipulates that resolution is not a reason for counterparties not to fulfill their obligations, and it foresees the suspension of contractual termination rights. Central clearing systems must not stop an institution under resolution from trading. On Monday after the "resolution weekend" the institution is assumed to resume operations as non-failing; counterparties are prevented from closing out until midnight. These suspensions facilitate the transfer of derivatives and other financial counteracts to solvent transferees.

The five resolution tools provided for under the BRRD are the:

- i) bail-in tool,
- ii) sale of business tool,
- iii) asset separation tool,
- iv) bridge institution tool and, as a last resort,
- v) government stabilization tool.

### **Powers, Tools and other Measures**

The resolution authority is given a broad range of powers to achieve the objectives of resolution. The resolution regime of the BRRD assumes that the powers are applied as a "bundle", called resolution tools, which may be used individually or in any combination on a case-by-case basis (except the asset separation tool, which may only be applied together with another resolution tool, [see chapter 18](#)). The five resolution tools provided for under the BRRD are:

#### **The bail-in tool**

- The bail-in tool allows the resolution authority to allocate incurred losses to the owners and debt holders of the institution: the interests of existing shareholders are cancelled, diluted, or transferred, and the claims of unsecured creditors are written down and/or converted into equity to recapitalize the firm ([see chapter 15](#)).

### Three transfer tools

- The sale of business tool allows for a swift transfer of shares, assets, rights and liabilities of the institution under resolution to a purchaser “on commercial terms” ([see chapter 16](#)).
- The bridge institution tool allows for a temporary transfer of shares, (good) assets, rights and liabilities to a (publicly owned) bridge bank in order to maintain critical functions of the problem bank ([see chapter 17](#)).
- Under the asset separation tool (impaired) assets, rights and liabilities are transferred to a (publicly owned) asset management vehicle, also known as a “bad bank”. This allows for a value improving workout of assets and avoids possible value destruction caused by a fire sale under liquidation ([see chapter 18](#)).

In addition, government stabilization tools (which are technically not defined as resolution tools) may be used as a last resort in the very extraordinary situation of systemic crisis and after having exploited all resolution tools. The resolution authority may seek funding from the government either by way of temporary public ownership or public equity support ([see chapter 19](#)).

The BRRD sets out in [Article 63](#) a list of general powers required by resolution authorities to prepare for the implementation and application of resolution tools. The minimum set of “key powers” envisaged for authorities under the BRRD are:

- Accessing information to prepare resolution actions;
- Taking control of a bank under resolution including the power to replace management. If the resolution authority decides to resolve a bank it will be crucial to gain control of the institution in order to effectively implement the resolution actions. This is especially true if there is reasonable suspicion that fraudulent behavior may have led to the failure of the bank;
- Exercising rights and powers conferred upon shareholders and the management body. To achieve the goal of gaining control, the resolution authority has the power to remove or replace the management body and senior management;
- Transferring shares, rights, assets or liabilities;
- Altering the maturity of eligible liabilities (as initially defined), converting them into shares or reducing the principal amount;
- Cancelling or reducing the nominal amount of shares or other instruments of ownership. To overcome obstacles relating to the ownership structure, an important power is the possibility of exercising all the rights and powers of the shareholders without their consent. This allows the resolution authority to swiftly substitute votes required by company law or to implement corporate law measures in order to create the targeted company structure.

The general powers of the resolution authority are the foundation for implementing and giving effect to the resolution tools.

The BRRD does not specify scope and nature of a moratorium

The general powers are as important as the resolution tools. They are the foundation for implementing and giving effect to the resolution tools and they ensure that the resolution authority is not facing procedural impediments to a resolution (for example, by giving the resolution authority the power to override company law). The so-called ‘moratorium’, for example, though not explicitly found in the list of resolution tools, was used in one of the first resolution cases under the new BRRD regime. The BRRD merely mentions the possibility of applying a moratorium without specifying its scope and nature, for example no (maximum) duration is stipulated nor type of liabilities and instruments specified. In the Heta case in Austria, shortly after the national BRRD transposition law came into effect, the national resolution authority (NRA) invoked the general power of altering the maturity of eligible liabilities and applied a moratorium on the payout of unsecured debt of two years (no depositors affected below EUR 100,000). In this case the NRA needed time to prepare resolution actions for a failing institution (an asset management vehicle) with no elaborated resolution plans (see the Heta case study in accompanying publication “Bank resolution and bail-in in the EU: Selected case studies pre and post BRRD”).

Member States may decide to entrust resolution authorities with additional powers and tools. However, in this case the use thereof must be consistent with the resolution principles and objectives, especially they should not impinge on the effective resolution of cross-border groups (e.g. through ring-fencing).

### Relevant documents

- [EBA Report on the perimeter of credit institutions established in the Member States, November 27, 2014](#)
- [Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms \(CRD IV\)](#)
- [Regulation \(EU\) No 575/2013 on prudential requirements for credit institutions and investment firms \(CRR\)](#)
- [EU roadmap resolution other than banks i.e. insurers and financial markets infrastructures](#)
- [Commission Delegated Regulation \(EU\) 2016/1075 supplementing Directive 2014/59/EU](#) with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges
- [EBA/RTS/2015/04, Final Draft Regulatory Technical Standards](#) on procedures and contents of notifications referred to in Article 81(1), (2) and (3) and the notice of suspension referred to in Article 83 of Directive 2014/59/EU

# CHAPTER 4:

## THE MAINTENANCE OF CRITICAL FUNCTIONS AS A KEY RESOLUTION OBJECTIVE

By Christian M. Stiefmueller

### KEY QUESTIONS

- What are critical functions and who defines them?
- What is the difference between core business lines and critical economic functions?
- Are core business lines automatically saved and protected in case of failure?
- Are critical functions defined at group level or for each individual entity?

### [ART. 2 BRRD](#)

### Defining Critical Functions and Core Business Lines for Recovery and Resolution Planning

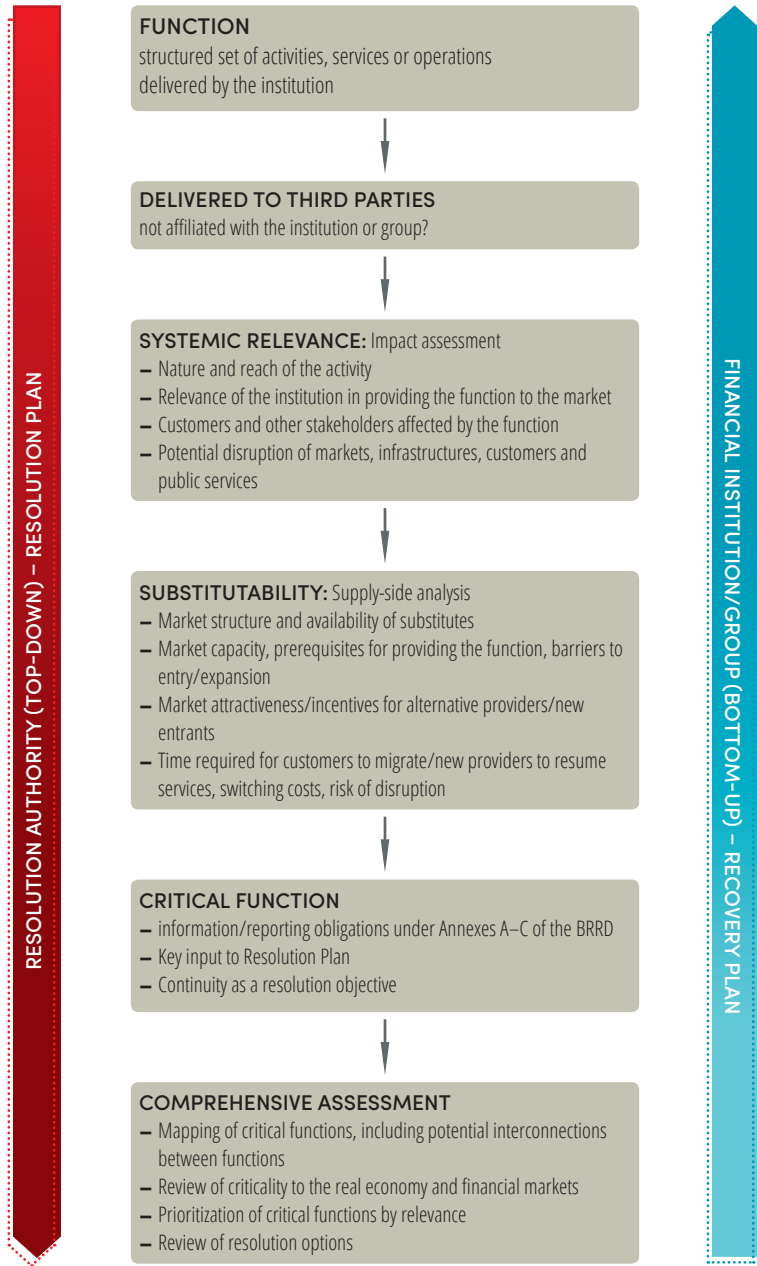
Continuity of critical functions is one of the five BRRD resolution objectives that govern all aspects of the resolution process and guide the resolution authority's application of resolution tools and the exercise of resolution powers. The BRRD broadly defines critical functions as any structured set of activities, services or operations of a financial institution that are provided to third parties and that are essential to the real economy and/or for preserving financial stability. As such, a critical function may underpin one or several of the institution's products or services but does not need to be a revenue-generating product or service in its own right.

Critical functions are the activities, services or operations of a financial institution provided to third parties that are essential to the real economy and/or for preserving financial stability.

Core business lines, by contrast, are defined as business lines and associated services that the financial institution has developed as part of its commercial offering to third parties and that represent a material source of its revenues, profits or franchise value. The distinctive feature of a critical function is its importance for the functioning of the real economy at large whereas a core business line is characterized by reference to its importance for the business of the institution itself, specifically in terms of profitability. The preservation of core business lines is not in itself a resolution objective but understanding them plays a central role in the recovery and resolution process by providing a framework for evaluating



Critical Services



the institution's operations as a going concern. This ensures recovery and resolution plans can be designed to preserve as much of the commercial value of the business as possible and minimize losses incurred by the institution's investors and other stakeholders.

The BRRD requires institutions to provide a detailed description of the process for determining the value of their core business lines, together with the value of the operations and assets of the institution, for the purposes of drawing up its recovery plan ([see chapter 6](#) and [Annex A point 8 of the BRRD](#)).

Critical functions must be identified and included in the recovery plan of the institution to ensure that its viability can be restored without significant adverse impact and while maintaining these critical functions. To improve the resilience of core business lines and critical functions, the competent authority may, as part of its review of the recovery plan, direct the institution to make changes to its funding strategy, e.g. by strengthening its capitalization, improving liquidity, or adjusting the maturity profile of its liabilities ([Article 6 BRRD](#)).

Resolution authorities ask institutions to provide regular information mapped specifically to the institution's critical operations and core business lines for the purposes of drawing up and maintaining a resolution plan ([see chapter 10a](#) and [Annex B of the BRRD](#)). The objective of this mapping is to facilitate the legal and operational separation of these critical functions and core business lines from the remainder of the institution's business in the event of failure

Resolution authorities are required, as part of their resolvability assessment for the resolution plan, to consider how the institution's "critical operations" are structured and organized ([Annex C of the BRRD](#)). This includes alignment of critical operations with the institution's legal and corporate structures, the availability of (physical, financial and human) resources to support these operations, and the adequacy of information provided by, and the resilience of, the institution's management information systems.

### **Defining Critical Functions Based On Systemic Importance and Substitutability**

According to the European Banking Authority (EBA), the assessment of critical functions (and services) consists of two complementary exercises:

- financial institutions performing a (bottom-up) self-assessment of critical functions (to third parties) and services (to entities of the group) as part of their obligations under the BRRD for recovery-planning and providing information for resolution-planning; and
- competent authorities and resolution authorities conducting a (top-down) mapping exercise for the purposes of reviewing and

Critical functions are first assessed by the bank itself in its recovery plan (going concern self-assessment) then in a second step by the resolution authority conducting a top-down mapping exercise under resolution aspects (gone concern).

evaluating the firms' assessments and from the perspective of preserving system-wide financial stability.

**a. Critical functions**

A two-step test assesses the criticality of a function:

- an impact assessment of the potential impact of a function's sudden discontinuance on third parties, focusing on systemic importance and including:
  - the nature and reach of the activity in terms of the type of function (product/service), the size (volume/number of transactions) and geographic scope (global/national/regional) of the activity, the number of market participants involved (customers/counterparties) and the number of customers for which the institution is the only, or principal, banking partner;
  - the relevance of the institution/group for the relevant market at a global/national/regional level, in terms of market share, interconnectedness, complexity and cross-border activity;
  - the number and type of customers (corporate/interbank/retail) and other stakeholders (e.g. central counterparties, public entities) affected by the function; and
  - the potential impact of the disruption of the function on markets, infrastructure, customers, and public services: in particular with respect to market liquidity; disruption to customers' business and short-term liquidity needs; the perceptibility to counterparties, customers, and the public; the capacity and speed of customer reaction; the relevance to the functioning, liquidity, operations, or structure of other markets; the effect on other counterparties related to the main customers; and the interrelation of that function with other services.
- a supply-side analysis evaluating the market for the provision and "substitutability" of that function, including:
  - the structure of the market for that function (e.g. in terms of number and relative size of market participants, market shares and overall market capacity) and the availability of substitute providers;
  - the ability of other providers in terms of capacity, the requirements for performing the function, and potential barriers to entry or expansion (e.g. legal and regulatory hurdles for potential new entrants or switching costs for customers);
  - the incentive of other providers to take on these activities (i.e. the attractiveness of the business to other market participants or potential new entrants); and
  - the time required by users to migrate to a new provider, the costs of that move, the time required for other market participants to take over the function, and whether that time is sufficient to prevent significant disruption.

The Single Rulebook does not set any specific quantitative benchmarks determining systemic relevance and criticality.

As part of the impact assessment, the institution and the resolution authority should take into account the size, market share, interconnectedness,

complexity, and cross-border activity of the institution or the group. So far, level 2 legislation (i.e. detailed implementation measures) does not set any specific quantitative benchmarks for systemic relevance/criticality based on these metrics. [The European Banking Authority's \(EBA\) Comparative Report](#) briefly discusses indicative threshold levels for a limited number of functions.

A function is substitutable if it can be replaced in an acceptable manner and within a reasonable timeframe without causing systemic problems for the real economy and financial markets. So far, level 2 legislation does not set any binding timelines as to when substitution has to be completed. The assessment of substitutability needs to be made at the appropriate level of granularity, e.g. local/national/regional, depending on the relevant market.

No concrete timeframe is foreseen for a function to be considered substitutable and replaceable.

As part of its “top-down” mapping exercise, the resolution authority should conduct an evaluation of the institution’s own assessment (going concern) against the specific characteristics of the institution, the market for that function and the overall characteristics of the relevant economy and financial market. Based on the mapping and aggregation of critical functions, the resolution authority should be in a position subsequently to prioritize these functions by order of criticality and to design and optimize resolution strategies accordingly (gone concern).

#### b. Critical services

Critical services are the underlying operations, activities and services performed for one (dedicated services) or more business units or legal entities (shared services) within an institution/group which are required to provide one or more critical functions.

Identification of critical services, and where they are provided and used within an institution/group, should enable institutions and regulators to take organizational and structural steps to ensure their continued availability. This might be achieved by placing them into separate entities, which could be carved out/transferred, or by entering into outsourcing arrangements with external providers that provide for their continued supply in the event of a crisis.

The process for the designation of critical services, as outlined by the EBA in its Technical Advice Note, is based on the identification of critical functions and consists of:

- an analysis of the impact of the failure of a particular service on one or more critical functions (impact assessment). A service would be deemed critical only when its failure or malfunction would lead to the collapse of, or create a serious impediment to, the performance of one or more critical functions by the user of the service; and

- an assessment of the substitutability of that critical service (supply-side analysis) considering, in particular, whether/how critical functions would be adversely affected, whether/how the service could be replaced and, if so, on what terms and within what time.

Critical services that are shared internally by several entities within the institution/group (shared services) or provided to third parties should be identified to the resolution authority as part of the resolvability assessment ([see chapter 10b](#)) so that interconnections between critical functions and associated services can be mapped and their criticality for the real economy and the financial system can be properly assessed.

### c. Core business lines

In line with the definition in [Art. 2/1 \(36\) of the BRRD](#), the principal criterion for identifying core business lines should be materiality. The EBA suggests in its Technical Advice Note a number of quantitative indicators including (actual and expected) revenues, profits, and assets attributable to the business as well as its market share. However, the EBA recommends against relying solely on quantitative indicators and that consideration also be given to the internal organization of the institution in its entirety to include, for instance, new, emerging businesses with significant growth perspectives or unprofitable businesses that nevertheless contribute substantially to the institution's franchise value.

### Practical Considerations

- For groups subject to consolidated supervision, the assessment of critical functions will be conducted, in the first instance, by the parent company and submitted to the consolidating supervisor as part of the group recovery plan.
- In the case of a cross-border group, the consolidating supervisor, in co-operation with the supervisory college, will evaluate the criticality of the group's functions in respect of each relevant jurisdiction as well as for the group overall.
- There is a distinct level of overlap between the assessment of critical functions, governed by the BRRD, and the designation of systemically important institutions under CRD IV (Art. 131) in that they both aim to identify entities that are likely to pose a systemic risk to financial stability. Authorities need to ensure that relevant analysis is conducted and applied consistently.
- Close cooperation between the competent supervisory authorities and resolution authorities in the assessment of critical functions will be paramount to ensure consistency between recovery and resolution planning and to provide for a seamless transition when resolution actions need to be taken.
- In its Technical Advice Note, the EBA points out that supervisory and resolution authorities are usually better placed than the bank itself to assess and define its critical functions since they are able to draw on

For cross-border groups, the consolidating supervisor, in co-operation with the supervisory college, evaluates the criticality of the group's functions in respect of each relevant jurisdiction as well as for the group overall.

information from multiple sources to form a consolidated view of the relevant market.

- Banks are obliged to list their critical functions and core business lines in the recovery plan, but resolution authorities are not legally bound to guarantee their continued availability in resolution.
- In recovery, the bank itself will usually be able to continue providing its” before critical functions. After its critical functions. After entering into resolution, decisions on these matters transfer largely to the resolution authority, whose primary concern will be the continuity of the function, not of the institution providing it.
- The concept of critical functions, as introduced by the BRRD, is new in most Member States and there is little precedent so far. Best practice guidance has yet to be developed.

### Examples

The FSB Guidance Note provides extensive examples of critical functions, including payments, custody, certain lending and deposit-taking activities in the commercial or retail sector, clearing and settlement, limited segments of wholesale markets, market-making in certain securities, and highly concentrated specialist lending sectors. Examples of critical shared services include the provision of information technology, given the dependency of core banking processes on IT, and other services such as facility management and administrative services.

The BRRD does not itself specify critical functions or services. The EBA provides a (non-exhaustive) list of critical functions in its Comparative Report. The functions most commonly considered as critical include retail deposits (current accounts), retail lending (incl. mortgages), payments, corporate lending and deposits, clearing and settlement, and derivatives. Other functions considered as critical comprise, among others, secondary-market trading, debt capital markets, custody services, other retail products and services (credit cards, savings accounts), and trade finance.

The functions most commonly considered as critical include retail deposits (current accounts), retail lending (incl. mortgages), payments, corporate lending, and deposits, clearing and settlement and derivatives.

### Relevant documents

- [Commission Delegated Regulation \(EU\) 2016/778 of February 2, 2016](#) supplementing Directive 2014/59/EU with regard to the circumstances and conditions under which the payment of extraordinary ex-post contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines
- [EBA Recovery Planning: Comparative Report on the approach to determining Critical Functions and Core Business Lines in Recovery Plans, March 6, 2015](#)
- [Financial Stability Board, Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services, July 16, 2013](#)

- [Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions, October 15, 2014](#)
- [EBA/GL/2015/06, Final Draft Guidelines on the minimum list of services or facilities that are necessary to enable a recipient to operate a business transferred to it under Article 65\(5\) of Directive 2014/59/EU](#)

# CHAPTER 5:

## THE RESOLUTION AUTHORITY: GOVERNANCE AND CONFLICTS OF INTEREST

By Dieter Huber

### KEY QUESTIONS

- Should the resolution authority be a separate body from the supervisory authority?
- How are responsibilities split between prudential supervision and the resolution authority?
- How can potential conflicts of interest between the resolution function and supervisory or other central bank tasks be managed?
- Does the resolution authority need approval from the Ministry when taking resolution action?
- Is the resolution authority independent? Is it held accountable?

### [ART. 3 BRRD](#)

The financial crisis demonstrated that supervisors are not always best placed to deal with failing banks. The BRRD foresees the establishment of an operationally independent “resolution authority” with the expertise, resources, and operational capacity to effectively apply resolution actions and exercise its powers with the speed and flexibility necessary to achieve the resolution objectives.

### **A Separate Resolution Authority?**

The BRRD envisages the resolution authority embedded within an institutional framework for crisis management and bank resolution. This framework should provide for explicit mandates and roles for the institutions involved, and provide a clear allocation of responsibilities, complemented by an effective system for information exchange. The governance structure shall clearly lay out accountability rules for the authorities’ governing bodies as well as rules of procedures.

**The exception has become the rule: in most countries a separate resolution unit has been set up within the supervisory authority.**

One or, exceptionally, two or more resolution authorities that are empowered to apply the resolution tools and exercise the resolution powers should be designated. Resolution authorities may be national central



**Resolution authority: governance, interplay with crisis management framework, conflicts of interest**



banks, competent ministries or other public administrative authorities or authorities entrusted with public administrative powers. Exceptionally, the authorities responsible for bank supervision may be designated the resolution authority. However, this legal exception to the rule provided for under [Article 3 of the BRRD](#) has, in practice, become the standard. In most Member States the resolution authority is set up within the supervisory authority (due to staffing reasons). For euro area countries, a single resolution authority, the Single Resolution Board (SRB), was established separated from the ECB as supervisor ([see chapter 2](#)). In some Member States, the competencies attributed to the resolution authority under the BRRD are split between two authorities. In Spain and Denmark, for example, functions of a “preventive nature” and resolution planning are attributed to a separate body within the supervisory authority, with a different resolution body responsible for the “executive phase” (the Fund for Orderly Bank Restructuring (FROB) in Spain and the Financial Stability Company (FSC) in Denmark).

### **Functional and Organizational Separation to Operate at Arm’s Length**

The aim is to ensure that sufficient mitigation, including structural arrangements, is in place to adequately address possible conflicts of interest and allow operational independence within supervisory authorities, national central banks, competent ministries, or other authorities. Operational independence and separate reporting lines between the resolution function and the supervisory, or other functions, of the relevant authority should be ensured by structurally separating the staff involved in carrying out resolution tasks. Such separation should, however, not hinder the exchange of information and cooperation between the authorities and functions.

**Operational and functional independence between the resolution and the supervisory, or other, functions must be ensured by a minimum set of structural arrangements (separate reporting lines, separate financing lines).**

When the resolution function is set up as part of another authority, for example the supervisory authority, the following minimum structural arrangements should be in place:

1. Separate reporting lines up to the highest possible level. A separate Board or a single Board Member, e.g. the Deputy Governor or a Director, should be ultimately responsible for taking resolution decisions.
2. Separate financing lines. Resolution financing should be strictly separated. When central banks exercise resolution functions they should be strictly prohibited from financing resolution tools or the resolution fund via the central bank’s own risk.
3. Clear allocation of responsibilities and ownership structures. If a “bridge bank” ([see chapter 17](#)) or an asset management vehicle (AMV) ([see chapter 18](#)) is created they should as a rule (depending on the expected period of existence) be operated at arm’s length from the resolution authority, but under its control. If the resolution authority partially owns shares in the bridge bank, day-to-day management should be the responsibility of the board of directors with only the limited involvement of shareholders. A separate public legal entity could be designated as the

shareholder. A similar outcome could be achieved if the resolution fund is placed outside the resolution authority and given separate legal personality. Otherwise, conflicts of interests, which arise when the same body licenses, supervises, manages, and owns a bridge bank, might become difficult or impossible to manage.

Resolution tasks may thus be government tasks or, if so mandated, tasks of the central bank. In the latter case, the central bank's independence should not be undermined. Specifically, aspects related to the solvency of banks, e.g. the financing of resolution funds or other resolution financial arrangements, remain a responsibility of the government. Liquidity-related aspects, e.g., the provision of emergency liquidity assistance to solvent credit institutions, are a central bank task. The central bank should also be authorized to recover its expenses and costs incurred in carrying out resolution measures from the institutions concerned. If tasks are entrusted to the central bank, there should be acknowledgement of potential new issues of institutional accountability and financial and political risk that members of the central bank's decision-making bodies may be exposed to. The relevant authority may be exposed to various conflicts of interest while performing resolution tasks:

**Operational and functional independence between the resolution and the supervisory, or other, functions must be ensured by a minimum set of structural arrangements (separate reporting lines, separate financing lines).**

#### **Intrinsic Conflicts of Interest**

Conflicts could arise if an existing authority (ministry of finance (MoF), central bank, supervisory authority) is additionally entrusted with the resolution function. Such conflicts could involve the predisposition not to question the work of the supervisory authority or favoring short-term fiscally beneficial solutions and thus delaying resolution decisions. Such conflicts should be mitigated by the above mentioned structural arrangements and ensuring that the resolution authority has the resources and expertise necessary for a speedy and flexible exercise of its powers.

#### **Extrinsic Conflicts of Objectives**

Resolution authorities face potential conflicts and trade-offs in a number of dimensions when applying resolution tools and exercising resolution powers embedded in the objectives of bank resolutions. These are in part mutually exclusive and include the following aims: to ensure the continuity of critical functions of a bank; to avoid a significant adverse effect on the financial system, in particular by preventing contagion; to protect public funds by minimizing reliance on extraordinary public financial support, and to protect depositors and client assets ([see chapter 4](#)). When pursuing the above objectives, the resolution authority should seek to minimize the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives.

Inter-institutional aspects are relevant too. For example, where public support is provided, the competent authority for executing the state aid framework has a say in parallel with the resolution authority. The

legitimate interests of different authorities should be accounted for by establishing balanced processes that envisage prior information, opinions or approvals of the institutions concerned. Conflicts of interest could be mitigated by clarifying the role of each authority involved in the resolution process and formalizing its interaction with other authorities (e.g. via Memorandum of Understanding).

### **Accountability and Government Involvement**

When performing the tasks conferred on them, resolution authorities should act independently and in the general interest. The resolution framework should clearly describe how the powers of the resolution authority will be executed. At the same time, there should be sufficient flexibility to deal with each individual resolution case. The resolution authority should be accountable to the national parliament, through participation in hearings and publishing annual reports.

Unless otherwise laid down in national law, ministry approval should be given before the implementation of decisions that have a direct fiscal impact or systemic implications. Where the resolution authority is not the competent ministry it should inform the competent ministry, usually the MoF, of decisions pursuant to the resolution regime. There should be close cooperation with the MoF, including granting authorized employees access to documents and information.

If the resolution authority is required to obtain the MoF's prior approval before taking resolution actions in a very broad range of circumstances – beyond cases in which the resolution measures have a direct fiscal impact – the question arises as to whether the MoF is considered to operate de facto as a second resolution authority. This would require the MoF to ensure operational independence of its resolution function. The responsibilities of authorities involved in the resolution process should be precisely defined to avoid any duplication or overlap of powers.

Conflicts of interest may also arise in situations where the government is a shareholder or creditor of the bank under resolution or has guaranteed its obligations: in such cases the function of resolution authority has to be clearly separated from the public stakeholder function (ownership or otherwise). This could gain relevance, for example, in the context of the determination of the amount required for recapitalization, which in turn informs the extent of write-down or dilution of ownership. Independent valuations as a basis for such determinations help to avoid accusations of preferential treatment of certain owners or creditors.

### **Cross-Border Interest Management**

The cross-border dimension of decisions is of particular importance, not only regarding the interests of banks, shareholders, or creditors in other countries. Execution of powers by a resolution authority may affect the

**Operational and functional independence between the resolution and the supervisory, or other, functions must be ensured by a minimum set of structural arrangements (separate reporting lines, separate financing lines).**

interests of taxpayers in other countries. For example, if certain liabilities are excluded from bail-in, the resolution fund may need to fill the gap, resulting in the resolution fund itself needing support from transnational sources. A framework for the coordination of resolution authorities in different countries should be established enabling the participating authorities to exchange information, including (parts of) resolution plans of banks, in a confidential manner. This could increase visibility of foreign operations and clarify whether foreign creditors might be beneficiaries of funds in the event that public support measures were undertaken, thus minimizing incentives to ring-fence along national borders. In general, the authorities involved should take into account the potential impact of their decisions on financial stability and the social and economic effects in other countries. This is precisely why crisis management groups and resolution colleges are being established to ensure coordination and consistency at all stages of the recovery and resolution process.

**Overview of “resolution related key tasks” and the division of responsibilities between supervision and resolution based on the BRRD framework**

✓ = formal responsibility

Task	Responsibility of Supervisory Authority	Responsibility of Resolution Authority
<b>Early intervention and preparation for taking recovery and resolution action</b>		
<b>Recovery plan</b> assessment + ordering a bank to remedy the identified deficiencies	✓	Information/consultation
<b>Early intervention:</b> corrective and enforcement measures to banks in (likely) breach of prudential requirements	✓	Information
<b>Conclusion of intra-group financial support agreement</b>	✓ General review	Assessment regarding the impact on financial stability and the resolvability of the entity providing the support
<b>Provision of intra-group financial support</b> in case of need	✓ Decision to prohibit or restrict support	Re-assessment of resolution plan if support is not given
Recommendation within Supervisory Review and Evaluation Process (SREP)	✓	Information/consultation
Definition of minimum requirement for eligible liabilities <b>MREL</b> (= loss absorbing capacity) for individual bank	Information/consultation	✓
<b>Resolution plan</b>	Information/consultation	✓
<b>Resolvability assessment including removing impediments to resolvability<sup>1</sup></b>	Information/ consultation	✓
Ordering a bank to contact potential purchasers ex-ante resolution	Close cooperation	✓ Upon information from the supervisor that early intervention measures are triggered
Write-down and conversion of capital	Information/cooperation Information that a bank has reached the point of non-viability (PONV) or is failing or likely to fail will generally come from supervision <sup>2</sup>	✓

Resolution phase		
<p>Determining the fulfilment of <b>conditions for initiating the resolution process</b></p> <ul style="list-style-type: none"> <li>– <b>failing or likely to fail (FOLTF)</b></li> <li>– <b>Public interest</b></li> <li>– no private sector solution</li> </ul>	<p>Information/cooperation</p> <p>Information that a bank is FOLTF will generally come from supervision<sup>3</sup></p>	✓
<p><b>Appointment of independent valuer</b> to define the exact amount of losses, recapitalization needs and the hypothetical loss under liquidation<sup>4</sup> (incl. prescribing detailed conditions and manner of carrying out the valuation)</p>	Information	✓
<p><b>Decision on and application of resolution tools and the use of Resolution Fund</b></p> <ul style="list-style-type: none"> <li>– <b>Bail-in</b> (incl. prescribing the terms and manner of performing the write-down and conversion of liabilities)</li> <li>– <b>Sale of business</b> (including bid selection etc.)</li> <li>– <b>Bridge bank</b> (transfer of assets, rights, liabilities, ...)</li> <li>– <b>Asset separation tool</b></li> <li>– <b>Business reorganization plan</b> of the restored bank (recapitalized via bail-in)</li> <li>– Possible <b>appointment of temporary manager</b> to replace the management body</li> </ul>	<p>Information/cooperation</p> <p>Licensing and supervision of bridge bank, consent for acquirer in case of sale, continue supervision of restored bank etc.</p>	✓
Revoking the license	<p>✓</p> <p>Outside resolution: always; Within resolution upon request of the resolution authority</p>	✓ or request to Supervisor
Decision on the <b>use of the deposit insurance money</b> for resolution	Information	✓ based on independent valuation
<b>Reporting</b>	✓	Automatic predefined information by supervisor to the resolution authority or direct access. Plus additional reporting for resolution purposes
<b>Cooperation with foreign resolution authorities</b> (Colleges)	Information	✓
Attendance at meetings of the bank's managing and executive board and participation in a bank's assembly/ shareholder meetings	✓	✓

<sup>1</sup> Resolvability assessment may conclude (for small non interconnected banks) that a bank is resolvable by simple liquidation.

<sup>2</sup> The BRRD leaves it open if the Resolution authority or the competent authority decides if a bank is considered to reach the PONV, [Article 59 \(3\) b](#). For the euro area [Article 21 \(2\)](#) holds that whether the entity is viable is decided by the Board under the SRM or the ECB PONV and FOLTF

<sup>3</sup> [See Article 32 \(2\) BRRD: The resolution authority may decide it in addition \(as a fallback\).](#)

<sup>4</sup> See chapters [11](#) and [20](#).

# RECOVERY PLANNING AND EARLY INTERVENTION

## CHAPTER 6: RECOVERY PLANS

By Emmeline van Heukelem

### [ART. 5–9 BRRD AND SECTION A OF THE ANNEX](#)

Recovery plans are both a preparative and a preventive tool: They have added value for banks and supervisors, also under business as usual conditions.

### KEY QUESTIONS

- Why are Recovery Plans needed for financial institutions?
- What is the role of supervisory authorities and resolution authorities in the assessment of a Recovery Plan?
- What are key success factors for a Recovery Plan?
- Do subsidiaries of banking groups need an individual plan as well?
- Does the BRRD provide for exceptions to the Recovery Plan requirements?

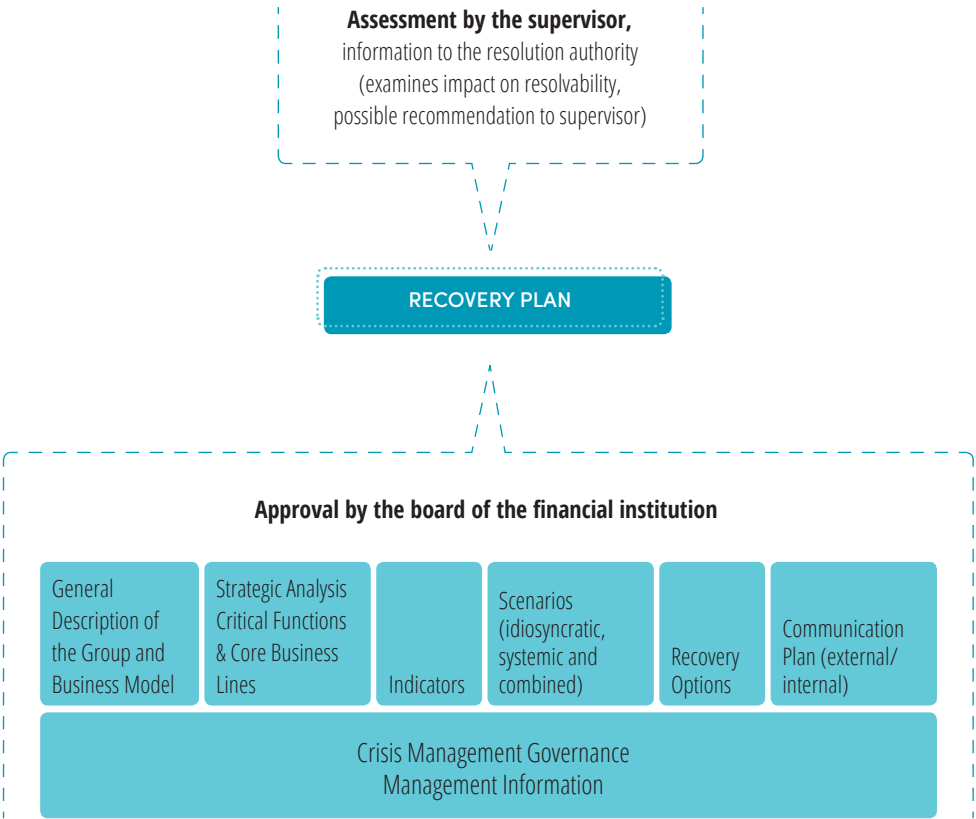
### Recovery Planning to Reduce the Impact of Bank Failures

Regulators in several jurisdictions responded to the financial crisis by asking banks to draw up a Recovery Plan before adoption of the BRRD. Although there were some differences in the scope and content of these plans, they all sought to tackle a bank(ing) crisis at an early stage, promoting financial stability and trust in the banking sector and reducing the societal impact of future bank failures.

Since then, enhancements have been made to the regulatory framework that reduce the likelihood of future crises and improve the resilience of institutions against a crisis. Still, one can never rule out the possibility that an institution could get into difficulties. Recovery planning addresses this specific point and serves both as a preparative and as a preventive tool.

With the implementation of BRRD, recovery planning is now accepted as an important and recurring aspect of regular supervision, providing valuable insights to both banks and supervisors, also under “business as usual” conditions, as will be set out below.

Elements of a Recovery Plan





As supervisory authorities in all EU Member States now work on a common legal basis, banks are expected to deliver more structured and consistent Recovery Plans that should also enable a more effective cross-border approach.

Furthermore, the BRRD creates a solid basis for supervisory authorities to share Recovery Plans with resolution authorities, enhancing cooperation between the respective authorities. Resolution authorities can use the Recovery Plan to identify whether any actions in the plan may adversely impact the resolvability of the institution and make recommendations in that regard to the competent authority.

Based on experiences from countries that requested Recovery Plans from their national banks before the BRRD, the following aspects can be considered key success factors for a Recovery Plan.

**Ownership by the bank is key for recovery planning.**

#### **Recovery Plans: By and For Banks**

Recovery Plans are drawn up and maintained by the bank. This is very different from resolution planning, where the authorities draft the plan.

In its Recovery Plan, the bank sets out how it monitors relevant negative developments (early warning thresholds and recovery indicators) and how it could steer away from severe stress should it occur. By using adverse scenarios, including system-wide and idiosyncratic stress events, the bank substantiates that it could take early action to handle a (progressively) deteriorating capital and/or liquidity position and, by doing so, is in a position to independently return to “business as usual”. This requires the application of certain recovery options, as well as a solid and timely escalation process in which the decision-making body of the bank is involved. The recovery planning and crisis management roles and responsibilities should be clearly defined. Given the importance of senior management involvement, the management body is required to formally approve the plan before it is submitted to the competent authority.

**Recovery planning improves bank management’s knowledge and awareness.**

In addition, some banks have chosen to organize crisis simulation exercises to test their Recovery Plan in practice. This offered valuable insights into the plans’ adequacy and effectiveness. In general, recovery planning provides a new perspective and as such yields additional insights. It also increases awareness among the bank’s senior management of which of the bank’s services are critical for the economy or could endanger financial stability (for more details, see the guidelines produced by the European Banking Authority and [chapter 5](#)). Although drawing up a Recovery Plan is a resource-intensive task, feedback provided by banks is generally positive and the Recovery Plan process helped improve banks’ crisis management capabilities and led to internal quality enhancements.

### **Timely Information and Appropriate Trigger Setting**

For a Recovery Plan to be relevant, the bank should:

- a) Apply an appropriate set of early warning signals and Recovery Plan indicators that are both qualitative and quantitative and that include forward-looking aspects;
- b) Ensure indicators are an integral part of regular risk management processes and are seen as a continuous process. Banks need the IT in place to intensify their monitoring or to provide reliable management information on a frequent or ad hoc basis;
- c) Determine (relatively) “easy to hit” indicator levels. Triggering these initiates activation of the crisis management governance, which means more intense monitoring and informed discussion at the right management level without delay – which is the whole purpose of a Recovery Plan. This also gives management sufficient time to successfully intervene. It is worth noting, however, that the bank is not obliged to execute recovery options when indicators are met.

### **Focus on Recoverability**

The bank should consider and describe a range of credible recovery options in the Recovery Plan and provide an assessment of their impact and feasibility. This demonstrates not only the potential overall “recoverability” but also the bank’s preparedness to address a variety of issues. The bank should list and assess the actions necessary to successfully implement its recovery measures.

Good practice is not only to look at the quantitative impact but also take operational considerations into account, for example the communication obligations under the relevant national laws. Furthermore, systemic and business model considerations are important, as are addressing effects on customers and the wider market.

In assessing this part of the plan, the interplay between recovery options and the calibration of the indicators is important. If the bank has only limited options available and they take a long time to generate an effect then indicators need to be set at an even more prudent level. Banks should also consider what the impediments are to execute measures, and critically assess how and when to remove those. The more critical a quick execution of a certain measure is, the more important it is to address the related impediments beforehand (“preparatory measures”). For group Recovery Plans, the assessment should also include an overview of substantial practical or legal impediments to the prompt transfer of own funds or the repayment of liabilities or assets within the group.

### **Assessment by Supervisors – Part of “Robust Governance Arrangements”**

A well-prepared and comprehensive Recovery Plan is a valuable source of information for banks and their supervisors and should be part of the

**Recovery indicators should be aligned with the regular risk management framework.**

**Impact and feasibility of recovery options must be assessed in the plan. The application of recovery options in a real recovery situation needs a case-by-case analysis by the institution’s management (no automatism).**

regular risk management processes and existing policies of the bank. The Recovery Plan should, for example, be aligned with the risk appetite framework, business continuity plans and contingency funding plans.

Assessment of the Recovery Plan by the competent authority will feed into the assessment of “internal governance and institution-wide controls” under the supervisory review and evaluation process (SREP) pursuant to [article 74 Directive 2013/36/EU](#).

Furthermore, the BRRD introduces a new range of supervisory measures that can be applied. Where an institution does not present an adequate Recovery Plan, competent authorities can require material deficiencies or material impediments to its implementation to be redressed. In extreme situations, this may even result in requiring the bank to take measures that the competent authority “considers to be necessary” including proportionately limiting the freedom of the bank to conduct certain businesses.

**Colleges of Supervisors are the forum for information-sharing and cooperation for group Recovery Plans.**

### **Group Recovery Plans and Cooperation Through Colleges of Supervisors**

Recovery Plans should be developed for groups as a whole and the plan should cover all material entities in a holistic way. This requires an in-depth understanding of the interconnectedness and dependencies within a group. A group plan also facilitates coordination and consistency, should the plan be executed. This means the Recovery Plan includes sufficient information on its material entities in the different building blocks of the plan (e.g. under governance, recovery indicators, recovery measures and scenarios).

The BRRD obliges the parent undertaking to draw up the Recovery Plan and submit it to the consolidating supervisor. Additional individual plans are only needed if the supervisor of the subsidiary so requires and then only after this has been the outcome of a Joint Decision process by the College of Supervisors, which is open to EBA mediation ([Article 8\(2\) BRRD](#)).

**As an exception, “simplified obligations” or a waiver may apply.**

### **Exceptions to Recovery Plan Requirements**

The scope of the relevant regulatory framework can deviate based on the characteristics of the institution. Based on certain restrictive criteria, *inter alia* the systemic importance of the institution, “simplified obligations” or a waiver may apply ([article 4\(5\) BRRD](#)).

### **Relevant documents**

- [EBA/RTS/2014/12 Final draft regulatory technical standards on the assessment of recovery plans under Article 6\(8\) of Directive 2014/59/EU \(BRRD\)](#)
- [EBA/GL/2014/06 Final draft technical standards and guidelines on the range of scenarios to be used in recovery plans](#)
- [EBA/Op/2015/05 Technical advice on the delegated acts on critical functions and core business lines](#)

- [EBA/CP/2014/25 Guidelines on the application of simplified obligations under Article 4\(5\) of Directive 2014/59/EU](#)
- [EBA/GL/2015/16 Guidelines on simplified obligations, July 7, 2015](#)
- [Commission Delegated Regulation \(EU\) 2016/962 of June 16, 2016](#) laying down implementing technical standards with regard to the uniform formats, templates and definitions for the identification and transmission of information by competent authorities and resolution authorities to the EBA according to Directive 2014/59/EU
- [EBA/RTS/2014/11 Final draft Regulatory Technical Standards](#) on the content of recovery plans under [Article 5\(10\)](#) of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms
- [Commission Delegated Regulation \(EU\) 2016/1075 of March 23, 2016](#) supplementing Directive 2014/59/EU with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges
- [EBA-GL-2015-02 Guidelines on the minimum list of qualitative and quantitative recovery plan indicators.](#)

# CHAPTER 7:

## INTRA-GROUP FINANCIAL SUPPORT AGREEMENTS (IGFSAS)

By Georg Merc

### ART. 19–26 BRRD

The adoption of an IGFSAs is voluntary and forms part of an entity's recovery plan. It may cover not only entities established within the EU but also third country subsidiaries covered by consolidated supervision.

IGFSAs are entered on a voluntary basis. These agreements may cover the parent undertaking and one or more subsidiaries of the group, provide for up-stream, down-stream, or side-stream support and may take the form of a loan, guarantee or other collateral.

### KEY QUESTIONS

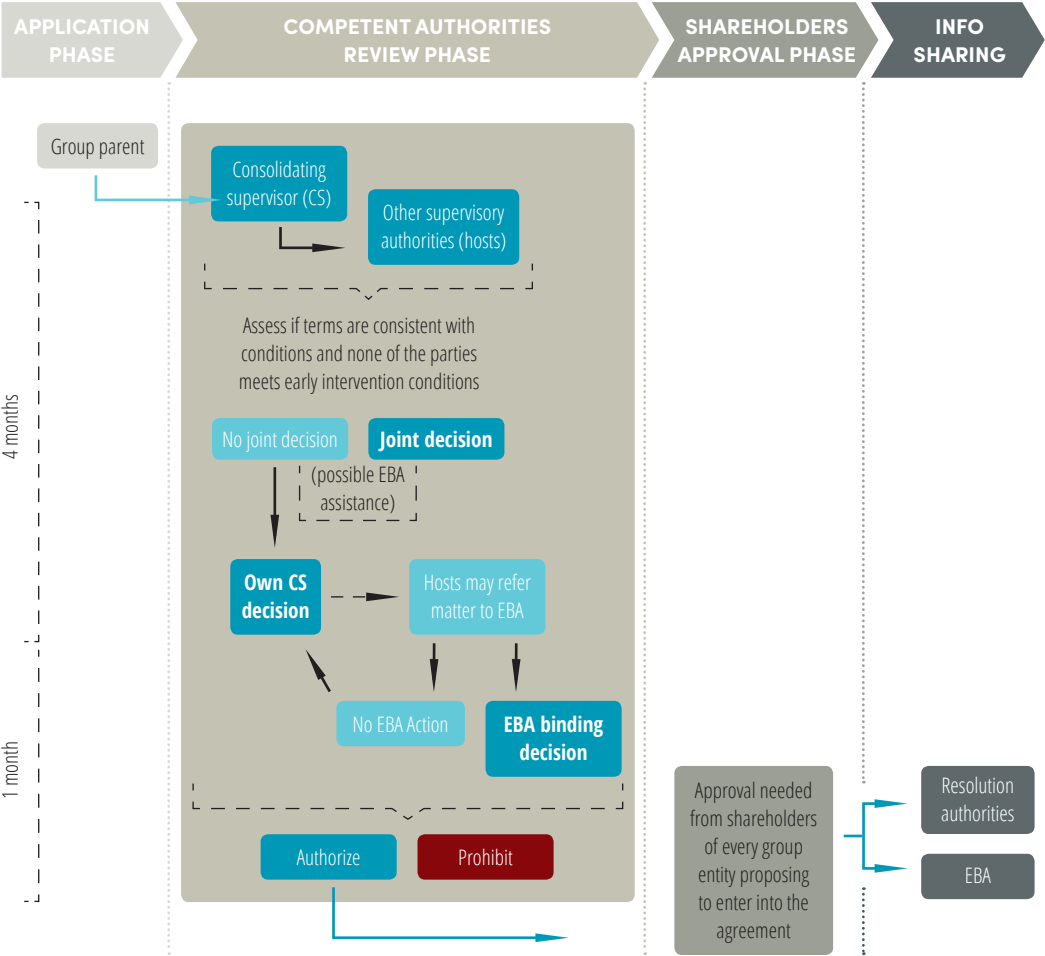
- What are the advantages of entering into an intra-group financial support agreement (IGFSA)?
- May IGFSAs include third country subsidiaries outside the EU?
- Who can restrict/prohibit the support?
- Must shareholders approve an IGFSA?
- Can the IGFSA lead to a temporary exemption from capital buffers, liquidity provision or large exposure requirements?
- Are IGFSAs part of the recovery plan?

### Voluntary Cross-Border Support Agreements

Entering into an intra-group financial support agreement (IGFSA) is a preparatory and preventive tool foreshadowed in the BRRD for cross-border groups. IGFSAs may cover not only entities established within the EU but also third country subsidiaries covered by consolidated supervision. Prior to the BRRD there was no specific EU legal framework for intra-group financial support. As a result, the terms and conditions for intra-group asset transfers have been very diversely governed by national laws. During the recent crisis, ring-fencing strategies were applied ([see chapter 2](#) on Banking Union). The BRRD provides a harmonized EU framework that specifies the principles for IGFSAs. This framework includes details for the calculation of the amount of intra-group financial support as well as the criteria that will be assessed by the competent authorities when permitting an affiliated entity to provide intra-group financial support to another group entity.

There is no obligation for group entities to enter cross-border support agreements. Group entities may conclude an agreement on a voluntary basis obliging each other to provide support in case one of the parties meets the conditions for early intervention (preparatory step) ([see chapter 7](#) on early intervention measures). These agreements may cover the parent undertaking and one or more subsidiaries of the group, provide for up-stream, down-stream, or side-stream support, and may take the form of a loan, guarantee or other collateral.

Approval process for intra-group financial support agreements



Following authorization by the competent authorities, the shareholders of every group entity need to approve the agreement and authorize their management to provide/receive support if required.

The granting of support under a concluded IGFS is decided on a case-by-case basis and can be prohibited by the supervisor of the providing entity.

### **Complex Review and Approval Process**

Group entities apply for authorization of an IGFS and transmit the relevant documentation to the consolidating supervisor. Supervisors of each entity of the group then have four months to review the general agreement and reach a joint decision. During this process, the agreement must also be assessed against the principles and conditions for financial support as outlined in the BRRD. If no agreement can be reached, the consolidating supervisor (the European Central Bank (ECB) within the euro area) can make its own decision, taking the views and reservations of the other competent authorities into account. If the matter is referred to the European Banking Authority (EBA) it must take a decision within one month, which is then binding on the group level supervisor (this is different for the actual granting of support where EBA has no binding mediation rights). Following authorization by the competent authorities, the shareholders of every group entity that proposes to enter the agreement need to approve the agreement and authorize their management to provide/receive support if required.

### **Conditions and Safeguards to be Considered in the Actual Granting of Support**

If early intervention is required, the actual granting of support based on the IGFS must be decided on a case-by-case basis by the management of the entity providing the support. The competent authorities again have to agree/prohibit or restrict the proposed support by reasoned decision within five days. Where the competent authority of the entity receiving support has objections regarding the decision to restrict or prohibit support it may, within two days, refer the matter to the EBA for non-binding assistance.

The final decision lies, however, with the competent authority of the providing entity. The prohibition/restriction of providing support may lead to a reassessment of the recovery plan.

Before approving group support as an early intervention measure, supervisors have to assess whether the following conditions and safeguards have been considered.

- The reasons for the financial distress of the receiving entity and the expected success of the support, as well as the prospect of reimbursement;
- In terms of the providing entity, its compliance/non-compliance with prudential requirements following the support, the interests of the providing entity and the group as a whole, the significance of the providing entity for the financial system of one or more Member States, as well as the effects of the support on the resolvability of the entity; and
- The terms under which the support is granted (e.g. the consideration or the maturity profile).

Competent authorities may authorize temporary non-compliance with prudential requirements (there are stricter assessment rules for upstream support) if the providing entity does not meet the combined capital buffer (CCB) requirement i.e. the capital conservation buffer, countercyclical buffer and systemic buffer to be held as Common Equity Tier 1 capital (CET1). In this case, the competent authority should decide whether to authorize the provision based on the capital conservation plan for the providing entity, thereby considering the purpose of the capital buffers concerned, the significance of the shortfall, and the timeframe for the restoration. The same procedure applies to a non-compliance with liquidity requirements, whereupon the competent authority has to assess the plan for eliminating non-compliance. Even the timely infringement of any large exposure requirement may be authorized (intra-group transactions are limited to 25 % of the respective institution's own funds).

Competent authorities may authorize temporary non-compliance with capital buffers, liquidity provision, or large exposure requirements.

In the case of upstream or side-stream support, the competent authorities have to take additional aspects into account and may grant authorization only under extraordinary circumstances (in particular the destabilization of the group as a whole and adverse effects on financial stability).

### **Limited Regulatory Incentives to Enter Cross-Border Support Agreements**

Business-as-usual financial support agreements (such as guarantees, letters of comfort) that do not confine financial support specifically to early intervention scenarios as well as ad hoc support arrangements do not fall under the scope of IGFSAs and the conditions and approvals stipulated under the BRRD. Also a support agreement is not a condition for providing liquidity within a group and the provisions do not affect liability arrangements that protect the institutions through cross-guarantees or equivalent arrangements. Furthermore, unlike the situation with institutional protection schemes, there are no regulatory facilitations (e.g. waivers) or benefits linked to such agreements.

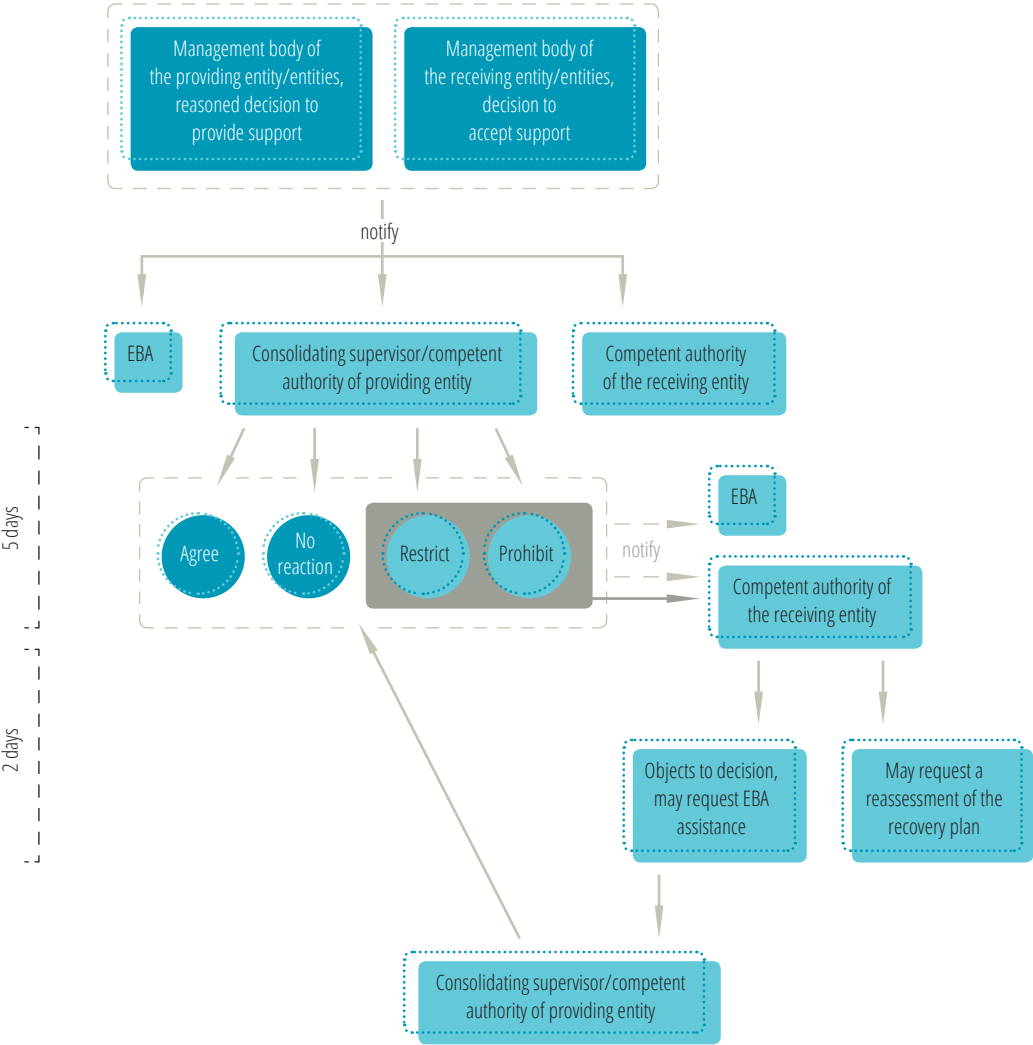
However, an IGFSa can be stated in the recovery plan as a possible recovery measure, and the preparatory agreement is a significant step to avoid ring-fencing and to ensure timely implementation since the support is already approved by the shareholders. Competent authorities may require the institution to make use of the support agreement during early intervention. Due to the disclosure requirements (description of the general terms) it might influence the creditworthiness of institutions. Finally, cross-border support agreements may help to receive a liquidity waiver (derogation from the application of liquidity requirements on an individual basis) or fulfill the criteria for special treatment under the liquidity coverage ratio (LCR) under the EU capital requirements (CRD IV/CRR) framework.



**Relevant documents**

- [EBA/CP/2014/30 Regulatory Technical Standards and Guidelines specifying the conditions for group financial support under Article 23 of Directive 2014/59/EU](#)
- [EBA/CP/2015/22 Regulatory Technical Standards on criteria for a preferential treatment in cross-border intragroup financial support under LCR](#)
- [Commission Delegated Regulation \(EU\) 2016/1075](#) supplementing Directive 2014/59/EU with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges
- [EBA/ITS/2015/07 Final Draft ITS on Disclosure of Group Financial Support Agreements](#)
- [Commission final C/2016/3440: Commission Implementing Regulation \(EU\) 2016/911](#) laying down implementing technical standards with regard to the form and the content of the description of group financial support agreements in accordance with Directive 2014/59/ establishing a framework for the recovery and resolution of credit institutions and investment firms

Approval process to provide support under the authorized agreement



# CHAPTER 8:

## EARLY INTERVENTION MEASURES (EIM)

By Dominik Freudenthaler

### ART. 27–30 BRRD

Early intervention measures empower supervisors – not the resolution authority – to react to an escalation of financial problems at an early stage, well before an institution fails.

“Rapidly deteriorating financial conditions” are assessed against a set of triggers including: a deteriorating liquidity situation, an increasing level of leverage, an increase of NPL portfolios, or a concentration of exposures, and may include a quantitative trigger of own funds plus 1.5 %.

### KEY QUESTIONS

- What are the conditions for taking early intervention measures?
- Are early intervention measures applied by the resolution authority or by the supervisory authority?
- How does the recovery plan intersect with early intervention?
- What is the relationship between early intervention and the supervisory review and evaluation process (SREP)?

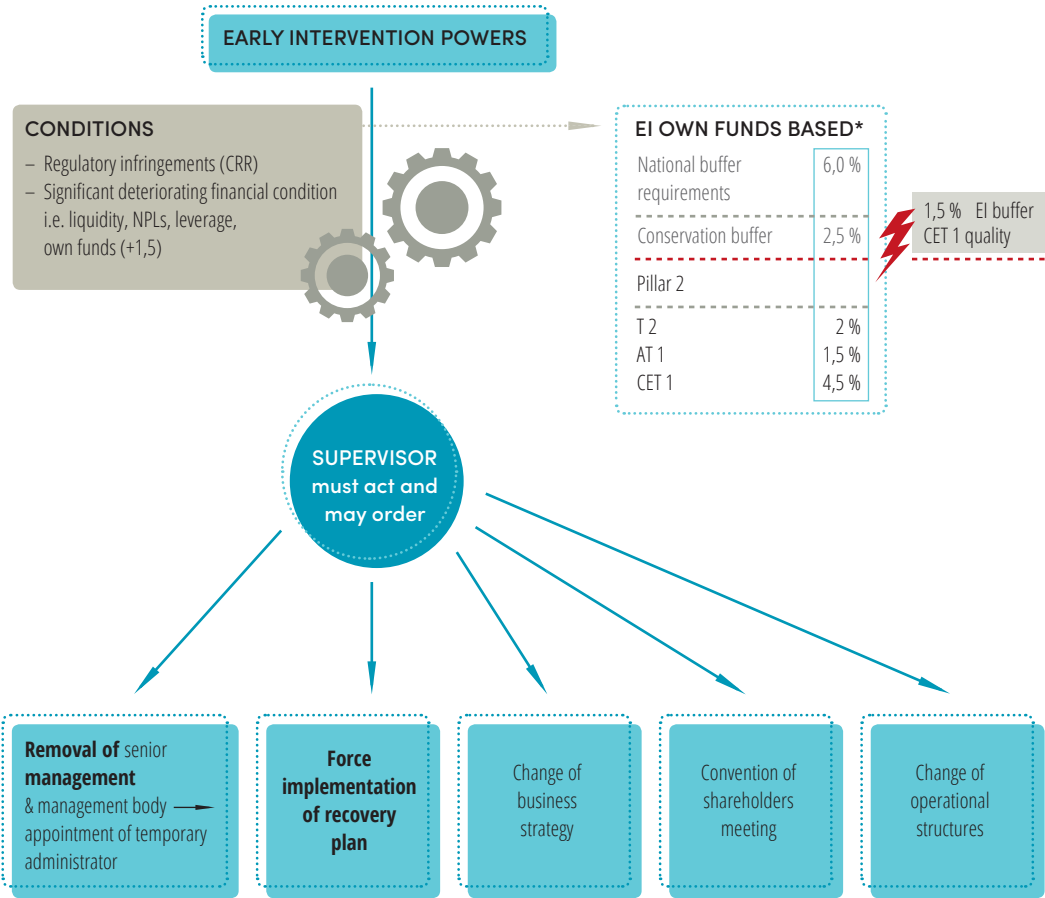
### Early Intervention to Avoid Banks Failing

Early intervention measures give the competent supervisory authority an effective toolset to help prevent an institution from failing. Early intervention measures empower supervisors, not the resolution authority, to react to an escalation of financial problems at an early stage, well before an institution fails. Hence the BRRD draws a clear line between ongoing supervision (which includes early intervention measures) and resolution – although close cooperation between the authorities is of course indicated in the early intervention phase. The resolution authority takes over only if the failure of an institution seems inevitable and if resolution is in the public interest, i.e. if such failure represents a risk to the system ([see chapter 13](#) on the conditions for triggering resolution).

### Triggers: Qualitative Indicators With Some Quantitative Elements

The BRRD establishes a set of qualitative triggers with some quantitative elements determining the application of early intervention measures. This gives supervisors the discretion to take account of all available information in deciding whether they should be applied. The generic trigger in the BRRD for early intervention measures is a “rapidly deteriorating financial condition”. This is assessed against a specific set of triggers, which include a deteriorating liquidity situation, an increasing level of leverage, an increase of non-performing loan (NPL) portfolios, or a concentration of exposures. In relation to own funds, the BRRD suggests that a trigger set 1.5 percentage points above the level of an institution’s own funds requirement may be provided for. This allows the

Early Intervention



\* The buffers figures in the "EI Own funds based" box are examples.

supervisor to act when infringement is likely in the near future before a material breach occurs.

More generally, any infringement of EU capital requirements (CRR/CRD IV) also triggers consideration of early intervention measures. Although this is arguably vague and gives much discretion to the authority, it should be seen in relation to the monitoring of key indicators under the supervisory review and evaluation process (SREP) requirements. To increase consistency of supervisory practices in relation to the application of early intervention measures triggers, the EBA guidelines clarify requirements that competent authorities should follow when setting thresholds related to financial and risk indicators. The indicators are to be routinely monitored under SREP. Hence, early intervention measures will intersect with other supervisory measures and powers and will supplement, rather than replace, the existing supervisory process.

The existing supervisory process (e.g. the monitoring of key indicators under SREP) supplements the taking of early intervention measures.

Further defining the set of triggers, European Banking Authority (EBA) guidelines stipulate that early intervention measures are to be applied if the institution is, or is soon likely to, infringe the requirements of relevant EU (capital requirements CRR/CRD IV) and national implementing legislation in the following circumstances:

- **Triggers based on the outcome of the SREP.** Early intervention measures should be considered if the overall or individual institution SREP score is 4; and also if the overall SREP score is 3 but individual elements for internal governance and control, business models strategy, capital adequacy or liquidity score 4.
- **Material changes or anomalies in the monitoring of the SREPs key financial and non-financial indicators.** EBA guidelines set out a 1.5 % above the institution's own funds trigger, including Pillar 2 requirements but excluding the capital buffers under CRD IV. In practice, therefore, the 1.5 % is an absolute minimum, mainly relevant for smaller banks without additional set buffers.
- **Significant events.** Early intervention measures may be triggered by events that could have a significant prudential impact on the institution's financial condition. For example, a major operational risk due to rogue trading, fraud, natural disaster, major IT incidents, a significant deterioration of the Minimum Requirement for Own Funds and Eligible Liabilities (MREL), or rating downgrades.

EIM triggers may be defined in further detail by the national law transposing the BRRD. The supervisor always makes the final decision on the exact configuration of triggers. An effective approach is to use mainly qualitative indicators in the statute. Quantitative individual triggers applicable to a specific institution should be included in the recovery plan indicators ([see chapter 6](#) on recovery plans). This enables the supervisor to take into account the individual circumstances of the institution and to meet the

requirements of the principle of proportionality. Hard triggers, once hit, might also be linked to a concrete measure that has to be implemented.

### **No Automaticity in Applying Early Intervention Measures**

Clearly defined triggers for early intervention measures increase legal certainty for both supervised entities and authorities. The breach of early intervention triggers should not, however, result in the automatic application of early intervention measures. The authority should instead be required to further investigate the situation to confirm the extent to which triggers are met and to consider if early intervention measures are required. If triggers are breached but the authority decides not to use early intervention measures it should ensure that the reasoning and justifications are well documented.

If early intervention is triggered by material change or anomalies in the monitoring of the SREPs, authorities might, in the interests of time and depending on the concrete circumstances of the individual case, apply early intervention measures without formally updating the assessment of the respective SREP. In the case of significant events the supervisor will regularly update the risk assessment and the SREP score. However, in certain circumstances a significant event may be used as a direct trigger for the decision to apply early intervention measures.

The determination that conditions for EIM are met is also of relevance in the context of triggering the application of intra-group support measures ([see chapter 8](#) on intra-group financial support agreements).

### **Early Intervention Measures**

If early intervention has been triggered, a variety of measures are available to supervisors to address the deterioration of an institution's financial and economic situation. First and foremost, the supervisor may require the management body of an institution to implement the appropriate arrangements and measures set out in the dedicated recovery plan ([see chapter 6](#), recovery plans). Hence this phase will be the acid test of the ex-ante part of early intervention measures i.e. recovery planning. The supervisor may require an immediate update of the recovery plan if, for example, circumstances differ from the assumptions made in the existing plan. If the recovery strategy is insufficient or inappropriate, the supervisor may also instruct the management body to address identified problems by developing an appropriate action program, including a timetable for implementation. The supervisor has the right to acquire all necessary information, including through on-site inspections.

If action under the bank's recovery plan proves to be insufficient, the supervisor may require changes to the institution's business strategy, its legal or operational structures, or the negotiation of debt restructuring.

In some circumstances the supervisor may require more robust alternative measures, e.g. changes to the institution's business strategy, or to its legal or operational structures. The supervisor may also demand the preparation of corporate actions to increase the institution's own funds in order to

Temporary administration replacing management can be used as a simple supervisory tool or to prepare and facilitate resolution action.

stabilize the institution. The management body may therefore be required to convene a meeting of shareholders, set the agenda, and recommend the adoption of certain decisions. The supervisor may also require the management body to draw up a plan to negotiate debt restructuring with some or all creditors ([see chapter 15](#) on consensual bail-in).

In extreme situations where there are well-founded reasons for a lack of confidence in the ability of one or more members of the management body or senior management to perform their duties, the supervisor may indicate that those individuals are to be replaced. This measure might be linked to the appointment of a temporary administrator (= conservatorship) if the supervisor concludes that the nominated replacement is unable to remedy the situation or if no adequate replacement is found in time. Conservatorship is, in principle, a tool in its own right and for its own purpose but can also be used to prepare and facilitate resolution and a transfer to a private purchaser or a bridge bank.

### **Early Intervention Measures Triggering Preparation For Resolution Action**

The supervisor should inform the resolution authority in all instances when triggers are breached and the conditions for EIM are met, regardless of the application of EIM. This information may trigger the power of the resolution authority to require the institution to contact potential purchasers in order to prepare for resolution ([see chapter 16](#) sale of business tool).

### **Relevant documents**

- [Financial Stability Board \(FSB\) Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Recovery Triggers and Stress Scenarios, July 16, 2013](#)
- [BIS Guidelines for identifying and dealing with weak banks, July 2015](#)
- [EBA/GL/2015/02 Guidelines on the minimum list of qualitative and quantitative recovery plan indicators](#)
- [Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms \(CRD IV\)](#)
- [Regulation \(EU\) No 575/2013 on prudential requirements for credit institutions and investment firms \(CRR\)](#)
- [EBA/GL/2015/03 Guidelines on triggers for use of early intervention measures pursuant to Article 27\(4\) of Directive 2014/59/EU](#)

# CHAPTER 9:

## PRECAUTIONARY PUBLIC SUPPORT – EXCEPTIONAL PUBLIC RECAPITALIZATION OF A SOLVENT BANK

By Dieter Huber

### KEY QUESTIONS

- Under what conditions can a precautionary public recapitalization be undertaken?
- What form of prior private loss absorbance and recapitalization is required before allowing a precautionary public recapitalization under EU state aid rules?
- Which forms can precautionary public support take?
- Which authorities decide if the pre-requisites for a precautionary public recapitalization are met?

### [ART. 32 BRRD](#)

The bank recovery and resolution framework embodied in the BRRD provides for instruments to deal with troubled banks at various stages of the early intervention<sup>1</sup> and resolution process while avoiding threats to the financial stability, covered deposits or other critical functions of banks. Recourse to public funds may only occur as a last resort and under strict conditions.

In general, the fact that a bank requires extraordinary public support would typically indicate that the bank is failing or likely to fail ([Art. 32\(4\)\(d\) BRRD](#)) and, provided the other prerequisites are met, should be resolved ([see Chapter 13](#)). However, in exceptional circumstances public financial support could be provided to an otherwise solvent bank without triggering resolution. Whether a Member State avails itself of this possibility depends on the transposition of the BRRD into national law and possible Parliamentary restrictions on the use of public funds.<sup>2</sup>

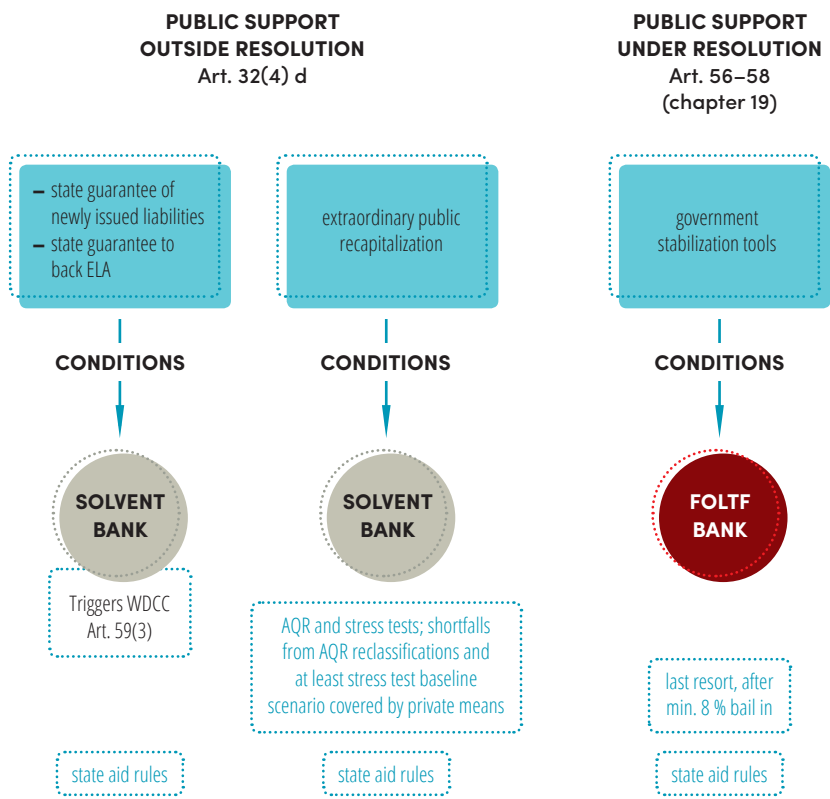
**A precautionary public recapitalization is the provision of temporary public financial support to an otherwise solvent bank to cover the shortfall identified under the adverse scenario of a stress test in order to remedy a serious disturbance in the economy and preserve financial stability.**

<sup>1</sup> Compare also the early intervention measures according to [Art. 104 of the Capital Requirements Directive \(CRD\)](#) and [Art. 16 SSM Regulation](#).

<sup>2</sup> In the SRM, the SRB (itself) may not use extraordinary public support instruments because this would impinge on the budgetary sovereignty of Member States.



Precautionary Public Support



In order not to trigger resolution, Member States aid must fulfil the following conditions stipulated in [Article 32\(4\)\(d\)\(iii\) BRRD](#):

- It is required to remedy a serious disturbance in the economy of a Member State and to preserve financial stability;
- It is of a precautionary and temporary nature;
- It is proportionate to remedy the consequences of the serious disturbance;
- It is not used to offset losses that the bank has incurred or is likely to incur in the near future;
- It is conditional on final approval under the state aid framework;
- It is granted at prices and on terms that do not confer an advantage upon the institution;
- It is confined to solvent banks and
  - Inter alia, the institution shall not have incurred or be likely to incur losses that will deplete all or a significant amount of its own funds ([Art. 32\(4\)\(a\) BRRD](#)),
  - No objective elements support a determination that the assets of the institution will, in the near future, be less than its liabilities, ([Art. 32\(4\)\(b\) BRRD](#)),
  - No objective elements support a determination that the institution will, in the near future, be unable to pay its debts or liabilities as they fall due ([Art. 32\(4\)\(c\) BRRD](#)) and
  - The institution shall not have reached the point for WDCC (i.e. when it is no longer viable unless capital instruments are written down or converted into equity and there is no reasonable prospect that any alternative private sector measures or supervisory action (including early intervention measures) can remedy this situation ([Art. 59\(3\) BRRD](#)).

In terms of execution of the transaction, precautionary extraordinary public financial support can take any of the following forms:

- a state guarantee to back liquidity facilities (emergency liquidity assistance, ELA) provided by central banks according to their conditions;
- a state guarantee of newly issued liabilities; or
- an injection of own funds or purchase of capital instruments.

Measures involving capital instruments shall be limited to injections necessary to address a capital shortfall established in a national, EU, or SSM-wide stress test, or by an asset quality review (AQR) or equivalent exercises conducted by the European Central Bank (ECB), European Banking Authority (EBA), or national authorities, and confirmed, where applicable, by the competent authority. Typically, from the EU Commission's state aid<sup>3</sup> perspective, only aid measures necessary to cover the capital

<sup>3</sup> From an EU competition law perspective, qualification of a support measure as state aid incompatible with the internal market requires that the measure is imputable to the state, financed by state resources, grants a selective advantage to certain undertakings, threatens to distort competition, and potentially affects trade between Member States. A measure typically provides a selective advantage if no rationally acting private person operating under market economy conditions would accept the terms of the transaction which therefore cannot be justified on the basis of the market economy operator principle (MEOP).

shortfall arising under the adverse scenario of a stress test will comply with the above requirements and could be considered precautionary recapitalizations. Capital shortfalls under the baseline scenario and asset quality reviews should be covered by private means (or trigger resolution). Contrary to loss absorbance under resolution (i.e. bail-in under [Articles 43ff BRRD](#)) no indication is provided that the 8 % prior bail-in requirement (see [chapter 15](#)) would have to be met before allowing precautionary public recapitalization as such support is confined to solvent banks.

Regardless of the prerequisites for precautionary recapitalization, the EU Commission's Banking Communication of 2013, while not binding on Member States, in general requires loss absorption and recapitalization ("burden sharing") by shareholders and junior creditors up to the level of subordinated creditors whenever extraordinary public support is granted. This ensures that state aid is limited to the minimum necessary and that any distortions of competition in the internal market are limited.<sup>4</sup> Therefore, precautionary recapitalizations will require prior "burden sharing" under state aid rules before they can be granted. In addition, state aid rules require submission and approval by the EU Commission of a restructuring plan for the bank before the precautionary recapitalization measure can be implemented.

**The provision of precautionary public recapitalization requires coordination and communication between supervisory and resolution authorities, the Ministry of Finance and the competition department of the European Commission.**

Several factors have to be analyzed by various authorities to evaluate whether a specific situation is suitable for extraordinary public support of a precautionary nature. Diverse interactions exist between the decisions these authorities have to take. The supervisory authority or, as the case may be, the resolution authority is responsible for determining that a bank is failing or likely-to-fail thus ensuring the precautionary recapitalization is only provided to a solvent bank.<sup>5</sup> The EU Commission as competition authority in turn assesses in accordance with Art. 107 TFEU whether a support measure constitutes state aid and, if so, its compatibility with the internal market. As an additional twist, the competition authority cannot deem a state aid measure compatible if it breaches intrinsically linked provisions of the BRRD and SRM Regulation. Therefore, the EU Commission needs to verify whether the aid can be granted outside resolution, thus also assessing its compliance with the conditions pursuant to [Art. 32\(4\)\(d\)\(iii\) BRRD](#).

Another interdependence regarding the authorities' decisions exists if assistance takes the form of, for example, a public capital injection. In this

<sup>4</sup> If a Member State undertakes a public recapitalization scheme which does not involve burden sharing by private investors, such public aid would likely be declared incompatible with competition law by the EU Commission unless justified in exceptional circumstances.

<sup>5</sup> Within the SRM, the supervisor (after consulting the SRB) generally determines if a bank is FOLTF. The SRB can conduct such an assessment itself should the supervisor fail to act within three calendar days of the request to take action (Chapter 14).

context, the necessity and amount of the capital requirement needs to be established in supervisory stress tests or asset quality reviews (AQR) whereby the supervisor appraises the bank under various scenarios. If it detects deficiencies in the capital position of the bank in the baseline scenario or the AQR, the shortfall needs to be covered by private means. If private capital or loss-absorption cannot be mobilized, the bank will generally be considered likely-to-fail and placed under resolution ([see chapter 14](#) on the conditions for resolution). If the shortfall is identified in the adverse scenario only (or in both scenarios but it will be covered by private means to the extent it relates to the baseline scenario or the AQR), precautionary recapitalization is in principle allowed provided that all other conditions are met. The supervisor must evaluate the recapitalization plans submitted by the bank, including the equity injection from public sources, and form a supervisory view on the timing and the likelihood of state aid yielding a positive outcome, thus informing the appropriate supervisory actions. According to the BRRD, the precautionary recapitalization is conditional on the final approval under the state aid framework. Still, in the interim the supervisor may need to evaluate whether, forward looking, the public capital injection can be qualified as equity for prudential purposes, thus ameliorating the bank's situation for the purpose of the failing-or-likely-to-fail assessment or in the context of early intervention measures.

Coordination and communication between the different actors (authorities responsible for state aid, supervision, and resolution, as well as the Ministry of Finance) is important to ensure a smooth interplay between the different roles of all the authorities involved. In practice, if a capital shortfall is identified in an adverse stress test scenario and a precautionary recapitalization is contemplated, all measures to minimise the public support should be taken. The Member State involved will contact the EU Commission as competition authority to discuss burden-sharing requirements, the restructuring plan, and to ensure that the support measure complies with the state aid rules. The basis for such pre-notification will be a capital raising plan established by the Member State and the bank and endorsed by the supervisor.

The capital shortfall to be covered by state aid is typically derived from the (private) capital raising plan, making allowance for the results of the bank's AQR and a forward looking capital adequacy assessment. Private capital raising and, potentially, liability management exercises (LMEs) should cover the capital shortfall deriving from the stress test baseline scenario and restatements due to AQR findings (if such shortfalls existed). Public support measures may then serve to cover the remaining capital shortfall only in the adverse scenario without triggering the failing or likely-to-fail criterion under the BRRD. Such measures could not only take the form of the simple acquisition of shares or CoCos ([see chapter 13](#)) by a public(ly financed) body but also, for example, underwriting a capital increase.

Member States generally have to notify a restructuring plan to the EU Commission and obtain state aid approval before any recapitalization measure is taken. It may on occasion be unclear whether the private burden sharing will generate sufficient capital and the authorities still deem it necessary to provide state aid for financial stability purposes; it would be prudent to stipulate that in such case the residual amount of the capital shortfall will be allocated to the shareholders and holders of subordinated liabilities of the bank concerned prior to the injection of public money, thus contributing to fulfilling the requirements for state aid. In case the prerequisites for a precautionary resolution would not be present, both the conditions for extraordinary public support under resolution (derived from the BRRD) and the state aid framework requirements would have to be met if state aid were to be provided (including the prior 8 % bail-in, [see chapter 15](#)).

**Relevant documents:**

- [Commission Decision of 29 November 2015 in State aid SA.43364 \(2015/N\)](#), "Amendment of the restructuring plan approved in 2014 and granting of new aid to Piraeus Bank" (OJ C 104, 18.3.2016, p. 8). [http://ec.europa.eu/competition/state\\_aid/cases/261238/261238\\_1733314\\_89\\_2.pdf](http://ec.europa.eu/competition/state_aid/cases/261238/261238_1733314_89_2.pdf)
- [Commission Decision of 4 December 2015 in State aid SA.43365 \(2015/N\)](#), "Amendment of the restructuring plan approved in 2014 and granting of new aid to National Bank of Greece" (OJ C 220, 17.6.2016, p. 6). [http://ec.europa.eu/competition/state\\_aid/cases/261565/261565\\_1733770\\_121\\_2.pdf](http://ec.europa.eu/competition/state_aid/cases/261565/261565_1733770_121_2.pdf)

# RESOLUTION PLANNING

## CHAPTER 10a: RESOLUTION PLANS

By Georg Merc

### KEY QUESTIONS

- What is the resolution planning process?
- Does the resolution plan build upon the recovery plan?
- Is a resolution plan required for all banks? What if a bank is considered to be resolvable through liquidation?
- What is the difference between single point of entry and multiple points of entry?
- Are banks informed about the content of their resolution plan?

[ART. 10–14 BRRD](#)  
[AND SECTION B](#)  
[OF THE ANNEX](#)

### Objectives of Resolution Planning and the Information Gathering Process

Resolution planning by resolution authorities is one of the preventive innovations of the BRRD. It better prepares for future crisis situations by assessing the significance of a bank with a focus on its critical functions and possible implications of a failure. Ensuring that resolution authorities have all the information necessary is the first essential component of effective resolution. Resolution authorities can request the information they need to draw up resolution plans from institutions directly as well as from supervisory authorities.

Liquidation is the rule and the application of resolution tools the exception.

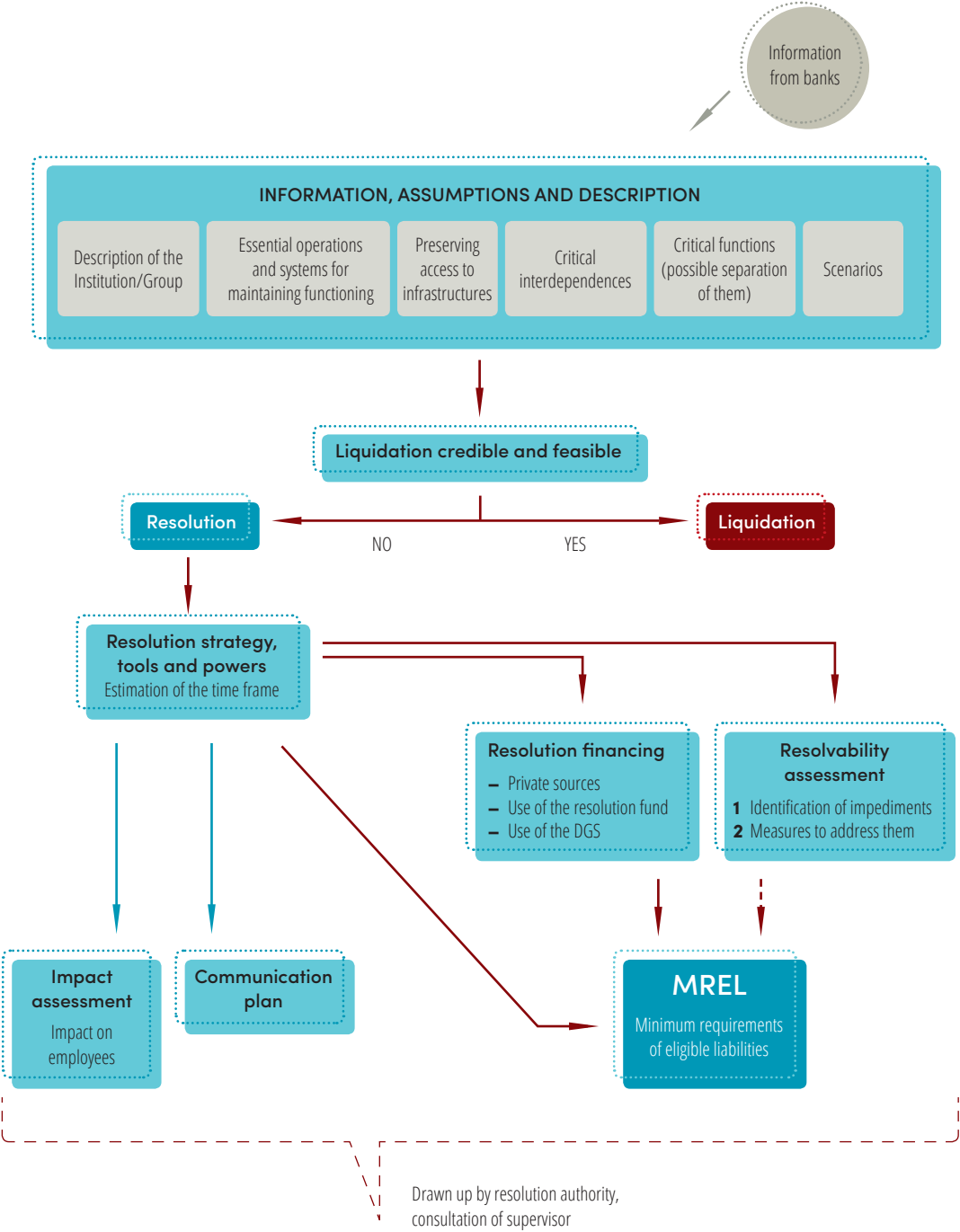
The SRB, for example, requests information from the institutions under its remit via the Liability Data Template (which includes concepts and categories of liabilities that do not correspond to those currently in use in the SSM) and exchanges information with NRAs.

### Key Elements of a Resolution Plan

Resolution planning starts with an assessment of the feasibility and credibility of liquidation under normal insolvency proceedings. As outlined in [chapter 10b](#), liquidation is the rule and the application of resolution tools the exception. If resolution is neither necessary nor justified in the

**Resolution authorities are expected to clearly define the preferred resolution strategy and the tools and powers required to implement this strategy for banks for which liquidation is not credible and feasible.**

Key elements of a resolution plan and interdependences



public interest and the failure of the institution would not have significant adverse consequences for the financial system, resolution tools are not available. This means that the institution should only be considered resolvable through liquidation and simplified obligations for drawing up a resolution plan would apply instead. Only where resolution authorities conclude that a wind down may not be feasible and credible will the identification of a resolution strategy and a “full” resolution plan be required. According to European Banking Authority (EBA) estimates, the vast majority of banks, especially small and non-systemic banks, will be considered eligible for liquidation. Out of about 6000 credit institutions in the EU the assumption is that about 420 will be subject to the full development of a resolution plan (and 110 investment firms).<sup>1</sup> Only for those banks must a credible and feasible implementation of resolution strategies be ensured and defined in the resolution plan.

The information provided in a “full” resolution plan covers at least:

- i) A description of the resolution strategy, including tools and powers to be used;
- ii) Arrangements to ensure operational continuity and information arrangements, including preparatory steps such as a valuation;
- iii) Financing arrangements;
- iv) A resolvability assessment ([see chapter 10b](#)); and
- v) A communication plan with all stakeholders (internal and external, [see annex 2](#)).

The requirement to provide a full resolution plan does not exclude the possibility of the application of proportionality to each and every item in the list.

Resolution authorities are expected to clearly define the preferred resolution strategy and the tools and powers required to implement this strategy. For groups, depending on the operational structure and business model and taking into account the issuing legal entities’ minimum requirements for eligible liabilities (MREL), either a single point of entry (SPE) issued by the top parent or holding entity if a high level of integration with management and services functions exists, or multiple points of entry (MPE) issued by more than one entity or sub-group where there is low integration with financially, legally and operationally independent subgroups, may be appropriate.

A single point of entry resolution strategy means that resolution tools and powers are exclusively applied by the resolution authority at the level of the consolidating holding entity. This concept requires that the holding company absorbs the losses of its subsidiaries which would need to be ensured by structural subordination of its intragroup liabilities. Only if

**Depending on the structure and level of financial, legal, and operational integration of a group, the two stylized approaches for a group’s resolution strategy follow either a SPE strategy issued by top parent or holding, or a MPE strategy issued by resolution authorities of more than one entity or sub-group.**

<sup>1</sup> [EBA/CP/2014/16, on RTS on the content of resolution plans and the assessment of resolvability, page 33.](#)



losses cannot be absorbed by the holding company will the externally-issued liabilities of the resolution entity be written down and/or converted as necessary when using the bail-in tool. In contrast the multiple point of entry strategy foresees different entities (typically parents of subgroups along national borders) that will be subject to resolution. However, these stylised concepts are mostly developed in the Financial Stability Board (FSB) context and not legally stipulated for in the BRRD. The implementation of the SPE/MPE concept is closely interlinked with the differentiation of internal and external total loss-absorbing capacity (TLAC) under the FSB term sheet. Internal TLAC is given when TLAC resources are issued to other entities within the group that are subordinated to the external liabilities. External TLAC is issued by the consolidating holding entity to the market.

Arrangements to ensure operational continuity of access to critical functions should include critical shared systems and operations (such as IT-systems or centralized risk management systems), payment systems and other financial infrastructures, together with an assessment of the portability of client positions.

The financing arrangements would be adapted to the resolution strategy (bridge institution, asset separation tool, bail-in, etc.) and should include a description of the potential sources of resolution funding, including private sources, resolution financing arrangements, and the deposit guarantee fund. Obviously, resolution plans should not assume access to extraordinary public financial support and central bank emergency liquidity assistance or expose taxpayers to the risk of loss.

The final two components of the resolution planning process are the resolvability assessment and, based on this, the determination of the minimum requirement for own funds and eligible liabilities (MREL) ([see chapter 11](#)).

**Resolution planning is a fundamentally dynamic process and should be reviewed at least annually and after any material changes.**

### **Updating the Plan and Sharing Information**

Resolution planning is not a one-off but a fundamentally dynamic process in line with changing business and fluctuating financial markets. The resolution plan should be reviewed at least annually and after any material changes. This requires close cooperation between resolution authorities and competent authorities. Competent authorities should transmit the recovery plans and notify any changes to the relevant resolution authorities, and the latter should transmit the resolution plans and notify any changes to the former, to ensure that all relevant authorities are fully informed.

However, even the best resolution plan will never consider all possible scenarios and impediments that may have to be addressed in the actual resolution of an institution. Resolution authorities should therefore take

into account and follow the measures provided for in the resolution plans, unless they assess that resolution objectives will be achieved more effectively in the circumstances of the case by taking actions that are not provided for in the resolution plans.

### **Cross-Border Resolution Planning Process**

The resolution-planning process for banking groups that are operating on a cross-border basis and outside the SRM in non-euro area Member States is very complex and requires coordination via resolution colleges. A range of outcomes are possible for groups. Within the EU, the group-level resolution authority and the resolution authorities of subsidiaries are expected to reach a joint decision about the group resolution plan. The relevant authorities should aim to achieve, to the extent possible, consistency with resolution plans for the rest of the group. However, there may be no consistent plan for the whole group. In case of disagreement, the group level resolution authority will adopt its own group level resolution plan and each subsidiary resolution authority will adopt an entity resolution plan. Both must set out the reasons for disagreement with the proposed group resolution plan. Other resolution authorities can go ahead with the group resolution plan, even if some subsidiaries choose to adopt their own entity resolution plan. Any resolution authority may refer the decision of the consolidating and subsidiary resolution authorities' resolution plans to the EBA for binding mediation. This means a deferral of the decision taking by the consolidating resolution authority and the resolution authority of the subsidiary which is then held to take a decision in accordance with the decision EBA may take. However, if a resolution authority argues that the subject matter under disagreement may impinge on its "fiscal responsibilities" the issue is excluded from EBA mediation.

Third country resolution authorities may be involved in group resolution at the discretion of the authorities involved and, for G-SIFIs, within the crisis management groups (CMGs).

### **Proportionality and Waivers**

The content of a resolution plan should be proportionate to the systemic importance of the institution or group. If an institution is permitted to go insolvent under normal insolvency procedures, then the resolution plan may be reduced to a description of the institution/group and a liquidation assessment (see above). The BRRD provides for simplified obligations regarding the content and details of resolution plans and the information required from institutions as well as the level of detail for the resolvability assessment. This may cover the range of scenarios or the variants of the preferred resolution strategy to be considered in circumstances when the preferred resolution strategy cannot be implemented.

Resolution authorities may waive the application of a resolution planning requirement only for institutions affiliated to a central body that are

**Within the EU, group resolution plans are expected to be agreed jointly by all involved resolution authorities, at group-level and of the subsidiaries, or refer disagreements to the EBA for binding mediation.**

**EBA mediation decisions are not binding if a resolution authority assesses the issue may impinge on the Member State's "fiscal responsibilities".**

**The content of a resolution plan should be proportionate to the systemic importance of the institution or group.**

wholly or partially exempted from prudential requirements in national law and apply the requirements on a consolidated basis to the central body and institutions affiliated to it ([Article 4 \(8\) BRRD](#)).

### Relevant documents

- [EBA/RTS/2014/15 Regulatory Technical Standards on the content of resolution plans and the assessment of resolvability](#)
- [EBA/ITS/2015/06 Implementing Technical Standards on procedures, forms and templates for the provision of information for resolution plans under Article 11\(3\) of Directive 2014/59/EU](#)
- [EBA/GL/2015/16 Guidelines on the application of simplified obligations under Article 4 \(5\) of Directive 2014/59/EU](#)
- [EBA/GL/2015/16 Final Report Guidelines on simplified obligations, July 7, 2015](#)
- [Commission Implementing Regulation \(EU\) 2016/962 of June 16, 2016](#) laying down implementing technical standards with regard to the uniform formats, templates and definitions for the identification and transmission of information by competent authorities and resolution authorities to the EBA according to Directive 2014/59/EU
- [Commission Implementing Regulation \(EU\) 2016/1066 of June 17, 2016](#) laying down implementing technical standards with regard to procedures, standard forms and templates for the provision of information for the purpose of resolution plans for credit institutions and investment firms pursuant to Directive 2014/59/EU
- [EBA/GL/2016/03 Final Guidelines on the provision of information in summary or collective form for the purposes of Article 84\(3\) of Directive 2014/59/EU](#)
- [EBA/ITS/2015/06 Final Report Draft implementing technical standards on procedures, forms and templates for the provision of information for resolution plans under Article 11\(3\) of Directive 2014/59/EU](#)
- [EBA/CP/2015/01 Draft ITS on procedures, forms and templates for the provision of information for resolution plans](#)
- [Commission Delegated Regulation \(EU\) 2016/1075 supplementing Directive 2014/59/EU](#) with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges
- [SRB, Data collection for resolution planning and the determination of the Minimum Requirement for own funds and Eligible Liabilities \(MREL\)](#)
- [FSB, Total Loss-Absorbing Capacity \(TLAC\) Principles and Term Sheet](#)

# CHAPTER 10b:

## RESOLVABILITY ASSESSMENT

By Georg Merc

### KEY QUESTIONS

- Is the resolvability assessment different from the resolution plan?
- Is there a timeline for banks to become resolvable?
- What are the contagion channels that need to be assessed?
- What are the consequences if a bank is considered unresolvable?

**ART. 15–28 BRRD  
AND SECTION C  
OF THE ANNEX**

### Assessment Steps

The resolvability assessment is the beginning of the resolution-planning process and uses the information provided by competent authorities and the institutions. There are three different consecutive stages:

- 1 Assessment of the feasibility and credibility of the liquidation. This considers the likely impact on financial systems through the four contagion channels: financial markets; infrastructures; other financial institutions; and the real economy. Feasibility includes the ability to provide information required by deposit guarantee schemes to ensure a timely payout. In case of liquidation the “resolvability assessment” should also identify and address the removal of impediments to the application of normal insolvency proceedings.
- 2 If liquidation is not credible and feasible then, as a second step, resolution authorities identify the preferred resolution strategy for the institution/group together with the resolution tools and power that would be used ([see Chapter 10a](#) for the content of a resolution plan).
- 3 Finally, the feasibility and credibility of the resolution strategy/ies provided for in the resolution plan need to be assessed. Impediments to the implementation of the strategy are assigned to one of the following categories: (i) structure and operations; (ii) financial resources; (iii) information; (iv) cross-border issues; and (v) legal issues. The likely impact of the resolution strategy on the four contagion channels mentioned above must also be considered.

There are three different consecutive stages in a resolvability assessment:

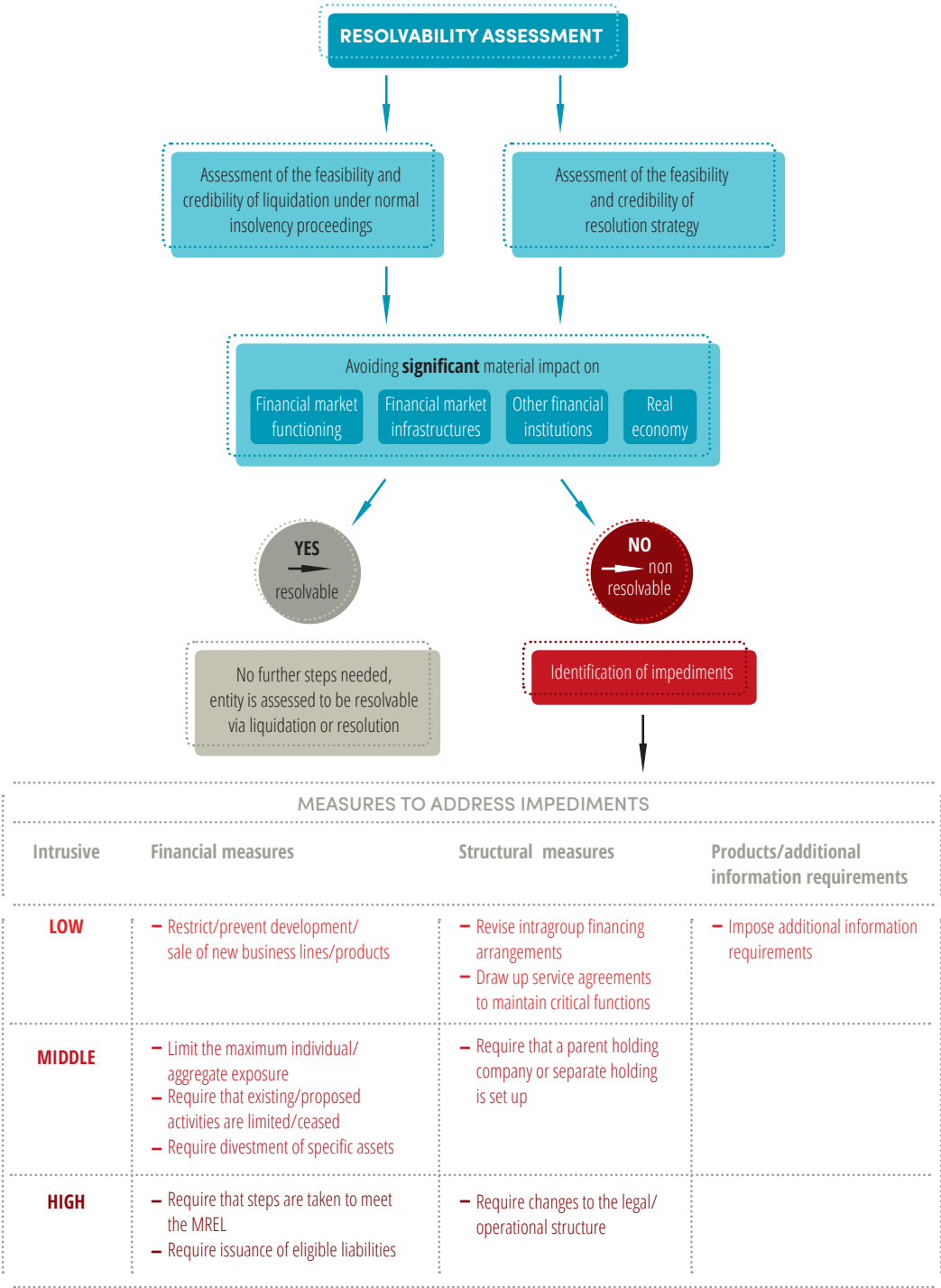
- i) assessment of the feasibility and credibility of liquidation;
- ii) if liquidation is not credible, the identification of the preferred resolution strategy; and
- iii) assessment of the feasibility and credibility of the resolution strategy.

**The removal of impediments to resolvability is based on an iterative process: The resolution authority notifies institutions about the outcome of a resolvability assessment and gives them the opportunity to propose possible measures to address or remove substantive impediments.**

### Intrusive Powers to Address Resolvability Impediments

The key element introduced by the BRRD are the far-reaching powers resolution authorities may use to ensure the resolvability of a bank either through the application of resolution tools or liquidation. Resolution

Key elements of a resolution plan and interdependences



authorities may intervene in an operating business independently of any liquidity and capital ratios or other prudential supervisory indicators. Depending on the concrete exercise this could make them almost shadow-managers of the banks and potentially more powerful than supervisory authorities. The process is however highly cooperative, and closely involve the bank's management and supervisory and other authorities. The resolution authority notifies institutions about the outcome of a resolvability assessment and gives them the opportunity to propose possible measures to address or remove substantive impediments. Only where the resolution authority assesses that the measures proposed do not effectively reduce or remove the impediments in question shall they require the institution to take alternative measures that may achieve that objective. The resolution authority, after consulting the competent authority and, if appropriate, the designated national macro-prudential authority, must duly consider the potential effect of those measures on the particular institution, on the internal market for financial services, and on financial stability in other Member States and the Union as a whole.

**Resolution authorities may use intrusive and far-reaching powers to ensure an institution's resolvability. Possible measures include organizational or structural changes, the restriction or prevention of activities, business lines, or sale of products.**

In case of groups, the group level resolution authority, in cooperation with the consolidating supervisor and the EBA, shall analyze the substantive impediments and prepare a report that will be provided to the EU parent undertaking and to the resolution authorities of the subsidiaries, which will provide it to the subsidiaries under their supervision and to the resolution authorities of jurisdictions in which significant branches are located.

The authorities' discretion should be limited to what is necessary in order to simplify the structure and operations of the institution solely to improve its resolvability. Measures should be neither directly nor indirectly discriminatory on the grounds of nationality, and should be justified by the overriding reason of being conducted in the public interest of financial stability. Furthermore, action should not go beyond the minimum necessary to attain the objectives sought.

Possible measures can be grouped under the following three headings:

- i) structural measures concerning the organizational, legal and business structure of an institution such as setting up a (separate) financial holding entity within the Member State or a EU parent financial holding entity, or entering into or revising the Intra Group Financing Support Agreements (IGFSA, [see chapter 7](#)) or service agreements;
- ii) financial measures relating to its assets and liabilities, e.g. to limit exposures, divest assets, limit/cease activities, restrict/prevent business lines, or sale of products, as well as to satisfy MREL and own funds;
- iii) products and additional information requirements.

**The BRRD does not impose a strict timeline for banks to become resolvable.**

### **Resolvability Timeline**

The BRRD does not impose a strict timeline for banks to become resolvable. Depending on the complexity of the institution/group and existing resolution impediments it could be a long way from having the first draft of a resolution plan, including the preferred strategy, to a positive assessment that the bank is resolvable. The resolution authority cannot directly take action to apply required measures during the assessment process, unlike its powers in the application of resolution tools. However, banks with impediments to be addressed will be requested to have a higher minimum requirement for own funds and eligible liabilities (MREL, [see chapter 11](#)). The resolution authority must notify the EBA in a timely manner where an institution or group is deemed not resolvable.

### **Relevant documents**

- [EBA/GL/2014/11 Guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied under Directive 2014/59/EU](#)
- [EBA/GL/2015/16 Final Report Guidelines on simplified obligations](#)
- [Commission Implementing Regulation \(EU\) 2016/962 of June 16, 2016](#) laying down implementing technical standards with regard to the uniform formats, templates and definitions for the identification and transmission of information by competent authorities and resolution authorities to the EBA according to Directive 2014/59/EU
- [Commission Delegated Regulation \(EU\) 2016/1075 supplementing Directive 2014/59/EU](#) with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges

# CHAPTER 11:

## THE MINIMUM REQUIREMENT FOR OWN FUNDS AND ELIGIBLE LIABILITIES (MREL)

By Georg Merc

### KEY QUESTIONS

- What is the difference between bail-in and minimum requirement for own funds and eligible liabilities (MREL)? Which liabilities are not MREL eligible?
- Are the amounts and types of liabilities to be held by banks as loss-absorbing capacity the same for all banks? Once defined will MREL stay at the same level?
- Is MREL part of the resolution plan? May resolution authorities set a different loss-absorption amount from supervisors?
- What are the main differences between MREL and total loss-absorbing capacity (TLAC)? Do banks that have to comply with TLAC at the international level automatically fulfil MREL?
- What sanctions do authorities have if the Bank does not fulfil MREL (any more)?

### [ART. 45 BRRD](#)

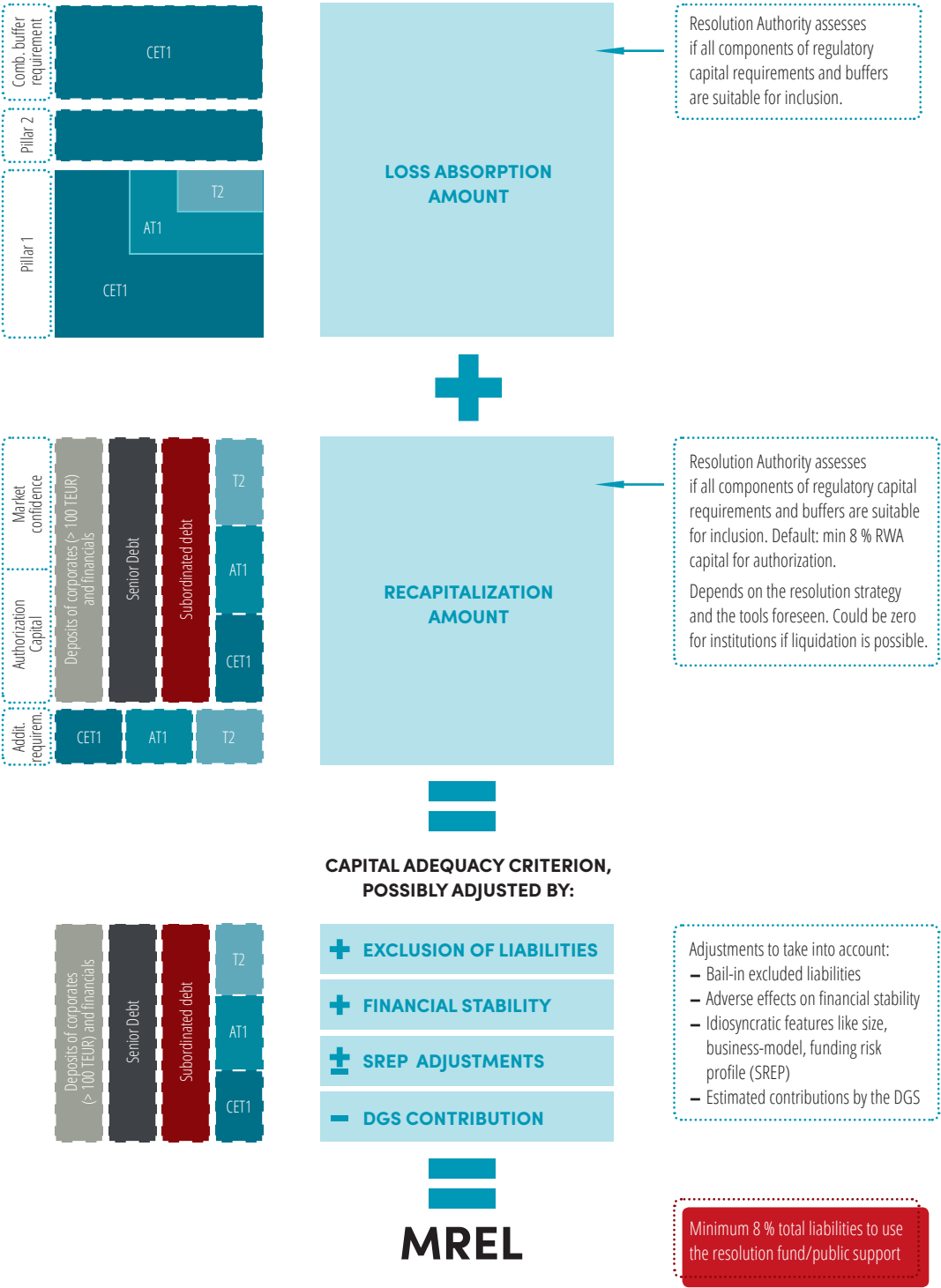
### The MREL Concept

The minimum requirement for own funds and eligible liabilities (MREL) should ensure there is sufficient loss-absorption capacity by shareholders and creditors to enable an effective bail-in and an orderly resolution without creating further contagion and without recourse to public funds. The BRRD introduces the MREL, a new regulatory ratio, as a highly loss absorbing buffer similar to the total loss-absorbing capacity (TLAC) concept of the Financial Stability Board (FSB). The MREL is expressed as a percentage of the total liabilities and own funds of the institution, where the numerator is composed of own funds and a specific type of liabilities (the MREL-eligible liabilities). The BRRD does not provide for a harmonized minimum level, instead MREL is to be set by the resolution authority for each individual bank on a case by case basis as part of the resolution strategy.

The BRRD introduces the MREL as a new regulatory ratio set by the resolution authority to map the passive side of credit institutions and ensure enough bail-inable instruments are available at all times in case a bank fails.



Process to determine the MREL



Not all bail-inable liabilities are eligible for MREL. MREL should consist of liabilities that can be bailed-in with minimum legal and operational risk and without endangering financial stability or creating contagion. Equity and debt instruments have to fulfil the following criteria to qualify as MREL under the BRRD:

- Issued and fully paid-up;
- Liabilities with a remaining maturity of more than one year;
- Not a liability related to a derivative;
- Not a liability that arises from deposits that benefit from preference in the insolvency hierarchy;
- Not owed to, secured by, or guaranteed by, the institution itself.

Liabilities governed by the law of another country will regularly be required to include contractual recognition clauses in order to be accepted as MREL, unless they are covered by statutory frameworks. TLAC stipulates for eligible instruments issued by other global systemically important banks to be deducted. In contrast, under the BRRD there are no specific deduction rules or detailed provisions addressing contagion aspects, apart from resolution authorities' ability to limit the extent to which other institutions hold bail-in able eligible liabilities (excluding entities that are part of the same group).

### **MREL: The Final Part of the Resolution Planning Process**

The MREL is based on the resolution strategy (multiple point of entry (MPE) or single point of entry (SPE)) and the resolvability assessment and is a key element of the resolution plan. There is no common or minimum MREL; however, for banks that will be resolved, the prior 8 % bail-in requirement ([see chapter 15](#)) that applies before the use of the resolution fund or public support is to be considered. No provision for use of state aid (including use of the resolution fund (RF)) should be included when drafting the resolution plan. MREL is set on a case-by-case basis by the resolution authority, applying relatively wide discretionary power, following the criteria below (outlined in the BRRD and further expanded by the European Banking Authority (EBA)):

1. The first element of MREL, the loss-absorption amount, is based on the definition of the prudential capital requirement. There is no binding minimum level for loss-absorbing capital foreseen but the MREL level set by the resolution authority is binding for the respective bank. The loss-absorption amount set by the national resolution authority (NRA) should, as a baseline default, be equal to the prudential capital requirements (including Pillar II and the combined buffers) as determined by the supervisory authority. NRAs in consultation with the supervisory authorities may, however, conclude that some capital components are not suitable for inclusion in loss absorption which in the end could be lower or higher than capital requirements. In terms of eligibility

**MREL is set by the resolution authority after consulting the competent authority for each individual bank (Pillar II) as part of resolution planning.**

**Institutions may fulfill the MREL consisting only of own funds if the resolution strategy is liquidation.**

of instruments, the loss absorption part of MREL should be satisfied, mostly, with the same instruments as the capital requirements (CET1, AT1, T2). By way of example, and depending on the specific firm and the outcome of the liquidation assessment that is part of resolution planning, resolution authorities may set a lower amount if macro-risks are not deemed relevant; or a higher amount if the need to absorb losses is not fully reflected (as illustrated in the graphs for Bank A and Bank C). In any case the amount determined needs to be sufficient to sustain market confidence and ensure both the continued provision of critical economic functions by the institution and access to funding without recourse to extraordinary financial support other than contributions from the financing arrangements. Despite the resolution authority's wide discretionary powers, it can be assumed that for banks that will be liquidated ([see chapter 10b](#) for the resolvability assessment) the loss-absorption amount will be the only criterion, and MREL will be set equal to the regulatory capital requirements (pillar 1 and pillar 2) (see the example of Bank B in graphs at the end of the chapter).

**The recapitalization amount ensures that the resolved institution meets the conditions for authorization after resolution (min. 8 % RWA).**

2. The second element of MREL, the recapitalization amount, should ensure that the institution meets the conditions for authorization (licensing requirements) after resolution (at a minimum 8 % of total risk exposure amount) and that the capital level is high enough to ensure market confidence following resolution. The appropriate level could be determined in comparison with peer groups. The recapitalization amount will regularly be zero for institutions that are expected to come under liquidation. Though unlikely, resolution authorities may require a recapitalization amount even for those banks that are expected to be liquidated, to ensure that liquidation achieves the resolution objectives (Bank D at the end of the chapter).
3. MREL, calculated based on the capital adequacy criterion, may be further increased if this is viewed necessary to support market confidence following resolution. It may also be necessary to increase the MREL following consideration of the potential adverse impact of an institution's failure on financial stability, or to allow for the exclusion of certain liabilities (under the NCWOL test, [see chapter 20](#)). Though in principle applicable to all institutions, adverse effects on financial stability may especially be assumed for Global Systemically Important Institutions (G-SIIs) and Other Systemically Important Institutions (O-SIIs) as determined by competent authorities.
4. Idiosyncratic adjustments, building on the Supervisory Review and Evaluation Process (SREP) and determined by reference to the size, business model, funding, and risk profile criterion may further influence the requirement in both directions (leading to an increase or decrease).

5. Finally, the possible deposit guarantee scheme (DGS) contribution may be considered as a source of financing for resolution depending on the share of covered deposits to total liabilities. An expected DGS contribution would lower the MREL requirement.

#### Overview of deposits eligible for MREL and bail-in

Amount	Maturity	Deposits of nat. persons & SMEs	Deposits of corporates	Deposits of financial institutions
< 100 thousand euro	< 1 year	<b>No bail-in, not MREL-eligible (covered by DGS)</b>	<b>No bail-in, not MREL-eligible (covered by DGS)</b>	Bail-in, <b>not</b> MREL-eligible
	> 1 year			Bail-in and MREL-eligible
> 100 thousand euro	< 1 year	Bail-in able, <b>not</b> MREL-eligible	Bail-in, <b>not</b> MREL-eligible	Bail-in, <b>not</b> MREL-eligible
	> 1 year		Bail-in and MREL-eligible	Bail-in and MREL-eligible

#### MREL Compared to TLAC

Both TLAC and MREL are defined as minimum amounts of own funds and specific debt obligations required for banks to ensure that they can be restructured or wound down in orderly ways. Despite having the same purpose, i.e. to facilitate private sector loss absorbency, they have significant divergences.

In terms of the scope of application, MREL is addressed to all credit institutions while the TLAC covers only global systemically important banks (G-SIBs). At the European level, MREL has been in force since the beginning of 2015. Initial MREL target levels are expected in 2016 (with interim targets during a transitional period). The Single Resolution Board (SRB) has announced a MREL target of not less than 8 % of total assets for all banks under its remit. MREL is set on a case-by-case basis with no differentiation between pillar 1 and pillar 2 requirements.

TLAC is (formally) based on RWA instead of total assets and defines a mandatory minimum pillar 1 requirement equivalent to 16 % of risk-weighted assets (18 % from 2022) and at least 6 % of the leverage ratio denominator from 1 January 2019 (6.75 % from 2022), with scope for resolution authorities to set additional firm-specific requirements on top of this (as per pillar 2 requirements). Contrary to MREL, capital buffers (typically ranging from 2.5 to 6 % of risk-weighted assets) are not included in TLAC so that Common Equity Tier 1 (CET1) capital cannot count simultaneously towards both TLAC and regulatory capital buffers.

**MREL and TLAC share the same purpose but are quite different in terms of scope, eligibility of instruments, method of sizing, and adjustments.**

**According to the BRRD framework, mandatory subordination of MREL liabilities is not required**

Regarding the eligibility criteria, the FSB TLAC term sheet requires subordination of TLAC eligible instruments, excluding operational liabilities (e.g. such as short term debt) thereby ensuring that liabilities within the same rank are treated equally and minimizing legal risks (esp. the risks of breach of the no-creditor-worse-off principle). According to the BRRD framework, mandatory subordination of MREL liabilities is not required and pari passu liabilities can be excluded on an ad hoc basis from bail-in or simply not qualify for bail-in (e.g. due to maturity reasons). Resolution authorities may, however, require that MREL eligible liabilities should be subordinated on a case-by-case basis, depending on the resolution strategy and the structure of a bank's liabilities.

**The European Commission plans to issue a legal proposal by the end of 2016 to transpose the FSB TLAC term sheet into EU legislation.**

Finally, TLAC provides for a resolution entity concept and distinguishes between an external and internal TLAC requirement with different eligibility criteria. Resolution entities should generally act as a source of loss-absorbing capacity for their material subgroups and are subject to an external TLAC requirement. Therefore, the other entities of the material subgroups are subject to an internal TLAC requirement of 75 % to 90 % of the external minimum TLAC requirement.

The European Commission plans to issue a legal proposal by the end of 2016 to implement TLAC within the BRRD MREL concept.

**MREL/TLAC comparison**

	EU – MREL	TLAC
Scope	All institutions	G-SIBs
Amount	No minimum, institution individual: Sum of loss absorption amount and recapitalization amount plus adjustments as of 2016 (with phasing in)	Minimum 16 % RWA or 6 % leverage (whatever is higher) as of 2019. Minimum 18 RWA/6.75 LRE as of 2022. Individual firm Pillar II add on
Deductions (to limit contagion)	Not specifically regulated	Deduction of TLAC eligible instruments issued by other GSIBS
Buffer	Capital buffers count to fulfill MREL	Regulatory buffers do not count as TLAC
Eligible liabilities	Included: Capital, debt, liability or other item that is paid in, unsecured, 1y minimum maturity, ... Excluded: Derivatives, covered deposits, ...	Included: Capital, debt, liability or other item that is paid in, unsecured, 1 year minimum maturity, not funded (in)directly by the resolution entity or related party, ... Excluded: Operational liabilities on which the performance of critical functions depends. Liabilities that give raise to material risks of NCWOL claims; structured notes, derivatives, covered deposits.
Subordination	Subordination is not explicitly required	Formal subordination to excluded liabilities is required (exceptions)
Entity or group level	Each legal entity (solo) plus on consolidated level; not specified if internal or external	Each "resolution group" to hold external TLAC; Material subgroups to hold internal TLAC of 75–90 % to the external TLAC that would apply to the material subgroup if it were a resolution group
Jurisdiction (Public)	Possible recognition of third country instruments	Instruments must be issued under the law of the jurisdiction where the "resolution entity" is located (as of 2022)
Disclosure	–	Amount, maturity and composition of external TLAC by each resolution entity, plus internal TLAC issued by each material subgroup to the resolution entity; Liabilities that rank pari passu or junior to TLAC must also be disclosed, at a minimum the amount, nature, and maturity

### **MREL: No Group Resolution Concept**

Within a banking group, the individual requirement for each individual subsidiary should be assessed separately from the consolidated group level. Parent undertakings must comply with the minimum requirements on a consolidated basis and also – unless a waiver has been granted – on an individual basis. The BRRD MREL concept does not provide any guidance on how the consolidated requirement set for the group should be taken into account when determining an appropriate level for the subsidiary. The BRRD leaves it to the resolution authority to decide on the resolution strategy (single or multiple point of entry (SPE/MPE)) and does not explicitly provide for internal arrangements regarding loss-absorbing capacity. It requires each institution to meet its own MREL individually and at a consolidated level, such that each entity is able to absorb losses and can be recapitalized. It is not specified whether loss-absorbing instruments can be internal, i.e. from within the banking group, or must be external, i.e. issued on the market.

**The MREL concept does not provide any guidance on how the consolidated requirement set for the group should be taken into account when determining an appropriate level for the subsidiaries.**

### **Determining MREL: Interaction Between Resolution Authority and Competent Authority**

The MREL is set by the resolution authority after consulting the competent authority. Resolution authorities should not be seen as shadow supervisors and should not duplicate their work, but they have to rely on supervisory assessments as a starting point. The supervisory judgments of unexpected losses, the classification of a bank as a G-SII or O-SII, and the SREP score are elements that need not be replicated by resolution authorities. Resolution authorities may conclude, in consultation with the competent authority, that some components of the loss-absorption amount are not suitable. Differences in judgment between the competent and resolution authority may be appropriate, but should be clearly reasoned.

The MREL is updated in parallel with the resolution plan. The BRRD does not provide for a strict timeline for all banks to set an initial MREL, just that decisions should start to be made. Resolution authorities may set an MREL requirement that increases over time to reflect the need for a transition period as the final definition of MREL will substantively impact on institutions' funding policy and the market will need time to adjust.

### **Third Country MREL**

Liabilities governed by the law of another EU Member State automatically count as MREL. Liabilities governed by the law of a non-EU Member State do not count as MREL unless the resolution authority is satisfied that the bail-in of this instrument decided by an EU resolution authority will be effective under the law of the third country.

**Liabilities governed by the law of a non-EU Member State do not (normally) count as MREL**

### **Exclusion from the MREL**

Mortgage credit institutions financed by covered bonds which are not allowed to receive deposits are excluded from the MREL. Group level

**The BRRD does not provide for a common sanctioning regime in case of non-compliance with MREL. Resolution authorities have powers to address non-compliance with the MREL under their powers to address impediments to resolvability.**

resolution authorities may waive the application of an individual minimum requirement to a EU parent institution, and the resolution authority may waive the application to a subsidiary, provided that certain conditions are fulfilled (e.g. the EU parent fulfills the MREL on a consolidated basis or the subsidiary and parent are subject to authorization and supervision by the same Member State). It is not finally determined whether such exemption concerns the setting of MREL at individual rather than at the consolidated level.

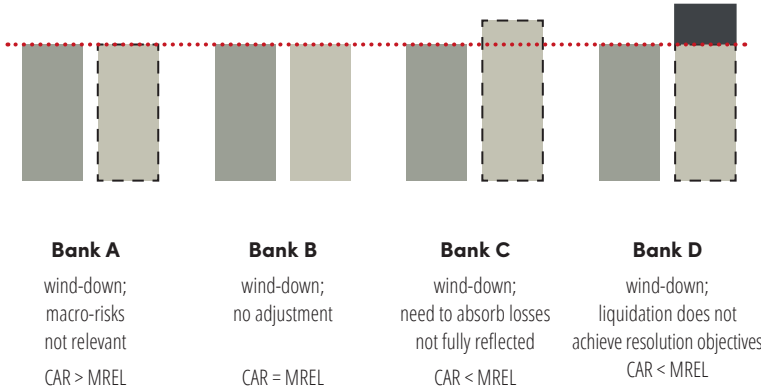
### **Sanctioning Non-Compliance With MREL**

The BRRD does not provide for a common sanctioning regime in case of non-compliance with MREL. Member States are required to lay down rules on administrative penalties and measures. However, resolution authorities have powers to address impediments to resolvability and non-compliance with the MREL may be considered as such an impediment ([see chapter 10b](#)). As a consequence, resolution authorities may direct the institution to issue eligible liabilities to become resolvable and to fulfil MREL.

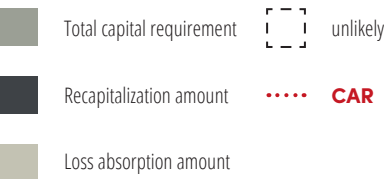
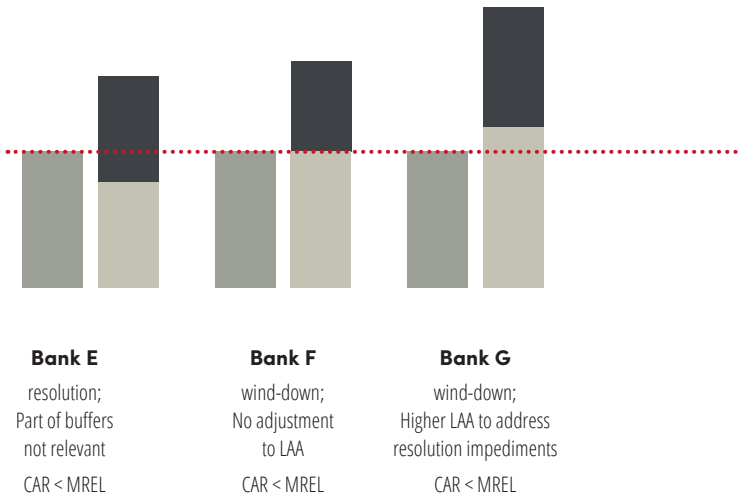
### **Relevant documents**

- [EBA/RTS/2015/05 Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU](#)
- [Financial Stability Board, Total Loss-Absorbing Capacity \(TLAC\) Principles and Term Sheet, 9 November 2015](#)
- [EBA/RTS/2015/05, Final Draft Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU](#)
- [EBA/Op/2016/02 09 Opinion of the EBA on the Commission's Intention to Amend the Draft Regulatory Technical Standards Specifying Criteria Relating to the Methodology for Setting Minimum Requirement for Own Funds and Eligible Liabilities According to Article 45\(2\) of Directive 2014/59/EU](#)
- [Commission Delegated Regulation 2016/1450 supplementing Directive 2014/59/EU](#) of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities

Examples for determining MREL for banks coming under liquidation



Examples for determining MREL for banks coming under resolution





# PREPARATION AND CONDITIONS FOR TAKING RESOLUTION ACTION

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## CHAPTER 12: VALUATION IN ADVANCE OF RESOLUTION

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By Dieter Huber

### [ART. 36, 44 BRRD](#)

#### KEY QUESTIONS

- What valuations are required for resolution purposes?
- Who undertakes valuations for resolution purposes?
- Is there a difference between accounting value/regulatory reporting and valuation for resolution purposes?
- Does the resolution value depend on the resolution tools?
- Are derivatives liabilities exempt from bail-in?

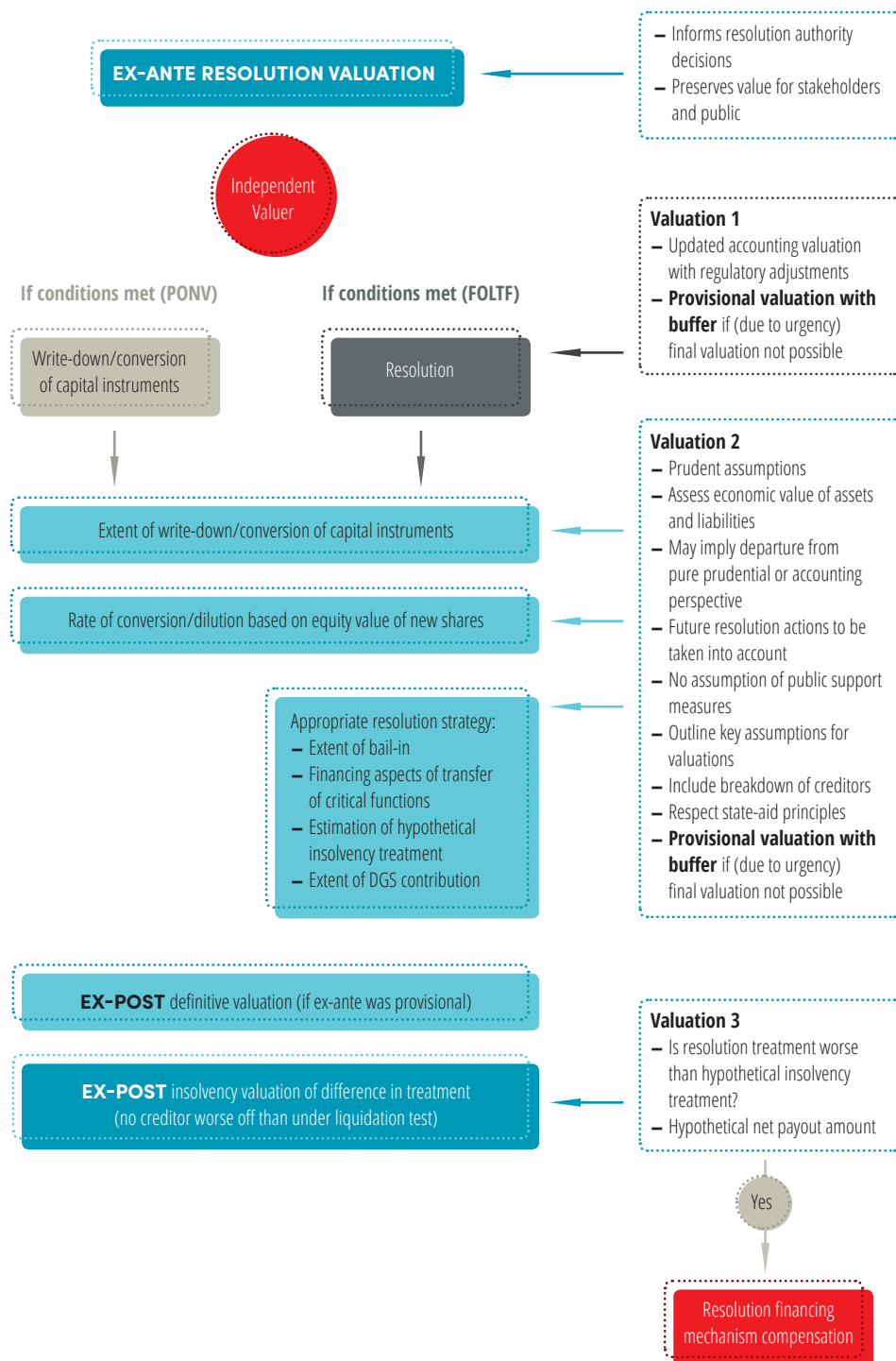
All key decisions taken by the resolution authority are informed by valuations of the bank's assets and liabilities. These valuations ensure that the resolution authority's powers are exercised in line with the resolution objectives, particularly to reduce risks to the public by minimizing reliance on extraordinary public financial support and prevent contagion, while also preserving value for stakeholders, and – crucially to avoid litigation – respecting the property rights of affected shareholders and creditors.

Mandatory valuations are undertaken by an independent valuer at the request of the resolution authority before, at the point of, and after, resolution.

#### **Valuation: An Integral Part of the Resolution Decision**

Valuation is an integral part of the decision to apply resolution tools or exercise resolution power; or the decision to exercise the write-down or conversion power of capital instruments. From a procedural point of view, the valuation itself is not subject to a separate right of appeal but may be subject to an appeal together with the decision itself.

## Ex-ante Resolution Valuation



The valuation must be without prejudice to the state aid framework, which indicates that the economics underlying the application of resolution tools need to meet those requirements as well. State aid limitations would apply if, for example, in the context of a transfer of assets bad loans were valued too generously.

Valuations, as a rule, undertaken by an independent valuer at the request of the supervisor or resolution authority, are required at various stages in the context of bank resolutions:

- i. Before resolution action is taken to decide if a bank is actually failing or likely to fail (as a default, to be performed by the supervisory authority, the resolution authority may perform such an assessment if provided for under national law);
- ii. At the point of resolution, to ensure losses are fully recognized and inform the right application of resolution tools;
- iii. After taking resolution action, to compare the treatment of shareholders and creditors under resolution with the losses that would have occurred under a hypothetical liquidation scenario ([see chapter 20](#) on NCWOL).

**An updated accounting valuation with regulatory adjustments determines if an institution is FOLTF.**

#### **Initial Valuation of a Struggling Institution: “Valuation 1”**

Valuation 1 is to determine whether the conditions for resolution (FOLTF) or point of non-viability (PONV) are met ([see chapter 12](#)). The key determinant for this is whether a bank's balance sheet is (in)solvent and whether there is a breach or likely breach of conditions for authorization. Hence, the measurement basis must be consistent with the one used for ongoing supervision; i.e. an updated accounting valuation with regulatory adjustments. The valuer must adequately support the valuation with evidence, thereby reviewing and challenging accounting and regulatory information and representing the bank's financial position fairly. The impact of actions taken by the resolution authority is not taken into account at this stage.

**Prudent assumptions are used and the economic value of assets and liabilities are assessed to ensure that losses are fully recognized at the point of applying resolution measures. This implies a departure from a pure accounting and going-concern perspective.**

#### **Resolution Valuation to Inform the Resolution Decision: “Valuation 2”**

If the resolution authority concludes that the bank meets the conditions for resolution based on the financial statements using the valuation principles detailed above under Valuation 1, a so-called “Valuation 2” is requested to inform the appropriate resolution action to be taken and to provide an estimate of the hypothetical liquidation value (for the decision on the final hypothetical liquidation value ([see chapter 20](#))). A resolution strategy can then be developed and measures applied to best serve the resolution principle and objectives, while also resulting in the highest value for the bank's shareholders and creditors.

Valuation 2 seeks to:

- ensure that any losses on the assets are fully recognized at resolution;
- inform bail-in and recapitalization needs;

- determine asset values for the application of resolution tools, e.g. a potential sale of business, or transfer to bridge institution or asset management vehicle;
- list creditors according to the insolvency hierarchy.

The valuation includes ascertaining the appropriate extent of an eventual write-down or conversion of capital instruments ([see chapter 13](#)) and, where necessary, eligible liabilities to restore compliance with regulatory requirements and sustain market confidence in the institution under resolution. Prudent assumptions are used and the economic value of assets and liabilities are assessed to ensure that losses are fully recognized at the point of applying resolution measures. This implies a departure from a pure accounting and going-concern perspective as the underlying principles may no longer be valid once the conditions for resolution are met. It is justified as transactions connected with the application of certain resolution tools (e.g. sale of business) are based on commercial terms. Asset values may therefore significantly differ from book values. The principle of equal treatment of all creditors must be respected, for example, in the transfer of certain assets or liabilities ([see chapter 15](#) on bail-in for exemptions).

All circumstances known at the valuation date, together with the possible impact of future resolution actions need to be taken into account. Public support measures may not be assumed. The choice of resolution tools may affect the estimation of the timing and amount of future cash-flows, e.g. yields from assets in a run-off entity with the aim to maximize value may be very different from assets disposed of right away. The valuer must outline the key assumptions underlying the valuation, apply judgment to identify the salient factors arising from different resolution actions that have a bearing on the value of assets, liabilities and equity and indicate where uncertainty is significant.

Valuation 2 should list creditors, broken down into classes based on their ranking in the insolvency hierarchy, and should estimate their treatment if the institution were wound up under normal insolvency proceedings. This allows resolution authorities to take the principle of “no creditor worse off than under liquidation (NCWOL)” into account when determining the resolution strategy. The final hypothetical/fictitious liquidation value will be measured ex-post resolution under Valuation 3 ([see chapter 20](#) and the Danish and Austrian case studies in accompanying publication “Bank resolution and bail-in in the EU: Selected case studies pre and post BRRD” for practical examples on the hypothetical loss calculation). The valuation also informs the decision on the eventual contribution of a deposit guarantee scheme ([see chapter 22](#) on the use of DGS for resolution purposes).

### Cancellation or Dilution of Shares?

If the going-concern value determined in Valuation 2 is zero or negative, a full cancellation or full transfer of shares or other instruments of

**The choice of resolution tools may affect the estimation of the timing and amount of future cash-flows.**

**Resolution authorities take the principle of “no creditor worse off” into account when determining the resolution strategy and an estimate on the hypothetical liquidation amount is provided under V2.**

ownership is necessary as well as a write-down of liabilities according to the creditors' hierarchy. A write-down of liabilities would however not be appropriate as long as shareholders retain some value.

If the institution has a positive net asset value, both on the basis of the assessment of its assets and liabilities under Valuation 2 and according to the fictitious liquidation valuation, a dilution of existing shareholdings would suffice. In that case creditors could be given new equity shares and participate in any upside potential. In this case, the valuation serves to determine the rate of conversion of debt to equity and estimate the equity value of the newly issued shares (estimated market price). This ensures that holders of converted claims receive sufficient value to satisfy the NCWOL principle.

If the institution has an asset value of zero according only to the fictitious liquidation valuation, authorities may choose from the whole set of options and decide which option is best operationally.

**The resolution authority has discretion to exclude derivative liabilities from bail-in under exceptional circumstances.**

#### **The Valuation of Derivatives for Bail-In**

In principle, derivative liabilities fall under the scope of the resolution authority's bail-in power. However, certain exceptions may apply: specifically, the exclusion of secured liabilities from bail-in to the extent that the value of the liability does not exceed the value of the collateral. Furthermore, the resolution authority may use its discretion to exclude derivative liabilities from bail-in under additional exceptional circumstances, e.g., when it is not possible to bail-in that liability within a reasonable time or when application of the bail-in tool would cause destruction in value, increasing losses borne by other creditors.

Valuation in the context of the bail-in tool entails some special features related to a liability arising from derivatives. The write-down and conversion powers ([see chapter 15](#) on bail-in) should be used only upon closing out the derivatives. Where derivative transactions are subject to a netting agreement, the resolution authority or the independent valuer should determine the liability arising from those transactions on a net basis in accordance with the terms of the agreement.

The liability will normally be assessed as an early termination amount based on the replacement cost of the contract. The valuation also informs the comparison that the resolution authorities need to undertake before actually closing out derivative netting sets: in this context, the gain in terms of increase in loss-absorption capacity through bail-in needs to be contrasted with the destruction in value resulting from closing-out the derivative contract. To the extent that liabilities to central counterparties (CCPs) are not exempt from bail-in, the valuation processes used by the authorized CCPs may typically serve to establish a proper valuation.

### **Ensuring Fair and Prudent Valuations by an Independent Valuer**

The valuation should be carried out by a person independent of any public authority, including the resolution authority, and the institution under resolution. Regulatory technical standards (RTS, see relevant documents below) set out what constitutes independence in this regard. Anyone who has completed a statutory audit of the entity under resolution in the year preceding the resolution year is automatically ineligible. Independence can also be compromised by material common or conflicting interests in the institution or entity such as shareholding, board membership or where the valuer is a significant creditor. Similarly, personal relationships could represent a material interest and exclude a firm as an independent valuer.

**Independent valuers must not have completed a statutory audit in the year preceding the resolution action, nor have conflicting interests as shareholders, board members, or creditors.**

### **Provisional Valuations**

Where an independent valuation is not possible, for example due to the urgency of the situation, a provisional valuation can be carried out (e.g. by the resolution authority). In this case a buffer for additional losses must be applied if there is evidence supporting their existence or where the amount of the likely losses cannot be reliably estimated. The ex-post definitive valuation must be carried out as soon as practicable after taking resolution action, either separately or together with the ex-post valuation used to compare the difference in the treatment of shareholders and creditors under valuation 3 ([see chapter 20](#)) and may be done by the same independent person.

**In case of urgency the resolution authority may itself carry out a provisional valuation.**

Differences between the provisional valuation and valuation 2 should be settled accordingly and any remaining funds (if any) in the buffer for additional losses must be distributed to the claimants in the order of the priority of their claims.

### **Bank Valuation Support**

It is a practical challenge to produce prudent, reliable valuations in a very short time frame. Banks are expected to support the valuation process using their own staff, systems and processes.

**Banks are expected to support the valuation process using their own staff, systems and processes.**

### **Valuation for Direct Recapitalization Under the ESM**

Valuation may also be required in the context of the European Stability Mechanism (ESM), which could as one funding line provide a direct bank recapitalization instrument under certain circumstances ([see chapter 21](#) a resolution financing). A valuation of the bank's assets is conducted under the guidance of the ESM, in liaison with the European Central Bank (ECB) and European Commission. This is used to determine the contributions of the requesting ESM Member and the ESM under a burden-sharing scheme.

### **International Consistency in Valuation For Resolution Purposes**

The International Valuation Standards Council (IVSC), an independent, not-for-profit organization, set up a special working group in 2014 to develop guidance on valuations for resolution and recovery in accordance

with the Financial Stability Board's "Key Attributes of Effective Resolution Regimes for Financial Institutions". The project should lead to a new Application Standard setting out common principles for the valuation of FOLTF businesses, with accompanying guidance on specific applications including the resolution of financial institutions.

**Relevant documents**

[Commission Delegated Regulation \(EU\) 2016/1075 supplementing Directive 2014/59/EU](#) with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges

# CHAPTER 13:

## WRITE-DOWN OR CONVERSION OF CAPITAL (WDCC) INSTRUMENTS

By Dominik Freudenthaler

### KEY QUESTIONS

- What is the difference between write-down or conversion of capital (WDCC) instruments and bail-in?
- Who determines whether an institution has reached the point of non-viability? Is it different to the conditions for resolution?
- Who may trigger a write-down or conversion outside resolution?
- To which liabilities are the write-down or conversion powers applicable?
- What is the role of CoCos (contingent convertible bonds) under the statutory WDCC powers?

[ART. 47, 59–62 BRRD](#)

At first glance, the power of resolution authorities to require write-down or conversion of capital instruments (WDCC) seems to share many commonalities with the bail-in power and therefore its purpose may seem rather puzzling and opaque. But a detailed analysis shows that WDCC is not just a bail-in of relevant capital instruments but evinces considerable differences.

### WDCC Within and Outside of Resolution

Unlike bail-in which, generally speaking, applies to all unsecured liabilities ([see Chapter 15](#)) the WDCC powers (as indicated by the name) apply only to relevant capital instruments i.e. Additional Tier 1 (AT1) and Tier 2 (T2) instruments. These instruments may be written down or converted to Common Equity Tier 1 (CET1) instruments, after CET1 instruments are written down first.

WDCC is not, strictly speaking, a resolution action as it should take place in advance of any resolution action<sup>1</sup>. The conditions under which WDCC powers may be applied are quite similar to the resolution triggers. WDCC

Unlike bail-in, WDCC powers apply only to relevant capital instruments (i.e. AT1 and T2 instruments), may take place in advance or instead of any resolution action, and have less stringent conditions for their use.

<sup>1</sup> [EBA Q&A 2015\\_1781](#)



WDCC

	WDCC	CoCo BOND
INSTRUMENT	<div><div>CET1</div><div>AT1</div><div>T2</div></div>	<div><div>AT1</div></div>
TRIGGER	<div><div><b>Conditions</b> Institution reaches point of non-viability without WDCC i.e.<ul style="list-style-type: none"><li>– Failing or likely to fail</li><li>– No other action but WDCC available to prevent failure of institution</li><li>– (no public interest test required)</li></ul></div><div>Terms governing the instrument should recognise WDCC powers</div></div>	<div><div><b>CoCo Bonds condition</b> If CET 1 falls below 5,125 % (other/higher triggers possible)</div></div>
NATURE	<div><div><b>Statutory power</b> to write down or convert AT1 and T2 instruments, determination<ul style="list-style-type: none"><li>– Either by supervisory or resolution authority</li><li>– In combination with or independent of resolution action</li></ul></div><div><ul style="list-style-type: none"><li>– <b>Waterfall</b> regime (bail-in) applies</li><li>– Authority may require institution to issue CET1 instruments</li></ul></div></div>	<div><div><b>Contractual CoCo Bonds</b> Conversion or write down on a contractual basis of hybrid perpetual AT1 bonds</div></div>

may be appropriate if the institution is deemed to be no longer viable, if it is failing or likely to fail, and if there is no reasonable prospect that any action other than WDCC would prevent its failure. The point of non-viability (PONV) should be understood as the point at which the relevant (supervisory or resolution) authority determines that the institution meets at least the first two conditions for resolution, or the point at which the authority decides that the institution would cease to be viable if capital instruments were not written down or converted.

**It is the resolution authority that applies WDCC, however the BRRD does not specify who shall determine whether an institution has reached the point of non-viability and trigger WDCC.**

No public interest justification is required if WDCC is conducted outside resolution. WDCC can be exercised by the resolution authority independently of resolution actions as a sort of in-between measure if the requirements for WDCC are met and if the write-down and conversion of capital instruments is sufficient to restore the bank.

WDCC has to be applied by the resolution authority, but the BRRD does not explicitly specify whether the supervisor, the resolution authority, or another appropriate authority is to determine whether an institution has reached the point of non-viability (instead, it is left open for national implementing law).

Under the Single Resolution Mechanism (SRM) (Article 21 SRMR), it is indicated that the Single Resolution Board (SRB) may determine the point of non-viability (PONV) if it has informed the European Central Bank (ECB) of its intention to do so and the ECB does not make such an assessment within 3 days (for the determination of FOLTF [see chapter 14](#)).

If WDCC is deployed, the bail-in waterfall comes into effect. In this respect there is no substantive difference in the legal technique between the WDCC and bail-in tool: existing shares are cancelled and either transferred or, in the case of a positive net value, diluted by converting WDCC eligible debt into equity. Like a bail-in, WDCC should be carried out on the basis of valuation under Article 36.<sup>2</sup> However, one noticeable difference is that WDCC does not allow for any exceptions: capital instruments cannot be excluded from write down or conversion. In contrast, under bail-in certain liabilities may be excluded or partially excluded in exceptional circumstances ([see chapter 15](#)) the same as under the state aid framework, when the implementation of the write down or conversion would lead to disproportionate results or would endanger financial stability.

**The point of non-viability is when the relevant (supervisory or resolution) authority determines that the institution meets the conditions for resolution, or decides that the institution would cease to be viable if capital instruments were not written down or converted.**

### **Not regulated under the BRRD: CoCo Bonds – Contractual Obligations for Write Down Or Conversion of AT1 Instruments Under the CRR**

The contractual conversion or write-down of contingent convertible bonds (CoCo Bonds), i.e. AT1 instruments, is in the hands of the institution and not regulated in the BRRD. Statutory WDCC as described above can

<sup>2</sup> [EBA Q&A 2015\\_1781](#)

be seen as a safety net – if the point of non-viability is reached and the management of the institution is unresponsive, the resolution authority can trigger WDCC including CoCo Bonds with sovereign public authority. The scope of WDCC is broader, able to convert or write down Tier 2 instruments, which are not necessarily issued as CoCos i.e. under a contractual obligation stipulating that the instrument may be converted or written-down in a crisis scenario.

CoCo Bonds are essentially convertible debts that fulfil the regulatory requirements for AT1 instruments. CoCo Bonds aim to protect financial stability in times of crisis by converting when the bank's capital ratio falls below a certain point – i.e. in a crisis scenario – while investors earn above average interest during times of financial soundness. This is somewhat different from plain vanilla convertibles, which give the holder the ability to receive stock in exchange for the bond at a time when the stock price is going up against lower interest payments than traditional debt.

**The contractual conversion or write-down of AT1 going-concern capital instruments (such as CoCos) is triggered by the institution and is likely to happen before a WDCC is deployed. By contrast, WDCC is a statutory power of resolution authorities and has a broader scope (i.e. ability to convert or write down Tier 2 instruments).**

Under the EU Capital Requirements Regulation (Article 52 CRR), AT1 instruments are issued with a contractual obligation stipulating that the instrument can be converted or written-down in a crisis scenario. The trigger for conversion or write-down of AT1 instruments is incorporated in the bond terms and can be set quite freely. The minimum requirement is the CET1 capital ratio of the institution falling below 5.125 %.

The trigger should ensure that conversion or write-down takes place sufficiently early (on a going-concern basis) to contribute to the continued viability of the institution. A contractual conversion or write-down of AT1 instruments is therefore likely to happen before a WDCC is deployed. This applies particularly to AT1 instruments that stipulate a trigger above the minimum requirement, i.e. a CET1 capital ratio above 5.125 % (so called high-trigger CoCo Bonds). As a quid pro quo for the conversion risk, investors are offered higher yields, which are indeed the main source of returns as CoCo Bonds are perpetual<sup>3</sup>.

### **WDCC Instead of Resolution if T2 is Sufficient to Stabilize the Institution**

The WDCC powers offer a “milder bail-in” option, with less stringent conditions for their use (no public interest test if conducted outside resolution) and are applicable to capital instruments. In practice, WDCC will be used in place of formally starting resolution if incurred losses can be covered by AT1 and T2 instruments and a bail-in of other liabilities is not required to stabilize and recapitalize the institution. AT1 instruments should be converted or written down ahead of any resolution authority decision to step in with sovereign public authority at the point of non-viability.

<sup>3</sup> [Article 52\(1\)\(g\) CRR](#)

The CoCo Bond market has grown rapidly and substantively in recent years and considerable growth is expected ahead. The future will show if CoCos work smoothly and contribute to stable financial markets by converting into equity or writing down principal. Doubts have already emerged following rumors about a case of a CoCo-coupon shattering confidence in one of the biggest EU banks. A concern is that rather than providing reassurance that potential issues will be identified early and swift action will be taken to address them, WDCC may instead be seen as a signal of trouble ahead and contribute to a mood of crisis.

### Relevant documents

- [EBA Report on the monitoring of Additional Tier 1 \(AT1\) instruments of EU institutions – second update, 11 July 2016](#)
- [EBA Final Report on the monitoring of Additional Tier 1 \(AT1\) instruments of EU institutions, 29 May 2015](#)
- [Regulation \(EU\) No 575/2013 on prudential requirements for credit institutions and investment firms \(CRR\)](#)
- [CoCos: a primer, BIS Quarterly Review, September 2013/43](#)
- [Commission Delegated Regulation \(EU\) 2016/1075 supplementing Directive 2014/59/EU](#) with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges
- [EBA/CP/2014/29 Draft Guidelines concerning the interrelationship between the BRRD sequence of write down and conversion and CRR/CRD IV](#)
- [EBA/CP/2014/40 Draft Guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments](#)

# CHAPTER 14:

## CONDITIONS FOR TAKING RESOLUTION ACTION AND THE ADOPTION OF A RESOLUTION SCHEME

### [ART. 32–34 BRRD](#)

By Dominik Freudenthaler and Pamela Lintner

#### KEY QUESTIONS

- What are the conditions for taking resolution action?
- Who determines if a bank is likely to fail and will enter resolution?
- What does the public interest test check? What happens if there is no public interest?
- Who decides on a group resolution scheme if more than one entity of a group is likely to fail?

The three main conditions for taking resolution action are:

1. the institution is failing or likely to fail;
2. no alternative private sector measures would prevent the failure; and
3. resolution action is in the public interest and fulfils the resolution objectives to at least the same extent as liquidation.

The supervisor determines if an institution is failing. Member States may empower the resolution authority to carry out this assessment instead of the supervisor.

#### Conditions for Resolution

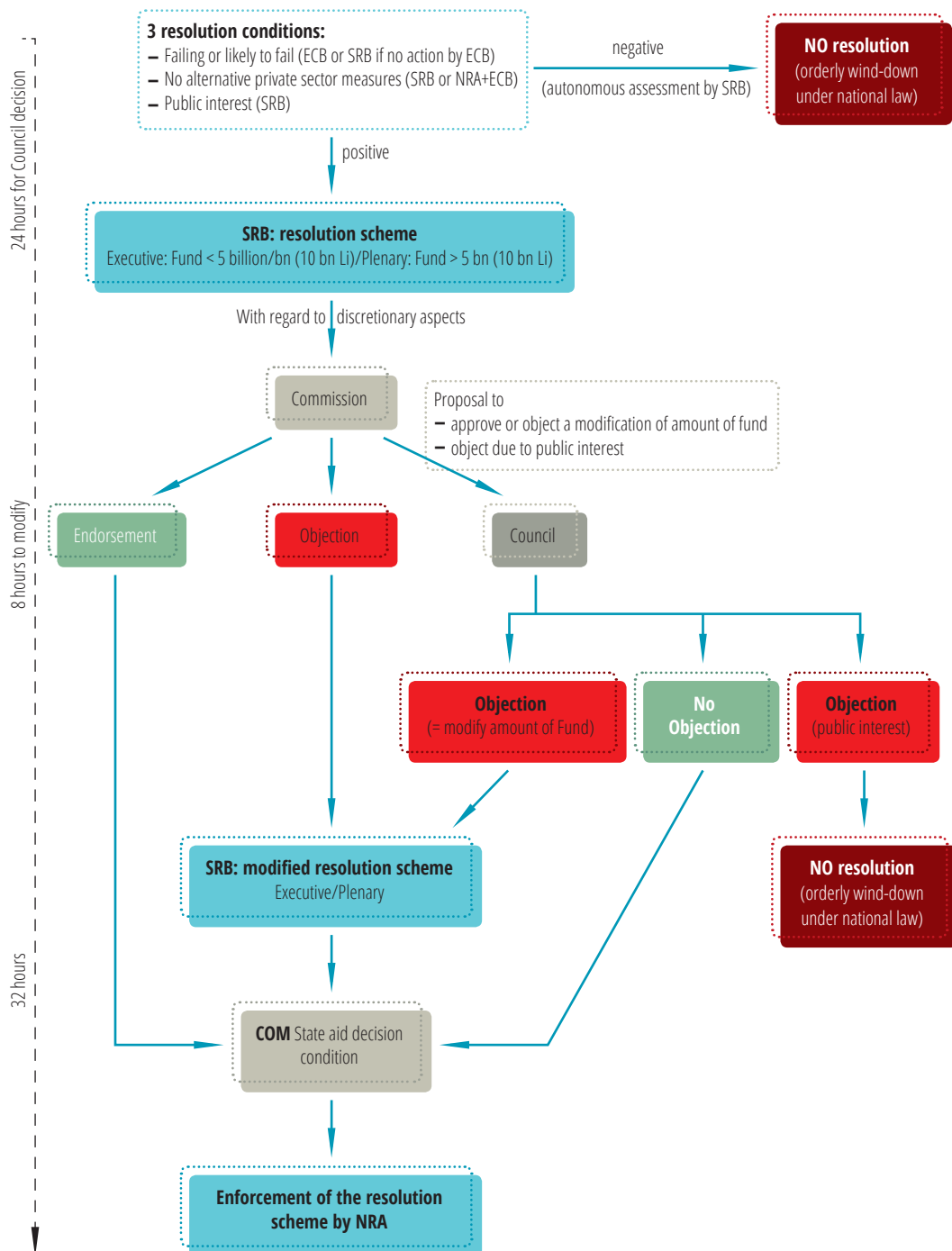
[Article 32](#) of the BRRD sets out a cascade of cumulative conditions that determine whether resolution authorities should take resolution actions (rather than applying regular insolvency law to a failing bank). There are three main requirements. First, it must be determined that the institution is failing or likely to fail (FOLTF). Second, there must be no reasonable prospect that alternative private sector measures would prevent the failure. Third, resolution action must be in the public interest.

The supervisor determines if an institution is failing. The BRRD additionally allows Member States to empower the resolution authority, given its access to the relevant information, to carry out the assessment in addition or as a fallback instead of the supervisor.

An institution shall be deemed to be failing or likely to fail if one of the following four legal prerequisites is met:

- the institution infringes the requirements for continuing authorization in a way that would justify the withdrawal of the authorization;
- the liabilities exceed the assets (“balance sheet” insolvency);

## Overview of SRB decision making process



- the institution is unable to pay its debts as they fall due (illiquidity or “cash flow” insolvency); or
- extraordinary public financial support is required (except in the case of explicitly listed exceptions if confined to a solvent institution under [Article 32 \(4\)\(d\)](#), [see chapter 9](#)).

**The FOLTF definition used under the BRRD is rather vague but gives required discretion to intervene early enough.**

The FOLTF definition used under the BRRD is rather vague (and it will be difficult in practice to define the point of non-viability) but gives the required discretion to intervene early enough. Hard capital ratio triggers might be an additional safeguard but are generally said to be slow in reflecting problems, and institutions may be tempted to underestimate and under-report risk weights. The European Banking Authority (EBA) further elaborates on the circumstances in which an institution will be considered as failing or likely to fail. The EBA guidelines ([EBA/GL/2015/07](#)) set out objective elements relating to the capital and liquidity position of the institution as well as governance arrangements and operational capacity.

**Resolution action must be justified by public interest as regularly it will affect fundamental rights of shareholders and creditors.**

### **The Public Interest Test**

If an institution fulfils the conditions for resolution, the application of resolution actions is likely to affect the fundamental rights of shareholders and creditors. The most prominent provision of the Charter of Fundamental Rights of the European Union that will be invoked is the right to property ([Article 17 of the Charter](#)). The right to an effective remedy and to a fair trial ([Article 47 of the Charter](#)) may also be relevant. A clear and overriding objective is therefore necessary to justify any interference with fundamental rights through the application of resolution tools. In Slovenia, the Court of Justice of the European Union (CJEU) held that burden sharing (bail-in) when required by the European Commission during state aid procedures does not infringe fundamental rights of investors (right to property) when loss absorbance is based on valuation rather than on actual liquidation (see case study in accompanying publication “Bank resolution and bail-in in the EU: Selected case studies pre and post BRRD”). This assessment, one can argue, applies *mutatis mutandis* to bail-in decision under the BRRD. The BRRD addresses this by two main safeguards – the NCWOL test and the public interest test:

Firstly, through the concept that no creditor should be worse off than in liquidation (NCWOL), the BRRD ensures that no creditor incurs a loss greater than if the institutions had gone into liquidation ([see chapter 20](#)).

Secondly, the BRRD provides that resolution action must be necessary in the public interest. The conditions of resolution specify that the resolution authority must conduct a public interest test before a resolution measure can be deployed. The public interest test is benchmarked against BRRD targeted resolution objectives. Resolution action is deemed to be in the public interest only if winding-up the institution under normal

insolvency proceedings would not meet those resolution objectives to the same extent ([Article 32 \(5\)](#)).

The objectives of resolution under the BRRD are manifold, comprehensive, and mainly of a generic qualitative nature: to ensure the continuity of critical functions; to avoid significant adverse effects on the financial system; to avoid, or at least minimize, reliance on extraordinary public financial support (i.e. taxpayer money); and last but not least, to protect deposits, investments and other client funds and assets ([see chapter 4](#)). These objectives set the bar high and make it challenging to assess, ex-ante and under considerable time pressure, if they can be met to the same extent through normal insolvency proceedings. For a concrete example of how the public interest test is specified by way of comparing the achievement of individual selected resolution objectives under resolution and liquidation see the HETA case study in accompanying publication “Bank resolution and bail-in in the EU: Selected case studies pre and post BRRD”. Authorities will also have to consider the impact of not taking resolution action when assessing whether to apply special resolution tools.

**The rather generic resolution objectives are open to interpretation and make it challenging to assess ex-ante if they can be met to the same extent through normal insolvency proceedings.**

The threshold to meet the conditions for resolution set in the public interest test is relatively low and open to interpretation. Resolution authorities may use the discretion provided by the rather abstract and generic definition of public interest under the BRRD and tend towards determining that resolution actions are justified in the public interest. The Bank of England (BoE), for example, has stated that discontinuity of access to transactional deposit accounts or current accounts could alone, in certain cases, substantiate public interest. The BoE argues that certain account holder’s reliance on daily access to their funds may mean that even a payout within seven days, as provided for by the deposit guarantee scheme, would constitute a serious problem and could justify the taking of resolution action. Following such reasoning and wide interpretation of the public interest test, resolution actions for deposit-taking banks would be justified in the public interest even if the failure of the institution was not considered a risk to the (national) financial system if the seven day payout period is considered not to ensure the same adequate protection of depositors as the taking of resolution action. For an example how the public interest was justified in one of the first resolution cases under the BRRD framework see the Heta case study (in accompanying publication “Bank resolution and bail-in in the EU: Selected case studies pre and post BRRD”) where resolution was considered appropriate inter alia because essential services could not be ensured to the same extent and with the same legal certainty under liquidation; the bankruptcy would have likely had considerable negative effects on financial stability in Austria as well as two other EU countries because the objective of protecting public funds could not be achieved to the same extent in a bankruptcy proceeding.



Depending on the practical interpretation and application of the “public interest” definition, it seems credible that resolution could be deemed to be in the public interest as a general rule in line with the BRRD. Under a wide interpretation of the public interest test, only the smallest banks (if at all) may be determined not to fulfil the conditions and be wound down under normal insolvency proceedings. Serious care must therefore be taken in order to justify resolution actions, and potential consequential interference with fundamental rights, and the use of resolution financing arrangements.

**If an institution is deemed not to be in the public interest during the ex-ante planning phase this should, as a rule, indicate that resolution is not deemed to be in the public interest. The BRRD’s flexible approach, however, allows ad hoc circumstances to justify public interest in the actual case of crisis.**

### **Further Specifying Public Interest**

A slightly alternative approach to limit and more concretely define the public interest test would have been to provide that the winding-up of an institution under normal insolvency proceedings must not endanger financial stability and that resolution is in all cases required to protect financial stability, a concept used in other contexts in the BRRD. For example, the resolution authority may only justify an exception from marketing requirements under the sale of business tool if, inter alia, the marketing requirements would undermine one or more resolution tools, plus if otherwise a material threat to financial stability would arise ([Article 39 \(3\)](#)). The EBA concludes that the concept of ‘material threat’ corresponds to the public interest test and provides an indicative list of circumstances to give further guidance to resolution authorities.

Another approach to the public interest test relates to resolution planning. [Article 4](#) of the BRRD refers to the possibility of winding up an institution under normal insolvency proceedings. Resolution planning and public interest should match. If an institution is deemed not to be in the public interest during the ex-ante planning phase, and is therefore eligible for simplified obligations or a low level of detail in contingency planning, this should, as a rule, indicate that resolution is not deemed to be in the public interest and this judgment should hold when it comes to a failure of the institution. The BRRD’s flexible approach however allows for ad hoc circumstances, not foreseeable in the planning phase, which justify public interest in the case of crisis.

**If no agreement can be found each resolution authority may apply its own resolution action for the respective entity under its jurisdiction.**

### **Adoption of a Group Resolution Scheme**

In principle under the BRRD each resolution authority is responsible for the entity under its jurisdiction and takes an individual decision on whether to start the resolution process or not and which resolution tools to apply. The taking of resolution action in one jurisdiction could impact other parts of a group, with the result that they may also be likely to fulfill the conditions for taking resolution action. In this case, within 24 hours of receiving notice from the national resolution authority of impending resolution action the group level resolution authority must decide on and share a group resolution scheme with all supervisory college members. A group resolution scheme outlines the resolution actions to be taken by the relevant national resolution authorities (or the SRB) in relation to the EU

parent and or particular group entities. A group resolution plan will normally have been reached ex-ante ([see chapter 10a](#)). Ideally also a common understanding on burden sharing arrangements and a financing plan is already in place ([chapter 21](#)). The general principles on cross-border resolution laid down in [Article 87 BRRD](#) oblige the authorities concerned to cooperate closely. There is however no legal certainty provided under the BRRD that a group resolution plan will be enacted as foreseen and that a common cross-border resolution strategy will be applied. The adoption of a group resolution scheme decision is not guaranteed. Cooperation in the supervisory college is stipulated when either a subsidiary or when a group parent company meets the conditions for resolution, and EBA may assist in reaching a joint decision on the group resolution strategy. In the end, however, each resolution authority may take its own decision for reasons of financial stability, and is obliged to provide a detailed reasoning. Obviously, the resolution authorities which reach a joint decision may go ahead covering the part of the group under their respective jurisdictions ([Articles 91 and 92](#)).

### **Adoption of a Resolution Scheme Under the SRM**

Within the euro area under the SRM, it is normally for the ECB to decide if a bank is considered FOLTF, after consulting the SRB. The SRB may exceptionally also determine that a bank is considered FOLTF if it has informed the ECB of its intention to do so and the ECB has not reacted within three days (Art 18 SRMR).

The SRB decides first if the conditions for taking resolution action are fulfilled (without veto powers in case of negative assessment, see below) and second on the application of a resolution strategy. Only the SRB can determine that all conditions for resolution are met, the European Commission and the Council of the European Union have no powers in this regard. If the SRB makes an initial positive determination that resolution is in the public interest and should go ahead it is, however, then possible for the European Commission to propose that the Council object to the proposed resolution scheme. The European Commission and the Council have power to veto approval of the SRB's resolution strategy. The proposal is transmitted to the Commission, which can within 24 hours either endorse the resolution scheme, object to it, and/or amend it "with regard to the discretionary aspects of the resolution scheme". The Council's involvement depends on the Commission's proposal to act and it may object or approve the SRB Boards positive assessment on the public interest and/or the use of the Resolution Fund. In case of an objection, the SRB has eight hours to modify the resolution scheme. If the Council objects because it considers taking resolution action not to be justified in light of the public interest test, the procedure is stopped and the entity wound down under regular national insolvency procedure. If there are no objections, the resolution scheme enters into force (see graph for an outline of the decision making process under the SRM above).

**The SRB, being responsible for all entities of a group within the euro area, adopts a resolution scheme within the SRM. Veto powers are attributed to the Commission and the Council. Implementation is the responsibility of national resolution authorities applying national law.**

Once approved, the implementation phase starts. The local national resolution authorities (NRAs) are responsible for implementing the tools set out by the resolution scheme. A proper and comprehensive transposition of the BRRD into national law is key to enabling local authorities to act with full powers and ensure coherent application of resolution tools (the NCWOL test for example is based on the respective national insolvency laws, [see chapter 20](#)).

**Relevant documents**

- [EBA/GL/2015/07 Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32\(6\) of Directive 2014/59/EU](#)
- [EBA/GL/2015/04 Guidelines on the sale of business tool](#)
- [EBA/GL/2014/09 Guidelines on the types of tests, reviews or exercises that may lead to support measures under Article 32\(4\)\(d\)\(iii\) of the Bank Recovery and Resolution Directive](#)
- [HM Treasury, Banking Act 2009: special resolution regime code of practice, March 2015](#)

**Cumulative conditions for resolution actions**



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**RESOLUTION ACTIONS**

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**IF ONE OF THE THREE CONDITIONS IS NOT MET:**

Winding up of institution under regular insolvency procedure or other crisis management tools

# RESOLUTION TOOLS AND LEGAL SAFEGUARDS

## CHAPTER 15: THE BAIL-IN TOOL

By Jeremy Jennings-Mares

### KEY QUESTIONS

- Does bail-in apply to each and every resolution case?
- Can all creditors/instruments be bailed-in? Will insured deposits be bailed-in?
- Are there any exemptions from bail-in?
- Who defines the amount of bail-in?

### [ART. 43–55 BRRD](#)

Bail-in is the most innovative of the tools given to resolution authorities by the BRRD in the context of bank resolution. Under bail-in, losses are imposed on owners and creditors of a failing bank, rather than on taxpayers under a “public bail-out”. The bail-in tool achieves loss absorption by either converting the liability into a common equity instrument, such as a share, or by writing down or writing off the principal amount of the liability (both are a form of a “bail-in”).

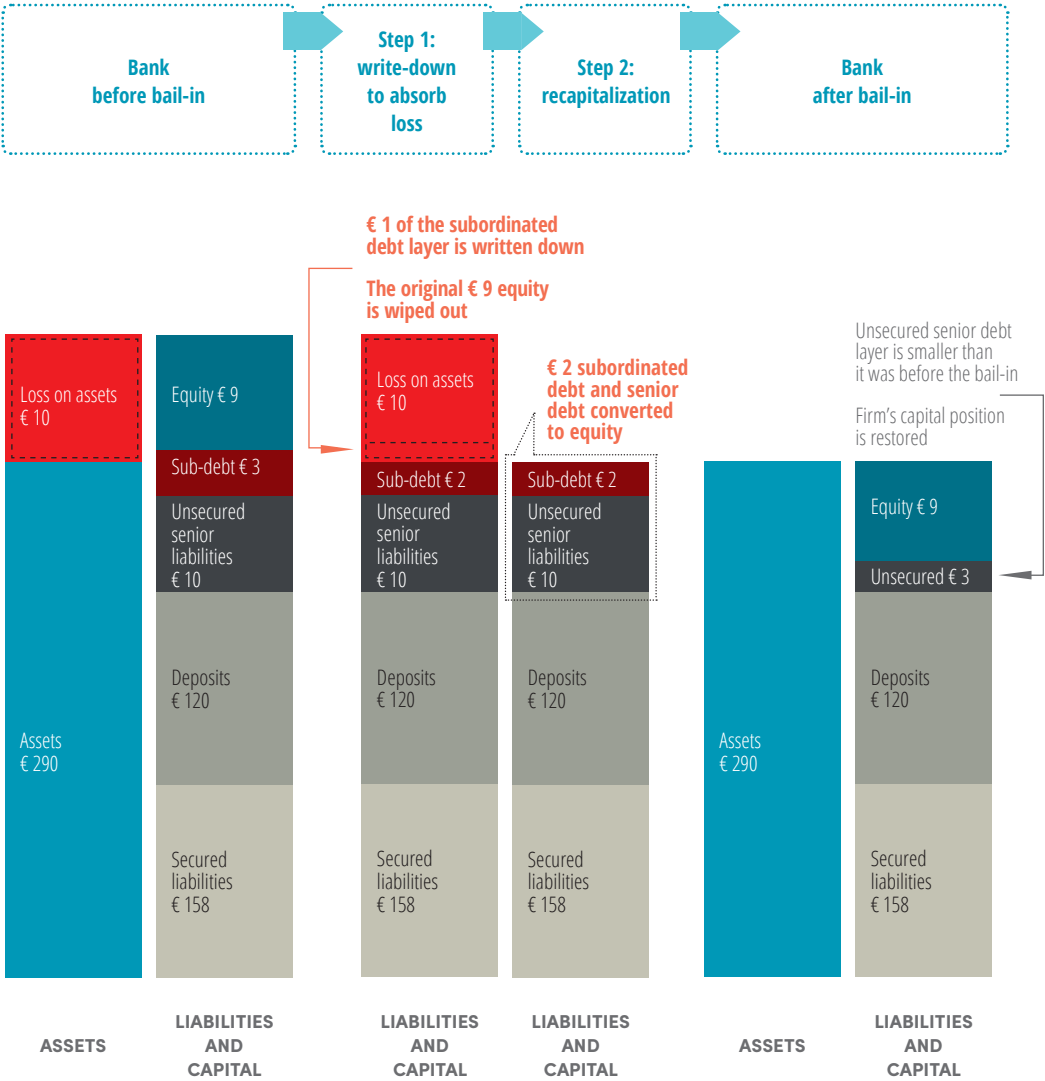
Under bail-in, losses are imposed on owners and creditors of a failing bank, rather than on taxpayers under a “public bail-out”.

### Why and How the Bail-In Tool Is Used

Bail-in can be defined as the statutory imposition of losses on liabilities of a financial institution where such liabilities are not designed, by their terms, to absorb such losses outside of an insolvency procedure. The first possible use of the bail-in tool under the BRRD is to capitalize an institution under resolution (“open bank bail-in”). The recapitalization amount would equal the aggregate amount according to the resolution valuation ([see chapter 12](#)) necessary to absorb all losses and also restore and maintain the institution’s compliance with its authorization conditions for at least one year, as well as sustain market confidence in the institution. The second possible use of the bail-in tool is to reduce the principal amount of, or convert into equity, claims or debt instruments transferred to a bridge institution (in order to provide capital for that bridge institution),

The bail-in tool achieves loss-absorption by either converting the liability into a common equity instrument, such as a share, or by writing down or writing off the principal amount of the liability.

Example of loss absorption and recapitalization in a bail-in



or claims or debt instruments that are transferred under the sale of business tool or the asset separation tool. It is worth noting that, as their debt claims are converted into equity instruments, the holders (in principle) will benefit from future profits of the relevant entity, whether from the payment of dividends or an increase in value of the equity instruments.

The conversion to equity could be achieved, in practice, by the following steps: i) the resolution authority could issue certificates of entitlement to creditors holding liabilities subject to bail-in; ii) the title to all the existing shares could be transferred to a depository to hold on behalf of the certificate holders; iii) once the resolution valuation has been completed, and the final terms of the conversion/write-down have been determined, the certificates of entitlement would be exchanged for the new shares. One possible result of such a bail-in is a change of control of the bank in resolution, in which case the approval of the bank's supervisory authority would be required, following an assessment of whether the new owner is a "fit and proper" person to have control of a bank.

See example illustrated above for a theoretical example of the loss-absorption and recapitalization elements of a bail-in action.

### Scope of Bail-In Tool

The BRRD provides that the bail-in tool can be applied to all liabilities that are not expressly excluded from the scope of bail-in. The following liabilities are expressly excluded:

- covered deposits, i.e. deposits up to the amount covered by a deposit guarantee scheme (DGS) (the DGS pays in lieu, [see chapter 22](#) on use of a DGS);
- liabilities in respect of holding client assets or client money, where the client is protected under applicable insolvency law;
- liabilities resulting from a fiduciary relationship, where the beneficiary is protected under applicable law;
- liabilities to other financial institutions (outside the group of the institution in resolution) with an original maturity of less than seven days;
- liabilities with a remaining maturity of less than seven days, owed to payment or securities settlement systems or their participants;
- employee remuneration or benefits (other than variable remuneration);
- liabilities to commercial or trade creditors relating to the provision of critical goods or services;
- liabilities to tax and social security authorities that are preferred by law;
- liabilities for contributions to deposit guarantee schemes; and
- liabilities to the extent they are secured, including covered bonds and hedging instrument liabilities of the covered bond issuer.

**All liabilities not expressly excluded by law are in principle bail-inable.**

Deposits and secured liabilities both have only partial exemption from the bail-in tool. Deposits are excluded only to the extent that they are covered

**In exceptional circumstances, bail-inable instruments (within the same creditor hierarchy rank) might be excluded upon the decision of the resolution authority.**

by a DGS. Any amount of the deposit liability in excess of the amount covered by the scheme could, therefore, potentially be bailed-in. Secured liabilities are only excluded from bail-in to the extent of the value of the collateral securing the liability. If the liability has a greater value than the collateral securing it, the difference in value could potentially be bailed-in.

In addition to the above list of excluded liabilities, the BRRD provides that, in exceptional circumstances, the resolution authority may wholly or partially exclude certain liabilities from bail-in, where:

- it is not possible to bail-in the liability within a reasonable timeframe (this could potentially apply to derivatives liabilities, which can be very difficult to value in a short space of time); or
- the exclusion is necessary and proportionate to achieve continuity of critical functions and core business lines; or
- the exclusion is necessary and proportionate to avoid widespread contagion that would disrupt the functioning of financial markets, in particular as regards deposits held by individuals and micro, small and medium size enterprises; or
- bailing-in the liability would cause higher losses to other creditors than not bailing it in.

Where a resolution authority decides to exclude all or part of an eligible liability from bail-in, it may increase the level of write-down or conversion applied to other bail-inable liabilities to take account of such exclusion, provided that the other creditors would not suffer greater losses than they would have under normal insolvency proceedings. This provision (the no creditor worse off than under liquidation (NCWOL) principle, see [chapter 20](#)) represents one of the key principles that must be observed by resolution authorities when applying resolution tools. Following application of the bail-in tool and any other applicable resolution tools, a further valuation (separate from the resolution valuation carried out for the purpose of determining the extent to which resolution tools should be applied) will be carried out in order to determine whether any creditor has in fact suffered losses greater than they would have incurred in a normal insolvency proceeding.

### **Prior Bail-In Before the Use of Resolution Financing Arrangements and Public Support**

Where an otherwise bail-inable liability is excluded by the decision of the resolution authority (see above), and the consequential non-absorbed losses are not fully passed on to other creditors, a contribution can be made by the resolution financing arrangement to cover any unabsorbed losses and restore the net asset value of the institution to zero, and/or to purchase shares or capital instruments in the institution in order to recapitalize it sufficiently to restore its Common Equity Tier 1 capital ratio.

Both government support ([see chapter 21b](#)) and use of the resolution financing arrangement ([see chapter 21a](#)) are conditional inter alia upon prior 8 % bail-in. Loss-absorption for an institution under resolution is only allowed where the institution's own funds, capital instruments and eligible liabilities have together already absorbed losses of at least 8 % of the institution's total liabilities (including own funds) measured pursuant to the valuation triggering resolution (Valuation 1).

**Government support and the use of the Resolution fund are conditional on prior 8 % bail-in**

It may not always be clear-cut what is "loss absorbance" (direct or indirect) and for which purposes the resolution financing arrangement could be allowed to contribute without fulfilling the prior 8 % bail-in requirement. The relevant issue is whether losses are absorbed, no matter if directly or indirectly (whether in the present or in future). The principles of [Article 44](#), including the prior 8 % bail-in obligation, should therefore be a prerequisite also in the context of impaired asset measures including guarantees, for example, used to bridge a valuation gap on off-market terms to the bridge bank or an acquirer.

The 8 % over total balance sheet has to be measured when the resolution is initiated (based on Valuation 1), i.e. at the point of failing or likely to fail (FOLTF). The 8 % is calculated against "total liabilities including own funds", which are always the same as assets, except where there is negative equity; in such case a calculational limit at zero own funds would have to be drawn in order to exclude distortive effects. Another aspect to consider (including when setting MREL, [see chapter 11](#)) is to account for potential deteriorations: as the balance sheet at the point of taking resolution action will "count", the bail-inable base will likely be reduced (and the equity to assets ratio will have dropped). This could for example have an effect on the feasibility of excluding certain liabilities from bail-in as planned.

It is also worth noting the difference between equity instruments and debt instruments under bail-in. While the value of the equity instruments may change (i.e. because of accounting losses) the value of hybrid debt instruments with loss-absorbing capacity will usually not change (unless they are fair-valued, which is theoretically possible according to IAS39 but unlikely). Hence, Tier 2, unsecured debt instruments and also Additional Tier 1 (AT1) instruments would preserve their book value pre-resolution. This could be an argument in favor of issuing more debt instruments in addition to equity (as required under the TLAC rules).

### **Loss-Absorption Priorities and Bail-In Hierarchy**

Now that the bail-in provisions of the BRRD are fully in effect, an institution under resolution will potentially have a large variety of instruments that can be used to absorb losses, but it is a key principle of the BRRD that losses are imposed on capital instruments and eligible liabilities in a prescribed order. Shareholders must bear the first loss and thereafter creditors must bear losses according to the priority that would apply in

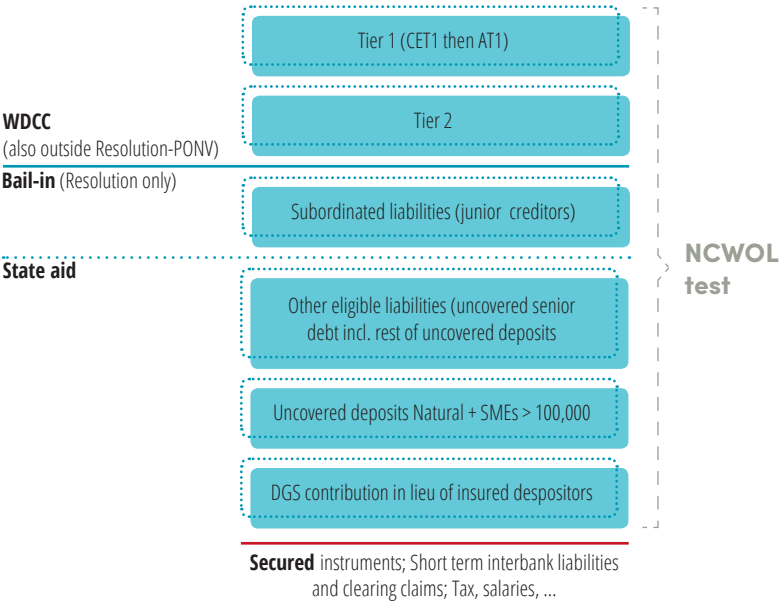
**The loss absorption order is aligned with the priority applicable in normal insolvency proceedings, in order to adhere to the NCWOL principle.**



normal insolvency proceedings. The prescribed order is intended to be aligned with the priority applicable in normal insolvency proceedings in order to adhere to the NCWOL principle. However, it is worth noting that the insolvency laws of the different EU member states are not harmonized. Therefore, it is important that each member state takes action to ensure that its laws regarding the priority of claims in an insolvency proceeding are not inconsistent with the provisions of the BRRD. A specific example of this is provided in [Article 108](#) of BRRD. This Article mandates Member States to ensure that deposits of individuals and micro, small, and medium enterprises that would be eligible for coverage under a DGS if they did not exceed the relevant coverage level, will have a preferred status above other unsecured non-preferred creditors. This ensures that if such deposits are excluded from a bail-in (as they are reasonably likely to be), the exclusion would not automatically give rise to potential claims from other unsecured non-preferred creditors under the NCWOL principle.

Therefore, regulatory capital instruments (Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments) will be written down or converted first (to the extent these were not already written down prior to the resolution [see chapter 13](#) on WDCC), followed by other subordinated debt instruments, and finally those senior unsecured liabilities subject to the bail-in tool.

Table: Bail-in Cascade



### **Minimum Requirement for Own Funds and Eligible Liabilities (MREL)**

To deter institutions from structuring their borrowings to be immune from the bail-in tool, the BRRD provides that resolution authorities must set a minimum required level of loss-absorbing liabilities (MREL) to be held by each institution (in its jurisdiction), expressed as a percentage of the aggregate of an institution's own funds and total liabilities. MREL will consist broadly of own funds (i.e. regulatory capital) and bail-inable liabilities. That said, some liabilities theoretically eligible for bail-in (such as derivative liabilities and structured securities) are likely not to count towards an institution's MREL, due to doubts as to how easily those liabilities could be bailed-in in an actual resolution scenario ([see chapter 11](#)). The specifications by each resolution authority of the required characteristics of MREL could be influenced by the desire to limit systemic instability and any contagion effects of the bail-in, as well as to limit the negative impact on non-professional creditors.

**The setting of MREL by the resolution authority could be influenced by the desire to limit any contagion effects and negative impact of the bail-in on non-professional creditors.**

### **Cross-Border Contractual Recognition of Bail-In**

Where a bail-inable liability is governed by the laws of one of the EU Member States, the courts of that governing law jurisdiction should support and enforce a resolution action (including a bail-in) of the institution's resolution authority. However, there is some doubt as to whether the courts of the governing law jurisdiction would necessarily give effect to the resolution actions of an EU resolution authority where that governing law jurisdiction is outside the EU and therefore not automatically bound to give effect to such action. Even within EU Member States, past cases have shown that courts are reluctant to recognize resolution decisions not fully covered by the scope of the BRRD (for examples see accompanying publication "Bank resolution and bail-in in the EU: Selected case studies pre and post BRRD"). As a result, the BRRD provides that where the liability is governed by non-EU law, it must contain in its terms provisions by which the creditor acknowledges that the liability may become subject to bail-in action and agrees to be bound by any resulting conversion or reduction in principal amount of the liability. Such contractual recognition is however not a prior requirement for EU authorities to apply bail-in.

**Where the liability is governed by non-EU law, its terms must contain provisions by which the creditor agrees to be bound by bail-in and any resulting conversion or reduction in principal amount of the liability.**

### **Bail-In Treatment of Unsecured Debt Instruments**

In a bail-in action, unsecured debt instruments would usually represent the majority of the liabilities being bailed-in, particularly if regulatory capital liabilities had already been converted or written down ([see chapter 13](#) on WDCC). Such bail-in could be imposed on the relevant creditors by the resolution authority or might be effected by the exercise of rights embedded in the terms of the instrument itself, such as contingent convertible (or CoCo) bonds, to the extent that the loss absorption provisions of these instruments had not already been triggered.

### **Bail-In Treatment of Shareholders**

In a bail-in action, any existing shares are to be cancelled or transferred to bailed-in creditors. Where, under the resolution valuation, the institution has a positive net asset value, existing shareholders are to be severely diluted by conversion of existing capital instruments or conversion of eligible liabilities.

**The BRRD gives resolution authorities the power to terminate and close out derivative contracts and apply bail-in.**

### **Bail-In Treatment of Derivatives**

A derivative liability may be bailed-in (to the extent that it is not secured by collateral) only once the derivative contract has been terminated and closed out, and the BRRD gives resolution authorities the power to do this. Assuming that it is subject to a netting agreement, such as the International Swaps and Derivatives Association (ISDA) Master Agreement, the liability should then be valued on a net basis (as part of the resolution valuation) and otherwise in accordance with prescribed regulatory technical standards on the methodologies and principles for valuing derivatives liabilities. These technical standards, whilst respecting the netting sets established by the institution's derivatives contracts, prescribe a uniform approach to establishing the replacement cost of the terminated transactions, irrespective of the terms of the individual contracts.

**Resolution authorities must have powers to complete all administrative procedures and remove any procedural impediments to bail-in.**

Whether a derivative contract is ultimately bailed-in or not, the BRRD provides the resolution authority with the power to suspend the termination rights of parties to contracts with the institution under resolution until midnight on the business day following official notice of the resolution action. This power will apply as long as all obligations regarding payments, deliveries and collateral exchange are up-to-date. This power is intended to ensure that a resolution authority's attempts to achieve an orderly resolution are not thwarted by a market panic, sparked by derivatives counter-parties attempting to protect their positions with the institution.

The International Swaps and Derivatives Association (ISDA) has also published the ISDA 2015 Universal Resolution Stay Protocol which achieves, for those parties adhering to it, a contractual agreement to be bound by such a suspension of termination rights by a resolution authority. This Protocol therefore represents an international solution to the problem of recognition of suspension action by the resolution authorities of foreign jurisdictions.

**A business reorganization plan must be prepared for the recapitalized institution within one month of the application of the bail-in tool.**

### **Reorganization**

A business reorganization plan must be prepared for the recapitalized institution by its management body, or other person appointed by the resolution authority, and submitted to the resolution authority within one month of the application of the bail-in tool. Within one month after such submission, the resolution authority and the relevant supervisory authority must assess and agree whether implementation of the business

plan would restore the long term viability of the institution, or whether amendments are needed to the plan in order to achieve this.

### **Ancillary Bail-In Provisions**

Resolution authorities have also been given powers by the BRRD to complete all administrative procedures needed to give effect to the exercise of the bail-in tool including amending registers, delisting securities, admitting new securities to trading and relisting any debt securities that have been written down (without the need for an EU Prospectus Directive-compliant prospectus). They also have powers to remove any procedural impediments to bail-in, for example by ensuring that an institution maintains at all times a sufficient amount of authorized share capital to give effect to any conversion.

This enables new shares to be issued without the need for a shareholder resolution or any change to the bank's constitutional documents. Several Member States have also provided in their national implementing laws that a resolution authority may override or ignore corporate law and contractual requirements, such as registration requirements and pre-emption rights, in relation to the issue of new shares in a bail-in action.

### **Relevant documents**

- [EBA/RTS/2015/06 Draft Regulatory Technical Standards on the contractual recognition of write-down and conversion powers under Article 55\(3\) of Directive 2014/59/EU](#)
- [EBA/CP/2014/39 Consultation on Guidelines on the rate of conversion of debt to equity in bail-in](#)
- [EBA/CP/2014/29 Draft Guidelines concerning the interrelationship between the BRRD sequence of write-down and conversion and CRR/CRD IV](#)
- [EBA/CP/2014/40 Draft Guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments](#)
- [EBA/RTS/2015/12 Final Report Draft Regulatory Technical Standards and Guidelines on business reorganization plans under Directive 2014/59/EU](#)
- [Commission Delegated Regulation \(EU\) 2016/1075 supplementing Directive 2014/59/EU](#) with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges
- [EBA/RTS/2015/06, Final Report Draft Regulatory Technical Standards on the contractual recognition of write-down and conversion powers under Article 55\(3\) of Directive 2014/59/EU](#)

- [Commission Delegated Regulation \(EU\) 2016/860](#) specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under [Article 44\(3\)](#) of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms

# CHAPTER 16:

# THE SALE OF BUSINESS TOOL

By Maria Hormaeche Lazcano

## KEY QUESTIONS

- Under what conditions is the sale of business tool applied?
- Is a public bidding process required in all cases? Is a fit and proper assessment needed?
- What phases will be implemented in a standard sale of business process?
- What types of sale are possible?

[ART. 38, 39 BRRD](#)

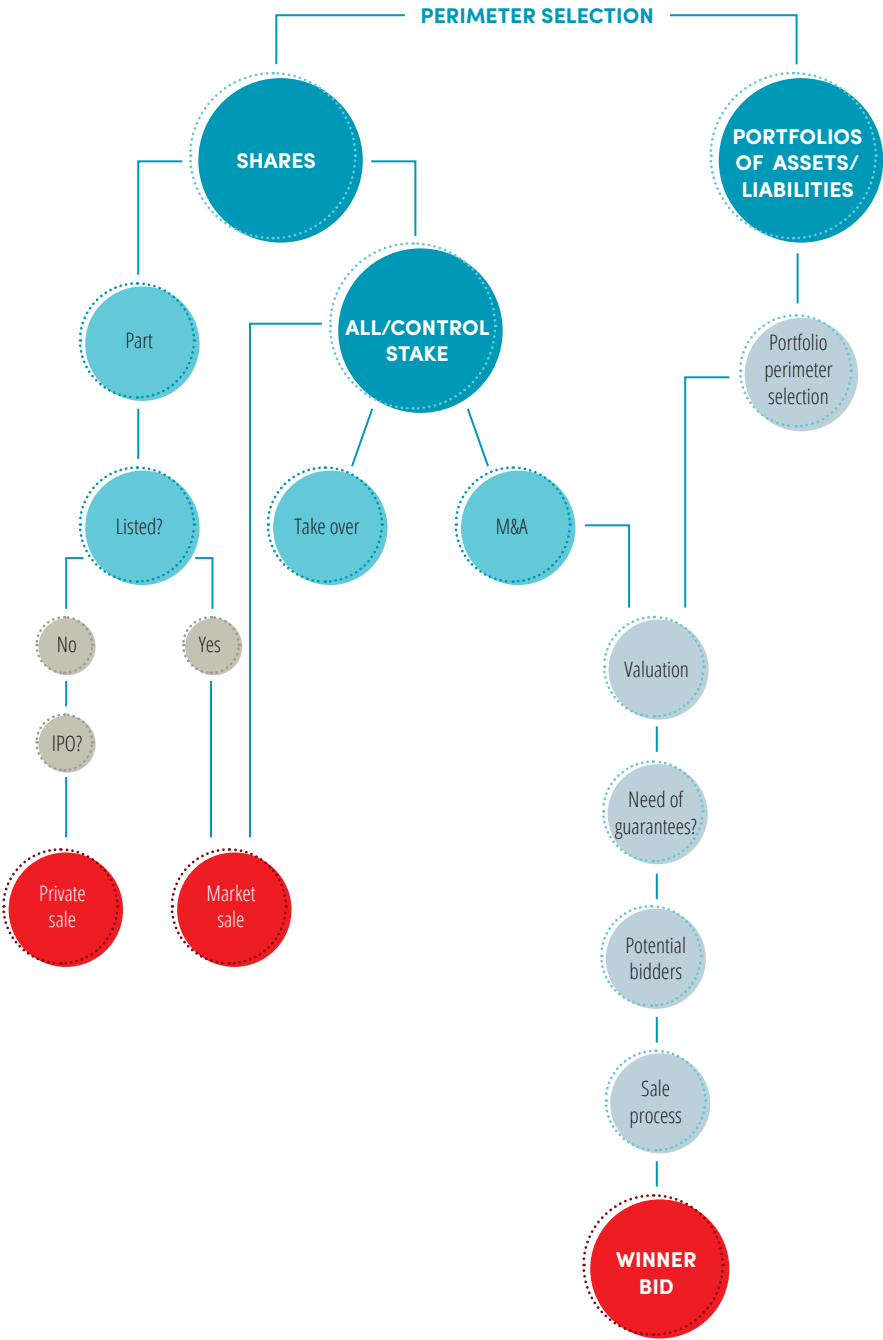
The sale of business tool enables resolution authorities to sell the institution (or parts of its business) to one or more purchasers with or without the consent of shareholders. The resolution authority has the power to transfer shares or other instruments of ownership issued by an institution under resolution; and all or any assets, rights or liabilities of an institution under resolution to a purchaser that is not a bridge institution. The sale of business tool may be applied individually or in combination with other tools ([Article 37 of BRRD](#)). As with the use of any resolution tools, its use must promote the resolution objectives ([Article 31 of BRRD](#)).

The sale of business tool enables resolution authorities to sell the institution (or parts of its business) to one or more private purchasers (without the consent of shareholders).

The price of the entity will be based on a fair, prudent and realistic valuation of the assets and liabilities ([see chapter 12](#)). The sale proceeds shall benefit either the owners of the entity in resolution or cover the cost of resolution as appropriate. The former would mean that if shares were sold and bail-in was applied, the transfer price would minimize losses for shareholders and creditors. If assets (and liabilities) are transferred, the residual entity under resolution will receive the proceeds.

When the sale of business tool is used to transfer parts of assets, rights and liabilities, the residual entity shall be wound down under normal insolvency proceedings. This should be completed within a reasonable timeframe taking into account the need: i) for the institution to provide services or support to the purchaser to meet the resolution objectives, especially to maintain the continuity of critical economic functions; ii) to ensure assets or liabilities chosen for sale do not adversely impact the financial system or contribute to contagion in any way; and iii) to protect depositors, client funds and client assets.

Sale of Business Tool



### The Sale of Business Process and Practical Considerations

When applying the sale of business tool, authorities should arrange to market the whole or the saleable part of the institution in an open, transparent, and non-discriminatory process with the aim to maximize, as much as possible, the sale price.

Transparency is important. All relevant information on the sale process and the institution under resolution must be given in the same way and at the same time to potential purchasers, for example vendor due diligence and information regarding the entity, decisions to be taken, and changes adopted during the sale process. To achieve the highest possible sale price within the allocated timing, the sale might be promoted as a competitive tendering process open to all relevant potential domestic and international investors. The process should clearly define the phases and conditions to fulfil and give potential investors the same opportunities, tools, and access to information to assess possible investment in the institution in resolution.

If, for reasons of urgency or potential effects on financial stability (e.g. flow of deposits, loss of franchise value), a full marketing process is not possible, authorities should take steps to redress detrimental effects on competition and on the internal market. This applies even during the resolution weekend. If urgency prevents a full sale process, preselected potential buyers must have passed a fit and proper assessment and the sale will be materialized once the entity has been declared failing or likely to fail.

Preparations for marketing should not increase the risk of the entity entering resolution. European Banking Authority marketing requirements guidelines determine the extent to which deviation/non-compliance can be justified in order not to undermine the effectiveness of the sale of business tool ([see chapter 16](#)) and the achievement of the resolution objectives. To maintain confidence and trust in the market, and in light of contagion risks, a shortened and simplified process can be applied. For example, the bidding can be restricted to pre-selected potential purchasers considered more likely to ensure financial stability due to their market size, structure, business model etc. than others. Incentivizing purchasers and limiting their risk, for example by providing guarantees (via the resolution fund) should also be considered to help achieve a timely transaction.

Contacts with potential purchasers may be initiated in advance to prepare the entity for resolution, subject to the conditions laid down in [Article 39\(2\)](#) and the confidentiality provisions in [Article 84](#). Authorities should have pre-prepared sale of business draft contracts available to ensure fast decision-taking in case of need.

**To achieve the highest possible sale price within the allocated timing, a competitive tendering process open to all relevant potential domestic and international investors is expected. However, if urgency prevents a full sale process, preselected potential buyers must have passed a fit and proper assessment and the sale will occur once the entity has been declared failing or likely to fail.**



A standard sales process will generally take several months. Only for lean institutions where no due diligence may be required could the sale possibly be completed during the resolution weekend.

### Phases of the Sale Process

In the case of a lean entity, whose information facilitated in the data-room is adequately proven to be true, which has a clear value of assets and liabilities, and no anticipated contingencies (and therefore no expected granting of guarantees), due diligence may not be required and the sale could possibly be completed during 'the resolution weekend'.

In most cases the process will take several weeks or even months. Depending on the specific situation, including the complexity and size of the bank, the following different phases could be considered (although each case is unique and not all will be appropriate in each case):

1. **Due diligence:** commonly undertaken by a contracted auditor;
2. **Preliminary survey of potential investors:** to help determine interest and generate momentum for the sale;
3. **Virtual data room:** the more comprehensive this stage, the better for competitiveness and sale price;
4. **Expressions of interest:** potential purchasers will be invited to express their interest and demonstrate their compliance with the prequalification criteria;
5. **Non-binding offers phase:** potential prequalified purchasers are invited to submit a non-binding offer. This should include reference to any guarantees, for example: legal contingencies, court rulings, breaking bank-assurance joint-ventures, mis-selling products, financial guarantees, Asset Protection Schemes, or liquidity facilities. It is very difficult to sell a big entity with no guarantees so the valuation of the offers received, with different schemes and proposals, give an additional challenge to the process and particularly to the valuation of offers;
6. **Binding offers:** potential purchasers whose non-binding offers were selected in the previous phase will be invited to submit binding offers which may be in a number of rounds and may include negotiations. The opening of more than one round in order to receive improved offers may maximize the price and ensure that the sale is conducted under a transparent and competitive process;
7. **Final decision:** this supposes the selection of preferred offer(s), negotiation by the institution and signature of a Sale and Purchase Agreement. The actual transfer price will, in practice, eventually diverge from Valuation 2 which informs the decision on the use of the resolution tool and provides an indicative transfer price ([see chapter 12](#));
8. **Enforcement of the final decision:** this would include formal notification to the European Commission under the competition and state aid rules, if applicable ([see chapter 14](#) regarding the Commission's involvement in a decision of the Single Resolution Board).

Specific circumstances of the individual case and time constraints will determine which and how many phases of the sale process are necessary and achievable. While the sale process should be initiated in an open and

transparent manner, it is of utmost importance that the process takes into consideration confidentiality concerns to preserve financial stability and the value of the entity under resolution. In this sense, all potential purchasers and their advisors should sign a non-disclosure agreement (NDA).

### Types of Sales

The resolution authority can choose to develop various types of sales. A specific structure might be designed for selling a portfolio of assets and liabilities, for example a special purpose vehicle (SPV). The sale of ownership of the entity can be achieved through shares. Full control of the entity can be sold via a merger and acquisition transaction; or partial ownership with the provision that if in the future it is listed or goes through an initial public offering there will be a market sale or a future corporate transaction.

A reverse transfer can be provided for and assets (and liabilities) moved back to the entity under resolution or to the bridge bank if, following the sale, additional details come to light on the quality of the transferred assets. This reverse transfer option will increase the entity's solvability and the chance of finding a private sector purchaser within a short(er) period of time. The resolution financing arrangements can include reverse transfer guarantees to the buyer in the sale contract.

The resolution authority can choose to develop various types of sales: a special purpose vehicle; the creation of shares; M&A transaction; etc.

The resolution financing arrangements can include reverse transfer guarantees to the buyer in the sale contract.

### Relevant documents

- [EBA/GL/2015/04 Guidelines on the effectiveness of the sale of business tool on factual circumstances amounting to a material threat to financial stability and on the elements related to the effectiveness of the sale of business tool under Article 39\(4\) of Directive 2014/59/EU](#)
- [EBA/GL/2015/06 Guidelines on the minimum list of services or facilities that are necessary to enable a recipient to operate a business transferred to it under Article 65\(5\) of Directive 2014/59/EU](#)
- [EBA/Op/2015/15 on Article 76 BRRD \(protected arrangements\), Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer](#)

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# CHAPTER 17:

## THE BRIDGE INSTITUTION TOOL (BRIDGE BANK)

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By Maria Hormaeche Lazcano

### [ART. 40, 41 BRRD](#)

The bridge institution tool is controlled by the resolution authority and authorized by the supervisors. It aims to bridge time (up to two years) and preserve the critical functions of the failing bank until a private sector solution is found.

### KEY QUESTIONS

- When is a bridge institution created?
- How is one created?
- Is there a maximum duration of a bridge institution?
- How are bridge institutions financed?
- Can a bridge institution be (fully) owned by private shareholders and creditors?

The bridge institution tool aims to bridge time until a private sector solution is found, preserving the critical functions of the failing bank. The tool allows for the transfer of: a) instruments of ownership issued by one or more institutions under resolution (share transfer); and/or b) all or any assets, rights or liabilities of one or more institutions under resolution (property transfer) – depending on the corporate structure of the entity under resolution – to a bridge institution.

A temporary bridge institution (also known as a bridge bank) is created and, for up to two years, critical functions will be maintained while a sale to a private purchaser, of either the whole or part, can be concluded. Any residual part of the bank that has not been sold is then wound down in an orderly manner. A bridge institution may be created in advance as a “shelf corporation” in order to respond more quickly to critical situations in case of need.

The bridge institution must be wholly or partially owned either through direct state ownership or the resolution financing arrangement ([see chapter 21a](#)), or one or more public authorities, and will be controlled by the resolution authority. If the resolution authority is owner and shareholder of the bridge bank possible conflicts of interests could potentially be reduced by creating a subsidiary for the (partial) ownership, especially in cases where the resolution authority is also the supervisory authority. The requirement that the bridge institution is wholly owned by public authorities is not relevant if the institution has been fully recapitalized by shareholders and creditors.<sup>1</sup>

<sup>1</sup> [see EBA Q&A 2015\\_1781](#)

Bridge Institution Tool



The bridge institution shall be wholly (or partially) owned by public authorities (either through: i) direct state ownership; ii) the resolution financing arrangement; or iii) one or more public authorities) except when the institution has been fully recapitalized by shareholders and creditors.

No losses should be transferred to the bridge institution. Losses should be absorbed in advance via bail-in or financed by new debt issuance.

The resolution authority may use the resolution financing arrangement to recapitalize or make a loan to a bridge bank, and/or to guarantee assets or liabilities transferred from the entity under resolution into the bridge bank.

The resolution authorities should always maintain control over the bridge bank. If bail-in creditors are converted into shareholders of the bridge bank it must be ensured that they cannot overrule decisions of the resolution authorities (e.g. by suspending voting rights).

### **Implementation of the Bridge Institution**

Once the assets and liabilities have been correctly valued, the first step in creating a bridge institution is to update the balance sheet of the entity under resolution. This must determine: a) the real losses of the entity (to assess the amount of capital and other eligible liabilities that might be needed to recapitalize the entity); and b) the real value of the assets, rights and liabilities to be transferred to the bridge bank ([see chapter 12](#)).

The assets, rights and liabilities need to be clearly defined. Particular attention must be paid to: a) the mapping of critical functions within the scope of the resolution plan; b) the core business lines necessary to preserve the daily business of the entity; and c) safeguards for counterparties and for trading, clearing and settlement systems in case of partial transfer.

The total value of liabilities to be transferred must not exceed the total value of the rights and assets and will be the basis for recapitalization of the entity. This means that no losses should be transferred. To ensure the transfer of an adjusted balance sheet, known losses should be absorbed via bail-in or financed by a new debt issue by the bridge institution (which may be guaranteed by the resolution financing arrangement). The resolution scheme must define the classes and conditions for the transfer of shares or other instruments of ownership, assets, rights and liabilities. Publication of the 'opening balance sheet' of the bridge institution and the external audit of those accounts are essential to provide investors and other stakeholders with objective information on its financial situation. If the estimated long term recovery value is above market price, it may entail state aid and therefore require approval under EU state aid rules.

### **Capitalization of the Bridge Institution**

Capitalization of the bridge institution depends not only on the minimum regulatory capital requirements but also additional capital requirements related to the specific nature of the bridge institution, the transfer process, and the future business model of the bridge bank. The resolution authority may use the resolution financing arrangement to recapitalize or make a loan to a bridge bank, and/or to guarantee assets or liabilities transferred from the entity under resolution into the bridge bank ([see chapter 15](#) on the prior 8 % bail-in requirement). It will be critical to determine the risk-weighted assets of the bridge institution; its immediate and medium-term liquidity needs; and the minimum regulatory capital needs as well as any additional capital considered appropriate for the bridge institution.

### Authorization of the Bridge Institution

The bridge institution must be authorized by the supervisor. Given its temporary nature, the supervisor should advise in advance the type of license that should be sought. The bridge institution must, in principle, fulfil authorization and supervisory requirements as any other bank, although short-term exemptions are possible; the bridge institution may be established and authorized without fully complying with EU Capital (CRD IV/CRR) and investment services requirements (MiFID) for a short period of time at the beginning of its operation. The resolution authority submits an exemption request to the competent authority which, if granted, indicates the period for which the bridge institution is exempted from complying with the requirements of those Directives and regulations.

Relevant corporate issues that will have to be defined by the resolution authority, taking into account the expected period of time and particular circumstances for the creation of the bridge institution, should include: a) appointment of the management body (Board), including the approval of the remuneration of the members of the management body and determination of their responsibilities; b) the fit and proper assessment (carried out by the supervisory authority; c) definition and approval of the strategy and risk profile; and d) ensuring key management functions are in place and effectively staffed.

The transfer of assets and rights to another entity implies the need to update the property registration of certain assets (real estate assets and movable property). The National Registration Office may require a full list of individually identified assets which can be time-consuming to prepare.

### Terminating the Bridge Institution

Proceeds achieved from the sale or disposal of the bridge institution business may be paid to: a) the owners of shares of the entity under resolution; or b) the residual entity of the failing bank (the entity under resolution). They may even be paid to compensate the resolution authority or the resolution financing arrangement for the resolution costs incurred. This is likely to happen in an insolvency procedure, which means that the net proceeds of the resolution will constitute an asset of the insolvency estate and be used to the benefit of creditors in accordance with normal insolvency priorities (the same applies to the sale of business tool, [see chapter 16](#)).

If no solution is found within two years the bridge bank shall be wound down under normal insolvency proceedings.

If no private sector solution can be found within two years (with a possible extension), the bridge bank, or its residual parts of assets, rights and liabilities, should be wound down under normal insolvency proceedings (national insolvency law). This should happen within a reasonable time-frame and having regard to the need to provide services or support to the purchaser to meet the resolution objectives or comply with the general principles of [Article 34](#) of the BRRD.

**Relevant documents**

- [Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms \(CRD\)](#)
- [Directive 2014/65/EU on markets in financial instruments \(MiFID\)](#)
- [EBA/GL/2015/06 Guidelines on the minimum list of services or facilities that are necessary to enable a recipient to operate a business transferred to it under Article 65\(5\) of Directive 2014/59/EU](#)
- [EBA/Op/2015/15 on Article 76 BRRD \(protected arrangements\)](#), Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer.

# CHAPTER 18:

## THE ASSET SEPARATION TOOL- ASSET MANAGEMENT VEHICLE (AMV)

By Maria Hormaeche Lazcano

### KEY QUESTIONS

- When is the creation of a public asset management vehicle (AMV) justified?
- What aspects should be assessed when creating an AMV?
- What challenges arise when creating and managing an AMV?
- Why can't the asset separation tool be implemented on a stand-alone basis?

### [ART. 42 BRRD](#)

Improper valuation of impaired assets was the cause of many financial institutions' problems during and since the most recent global financial crisis. In response, some authorities established asset separation schemes ("bad banks") to relieve distressed bank's balance sheet of "bad" assets and their associated risks.

The BRRD asset separation tool aims to assist in a similar way. It allows for parts of a distressed bank that do not need to be maintained permanently to be wound down in an organized and measured way. The asset separation tool is used to transfer assets and liabilities to a separate asset management vehicle (AMV). The AMV is wholly or partially owned by one or more public authorities including the resolution authority, or the resolution financing arrangements ([see chapter 21b](#)). It is temporarily created to receive the assets, rights and liabilities of one or more institutions under resolution or from a bridge institution. These are managed by the AMV with a view to maximizing their value for an eventual sale, or an orderly gradual wind-down if immediate liquidation would be disadvantageous at that point in time.

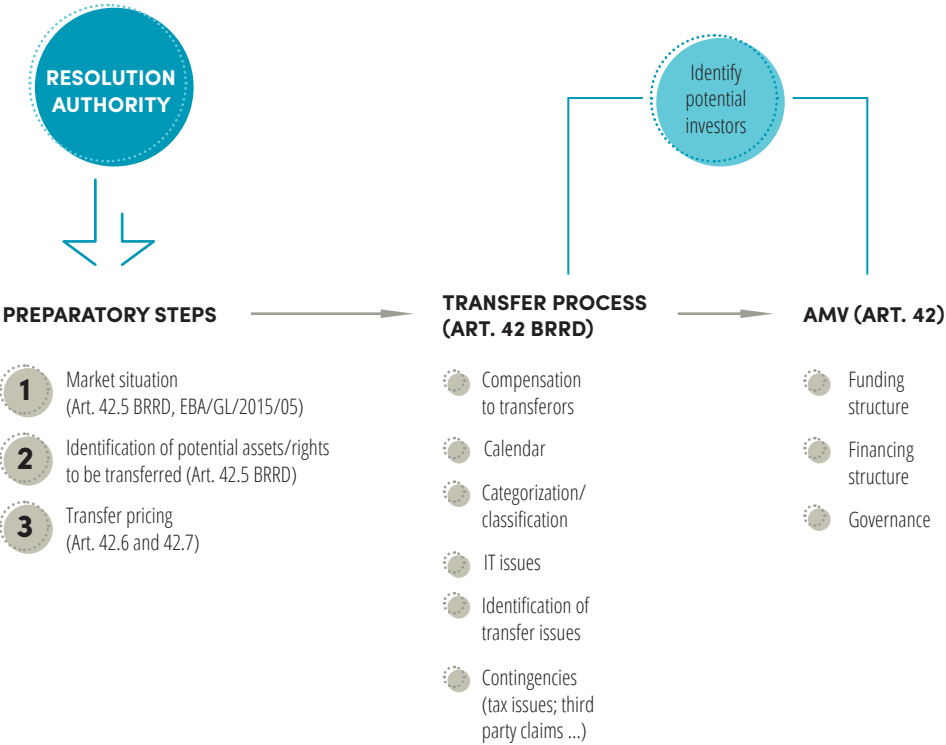
Assets and liabilities of one or more institutions under resolution (or from a bridge institution) are transferred to a separate publicly owned asset management vehicle (AMV) whose goal is to maximize their value for an eventual sale, or an orderly gradual wind-down.

### The Legal Framework

The asset separation tool acts to wind down and sell the elements transferred in an orderly manner while maintaining the continuance of the



Asset Separation Tool



institution's critical functions. It must always be applied together with another resolution tool (sale of business, the bridge institution tool and/or the bail-in tool).

The resolution authority must ensure that it has the power to transfer assets, rights, or liabilities of an institution under resolution, or a bridge institution, to one or more AMVs. In line with the general resolution powers of the resolution authority to take over shareholder rights, the transfer may take place without the consent of shareholders of the institution under resolution or any third party other than the bridge institution, and without complying with any procedural requirements under company or security law.

The AMV should operate under the control of the resolution authority and subject to the following provisions: a) the content of the AMV's constitutional documents are approved by the resolution authority; b) the resolution authority either appoints or approves the AMV's management body; c) the resolution authority approves the remuneration of the members of the management body and determines their appropriate responsibilities; and d) the resolution authority approves the strategy and risk profile of the AMV.

### **The Transfer Process and Assets to be Transferred**

The identification of assets for transfer is of particular importance. The focus should be on assets of no further strategic value; that are related to a specific impaired market; that contain risks considered to be no longer acceptable; that are too capital-intensive; and/or that may be unsuitable for obtaining future long-term funding.

[Article 42\(5\)](#) of the BRRD provides that the resolution authority may only use the asset separation power to transfer assets, rights, and liabilities in one of the following three scenarios:

1. The market for those assets is such that their liquidation under normal insolvency proceedings could have an adverse effect on one or more financial markets and impact financial stability. European Banking Authority Guidelines sets out three specific categories of elements that should be considered: a) whether the market for these assets is impaired; b) the impact of the disposal of these assets on the markets where they are traded; c) the situation of the financial markets and the direct and indirect effects of an impairment of the markets for these assets;
2. The transfer is necessary to ensure the proper functioning of the institution under resolution or bridge institution; or
3. The transfer is necessary to maximize the liquidation proceeds and preserve the value of the assets.

A range of criteria and attributes should help inform the selection of assets to be transferred to the AMV. The legal threshold for a transfer set out in

The AMV must always be applied together with another resolution tool (sale of business, the bridge institution tool and/or the bail-in tool) and is only justified if immediate liquidation would be disadvantageous at that point in time.

"Bad assets" to be transferred should: have no further strategic value; be related to a specific impaired market; contain risks considered to be no longer acceptable; be too capital-intensive; and/or be unsuitable for obtaining future long-term funding.

Issues encountered when transferring assets to the AMV might include compensation to the transferors, differences between the value of the assets at the “value date” vs. their value at the “date of transfer”, incorrect classification, IT and tax issues, third party claims and consent requirements.

Article 42(5) of the BRRD must be met and the assets transfer should help to ensure that the resolution objectives can be achieved and that the institution in resolution can continue to perform critical economic functions. Consideration should also be given to: i) the funding that can be secured by pledging the assets; ii) the current price of the assets; iii) the long-term economic value of the assets; iv) the strategic value of the assets to the institution in resolution; v) the nature of the market for the assets, including any impairment in that market; and vi) the riskiness of the assets and appropriateness of the assets in the context of the strategy of the institution in resolution.

Transfer issues could slow down the process. These might include certain impediments and removals, compensation to the transferors, differences between the value of the transferred assets at the “value date” vs. their actual value at the “date of transfer”, incorrect classification, IT and tax issues, third party claims and consent requirements.

### **The Transfer Price**

A realistic valuation/pricing of assets based on market pricing, sound accounting norms, strong loan classification and provisioning standards, and/or discounted present values, is crucial to the success of the AMV. The determination of the transfer price can be done by portfolios or individual assets.

The AMV should purchase the assets at market value, or the estimated long-term recovery value, following independent valuation under “Valuation 2” ([see chapter 12](#)).

The resolution authority will face various challenges when transferring assets to an AMV. The most common will be: determining the transfer price, servicing the assets retained by the entity under resolution, dealing with corporate governance issues and potential conflicts of interest, as well as designing a credible business plan and the strategy for divestment channels.

### **Funding the AMV**

The funding structure of the AMV will depend on the value and characteristics of the assets transferred. The amount of bail-in has to take into account a prudent estimate of the capital needs of an AMV. Any consideration paid by the AMV in respect of the assets, rights or liabilities transferred directly from the institution under resolution may be paid in the form of debt issued by the AMV which may carry the guarantee of the resolution financing arrangement.

### **The Challenges of Transferring Assets to an AMV**

While preparing for a potential transfer of assets should form part of the resolution planning process, the resolution authority is still likely to face various challenges if they need to put these into action. The most common will be determining the transfer price, servicing the assets retained by the entity under resolution, dealing with corporate governance issues, and potential conflicts of interest, as well as designing a credible business plan, and the strategy for divestment channels. Authorities need to properly consider the operational and reputational risks of managing an AMV to ensure they can sell the transferred assets.

**Relevant documents**

- [EBA/GL/2015/05 Guidelines on the determination of when the liquidation of assets or liabilities under normal insolvency proceedings could have an adverse effect on one or more financial markets under Article 42\(14\) of Directive 2014/59/EU](#)
- [EBA/GL/2015/06 Guidelines on the minimum list of services or facilities that are necessary to enable a recipient to operate a business transferred to it under Article 65\(5\) of Directive 2014/59/EU](#)
- [EBA/Op/2015/15 on Article 76 BRRD \(protected arrangements\), Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer](#)

# CHAPTER 19:

# THE GOVERNMENT

# STABILIZATION TOOLS

By Dieter Huber

[ART. 56–58,](#)  
[32\(4\)\(d\), 37\(10\) BRRD](#)

## KEY QUESTIONS

- What are the conditions for using taxpayers' money?
- Does the government provide public support only if the money in the resolution fund is not sufficient?

The use of public funds is not fully excluded under the BRRD but is strictly regulated to reduce reliance on public financial support.

A key principle underlying post-crisis resolution frameworks, in line with the Financial Stability Board (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions, is that use of public funds should be avoided or at least minimized as far as possible. Use of public funds is not excluded under the BRRD but is strictly regulated to reduce reliance on extraordinary public financial support. Resolution authorities should instead have a credible set of tools to intervene in an unsound or failing institution sufficiently early and quickly to ensure the continuity of the institution's critical functions, while minimizing the impact of an institution's failure on the economy and financial system. Shareholders should bear losses first, followed by creditors ([see chapter 15](#)).

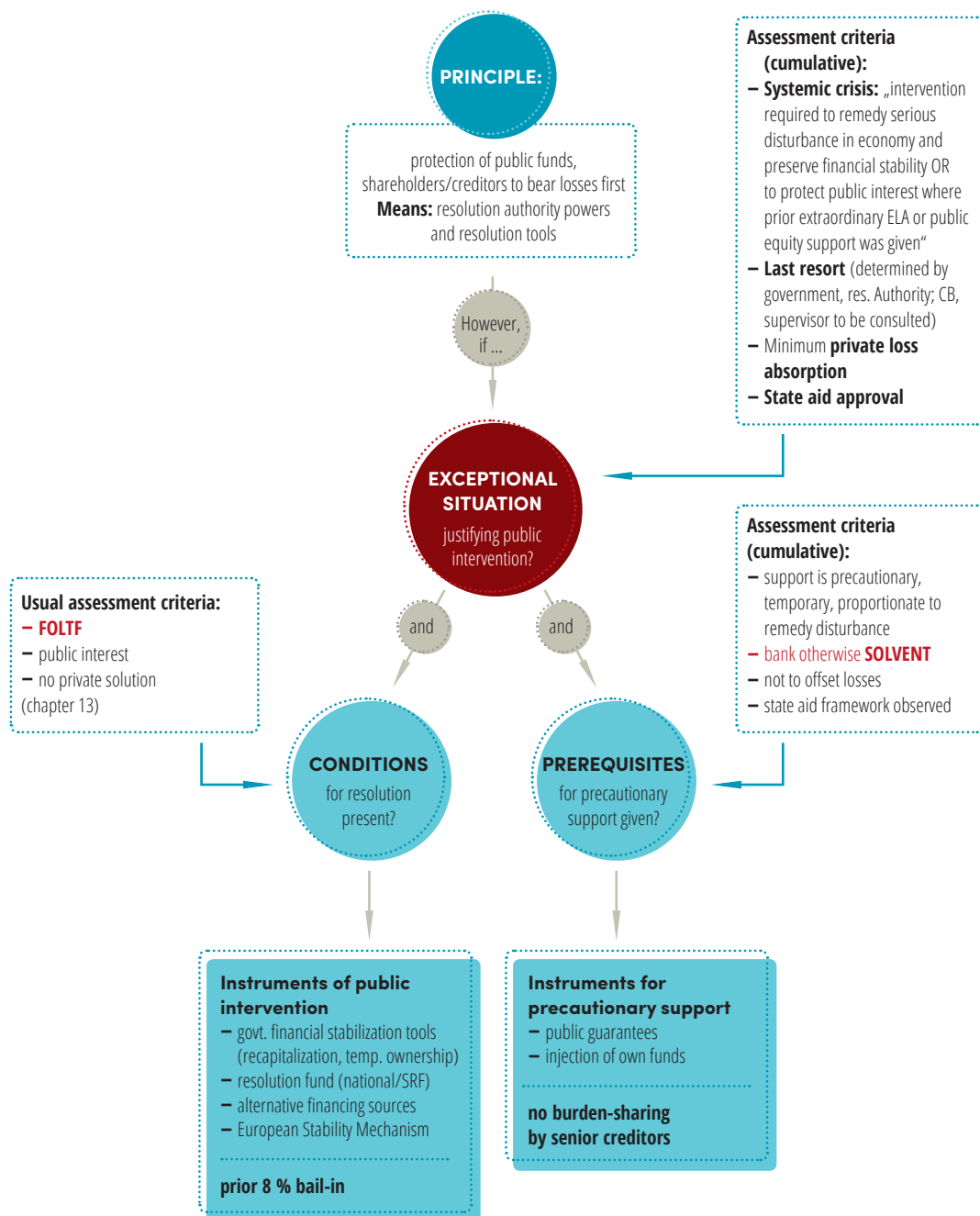
In exceptional circumstances, however, the greater good of financial and economic stability may require "amendments" to this general principle. These amendments may apply in the process of resolution of a problem bank or for precautionary purposes.

In the exceptional situation of a systemic crisis, the government may, subject to prior approval under the EU state aid framework, provide funds through the government stabilization tools of temporary public ownership and public equity support.

## Government Funding as a Last Resort in Case of Systemic Crisis

In the exceptional situation of a systemic crisis, after exhausting resolution tools to the extent practicable while maintaining financial stability, the resolution authority may seek funding from public sources of financing (notwithstanding the role of central banks in providing liquidity to the financial system even in times of stress). The government may, subject to prior approval under the EU state aid framework, provide funds through the government stabilization tools of temporary public ownership and public equity support.

## Government Stabilization



In these cases a minimum loss absorption (bail-in) of not less than 8 % of total liabilities, including own funds of the institution under resolution, is required from shareholders and creditors before government support is allowed.

These instruments may only be used as a last resort to balance the financial stability objective with the general aim to minimize taxpayer support. The justification of public support is determined by the government or the competent ministry together with the resolution authority (after consulting the central bank and the supervisory authority). A case for protecting the public interest could also arise, for example, if extraordinary liquidity assistance from the central bank or equity support has previously been given to the institution. In all cases a minimum loss absorption of not less than 8 % of total liabilities, including own funds of the institution under resolution, is required from shareholders and other eligible liabilities through write-down or conversion before government support is allowed under the BRRD ([Article 37 \(10\)](#)). EU state aid principles must also be respected.

The intervention should be carried out under the leadership of the competent ministry or the government, in close cooperation with the resolution authority, only if the conditions for resolution of the institution are met. In case they avail themselves of these tools, Member States must ensure that the competent authorities have both the necessary tools and the budgetary capacity and powers to administer them.

Government support can take the form of:

- participation in the recapitalization of a bank in exchange for shares or other capital instruments (temporary public equity support); or
- taking a bank into temporary public ownership through the use of a transfer order (temporary public ownership).

In either case the bank must be managed on a commercial and professional basis and transferred to the private sector as soon as commercial and financial circumstances allow.

### **Liquidity to resolution funds**

Public support may also be required to provide liquidity to resolution funds. Loans from banks or other third parties willing to provide pre-funding, including the government or possible international sources, may be contracted if the resolution fund is insufficient or not readily available ([see chapter 21a](#)).

Precautionary public recapitalization for a solvent bank [see chapter 9](#).

### **Relevant documents**

[EBA/GL/2014/09, Guidelines on the types of tests, reviews or exercises that may lead to support measures under Article 32\(4\)\(d\)\(iii\) of the Bank Recovery and Resolution Directive](#)

# CHAPTER 20:

## VALUATION OF DIFFERENCE IN TREATMENT EX-POST RESOLUTION – NO CREDITOR WORSE OFF THAN UNDER LIQUIDATION (NCWOL)

By Georg Merc

### KEY QUESTIONS

[ART. 74, 75 BRRD](#)

- Is an ex-post hypothetical insolvency valuation needed in every resolution case?
- Is there a maximum timeframe for conducting an ex-post valuation?
- Does NCWOL mean that the applied resolution tools were the least costly for the shareholder/the creditor?

The ex-post counterfactual valuation (“Valuation 3” in European Banking Authority terminology) is one of the safeguards in the BRRD to ensure that the no creditor worse off than under liquidation (NCWOL) principle is fulfilled in every resolution case ([see chapter 21a](#) on fundamental rights protection). This valuation determines whether shareholders and creditors would have received better treatment if the entity had entered into normal insolvency proceedings. It is conducted on a gone-concern basis following resolution with the sole purpose of determining the appropriate discounted amount of cash flows that could hypothetically have been expected under national insolvency procedures. These recoveries can then be compared to the losses determined in resolution.

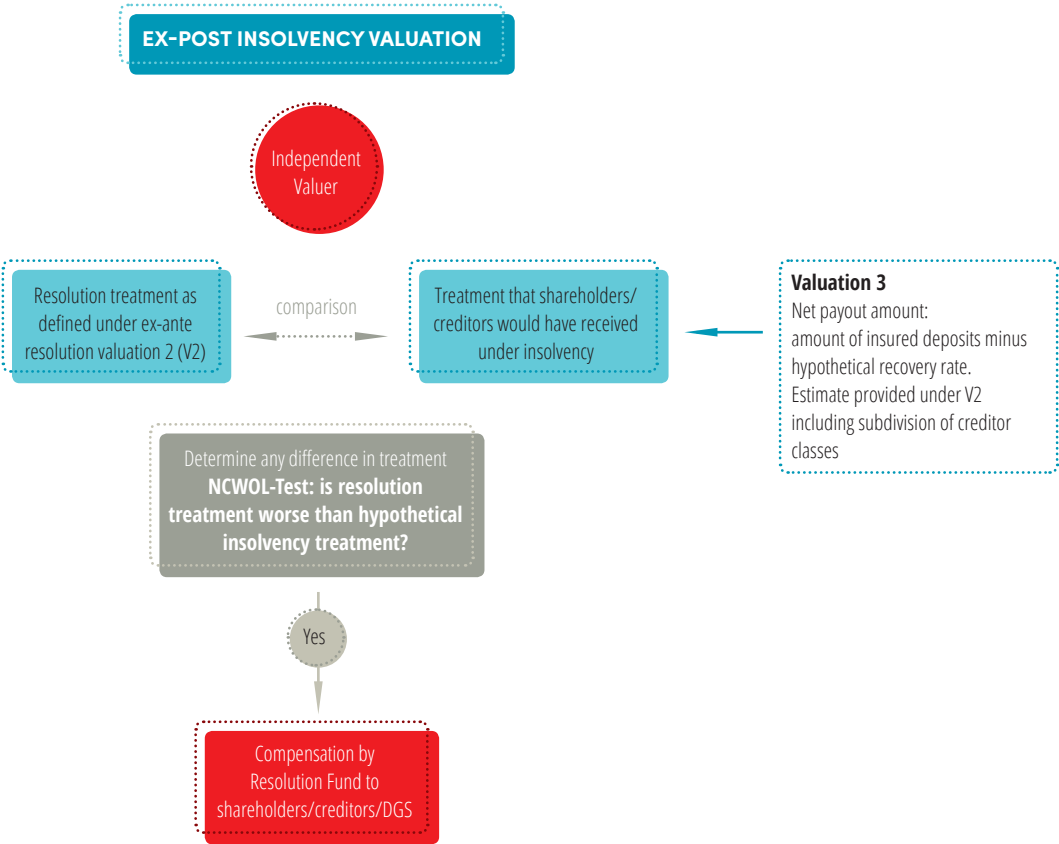
The ex-post counterfactual valuation is one of the safeguards foreseen in the BRRD to ensure that the NCWOL principle is fulfilled in every resolution case.

### Key Elements of an Ex-post Insolvency Valuation

The ex-post valuation begins as soon as possible after resolution starts and is likely to take from several months to years (no explicit maximum timeframe is set). It must be conducted by an independent valuer, this can be the same valuer used for the ex-ante resolution valuation ([see chapter 12](#)). The valuation methodology includes three key elements:



Ex-post Valuation (NCWOL-Test)



- i) the treatment shareholders/creditors would have received under insolvency at the time when the authority decided to apply the resolution strategy (hypothetical liquidation valuation). This is the net payout amount (amount for the payout of insured deposits minus recovery proceeds from the liquidation estate) and includes a calculation of discounted amount of expected cash flows taking reasonably foreseeable costs as well as financing costs into account. For assets traded in a liquid and deep market the observable market price should be used. If assets are not traded, the prices of similar assets should be used or prices based on a marking-to-model valuation technique;
- ii) the actual treatment shareholders/creditors received in resolution; and
- iii) the difference between the actual and hypothetical treatment for each class of shareholders/creditors.

The valuation is based on any relevant available information, including distressed market conditions, that could reasonably have been known at the time the decision on resolution was made by the resolution authority (the resolution date). As a rule, losses under hypothetical liquidation based on gone concern will be greater than under the application of resolution tools where the franchise value can be preserved. Hence it is unlikely in practice that shareholders or creditors would have been better off under liquidation than under the application of resolution tools. In the pre BRRD resolution case of Bankia in Spain the economic valuation of the BFA Group was fixed at EUR -10.44 billion, while under hypothetical liquidation it would have increased to EUR -64.02 billion. The estimate of the hypothetical insolvency scenario in the HETA case in Austria was calculated with a 34 % recovery rate compared to 46 % (Erfuellungsquote) under resolution. In the Andelskassen case in Denmark, the difference between the losses under resolution (valuation 2: DKK -96,4 Million) and the hypothetical insolvency losses (valuation 3: DKK -142,7 million) were calculated at DKK 46 Million, which means losses were assumed to be about 50 % higher under hypothetical liquidation (for more information on these three cases see accompanying publication "Bank resolution and bail-in in the EU: Selected case studies pre and post BRRD").

The NCWOL test will be of special importance if specific creditors within the same rank have been excluded from bail-in ([see chapter 15](#) on the exemption from bail-in) to prove that although the remaining creditors who shared the burden (if it was not taken over by the Resolution Fund) may be worse off than without this exclusion, they are still better off than they would have been under liquidation. The lack of a mandatory subordination of MREL liabilities ([see chapter 11](#)) will increase the risks of breaching the no creditor worse off principle and the likelihood of subsequent legal claims: as bailed-in MREL creditors might argue that under "hypothetical insolvency" they would have ranked *pari passu* and lost less. Also national rules providing for a subordination of e.g. intragroup creditors may affect the outcome of NCWOL assessments in that jurisdiction.

There is no explicit maximum timeframe for conducting an ex-post valuation. It should begin "as soon as possible" after resolution starts and is likely to take from several months to years.

As a rule, losses under hypothetical liquidation based on gone concern will be greater than under the application of resolution tools where the franchise value can be preserved. Hence it is unlikely in practice that shareholders or creditors would have been better off under liquidation than under the application of resolution tools.

The lack of mandatory subordination requirements for MREL will increase the risk of breaching the NCWOL test.

Any difference in treatment that emerges from the ex-post valuation compared to the actual treatment under resolution entitles shareholders/creditors, including the deposit insurance agency in lieu of insured depositors, to compensation from the resolution financing arrangements.

Note: The NCWOL ex-post resolution valuation described in this chapter is to be clearly distinguished from the ex-post revaluation of the provisional valuation undertaken by the resolution authority or an independent valuer as available, in cases where an independent ex-ante Valuation 1 and/or Valuation 2 has not been possible due to the urgency of the situation and the circumstances ([see chapter 12](#)).

#### **Relevant documents**

[EBA/CP/2014/38 Regulatory Technical Standards on ex-ante valuation and ex-post valuation under Directive 2014/59/EU](#)

# RESOLUTION FINANCING

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## CHAPTER 21a: RESOLUTION FINANCING

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By Dieter Huber

### KEY QUESTIONS

- How is bank resolution financed?
- When is public money used and how is this approved?
- What is the role of shareholders and creditors?

[ART. 48, 56–59,  
100–105, 108 BRRD,  
ART. 107\(1\) TFEU](#)

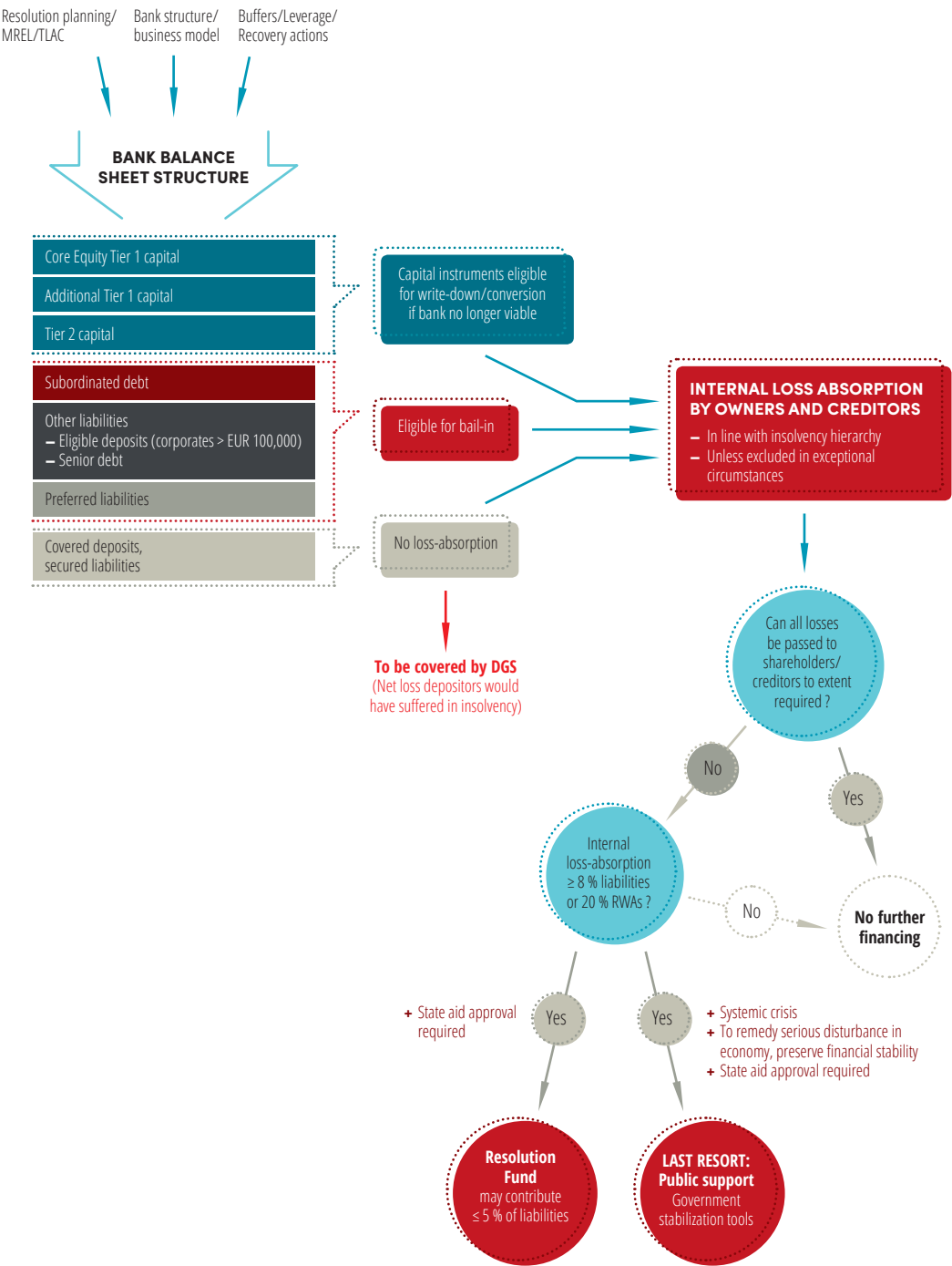
Bank resolution financing essentially involves the allocation of incurred or potential future losses in support of the resolution objectives – primarily to uphold uninterrupted access to critical bank functions and preserve financial stability. Resolution financing discussions should also include resolution-planning, the determination of the minimum requirement for own funds and eligible liabilities (MREL) and the size of buffers, intra-group mechanisms for transferring losses, the removal of impediments to the resolvability of an institution, and early intervention. Every decision has a potential impact on future financing requirements if an institution reaches the point of resolution. This continuum of possible approaches should be kept in mind when designing the resolution framework and resolution-financing arrangements, as well as when executing the powers of the resolution authority.

Financing of a bank resolution takes place against the backdrop of the general principles governing resolutions. The resolution authority seeks to minimize the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives. The BRRD limits use of public funds to exceptional cases as a last resort and only when there is a strong public interest ([see chapter 19](#)).

### Shareholders and Creditors Bear First Losses

A bank is only resolved if it is deemed to be in the public interest, for example to preserve financial stability or protect deposits or public funds ([see chapter 14](#)).

Resolution Financing



The resolution framework does not preclude banks from being declared insolvent and being wound up under normal insolvency proceedings, nor the winding up of non-systemic parts, and shareholders and creditors must bear losses in accordance with normal insolvency rules. In all cases, shareholders of the institution under resolution bear losses first, followed by creditors in accordance with the order of priority of their claims under normal insolvency proceedings (the typical trade-off for the benefits they receive as shareholder or creditor). Creditors of the same class are, as a rule, treated in an equitable manner (for exemption from bail-in [see chapter 15](#)). The no-creditor-worse-off-than-under-liquidation (NCWOL) principle must be respected and covered deposits must be fully protected.

The BRRD framework guides the resolution authority in deciding which claims against troubled banks deserve special protection and which types and classes of stakeholders should participate in the absorption of losses ([see chapter 11](#) on the lack of a subordination requirement). The state aid framework should be adhered to and resolution tools and powers should be exercised in a way that minimizes the negative impact on other entities of the banking group and on financial stability.

It could be argued that the decisions of the resolution authority in the planning phase allocate costs to shareholders in terms of a reduced return on equity, which could be viewed as an ex-ante allocation of hypothetical future resolution costs: exerting influence on the structure or business model of banks and thus restricting business opportunities; or prescribing a certain level of own funds and MREL and thus restricting the leverage applied to a bank's business. However, the exercise of these powers ideally avoids the bank reaching the resolution stage, thereby benefitting shareholders and creditors whose profits would otherwise likely be diminished, and reduces the possible need for extraordinary public financial support.

### **The Hierarchical Order of Loss-Absorption**

If a bank reaches the point of non-viability, Additional Tier 1 and Tier 2 capital instruments should act as a first financial “line of defense” after equity capital, and fully absorb losses of the issuing institution. Before any resolution action is taken, the resolution authority should be required to write down those instruments in full, or to convert them to Common Equity Tier 1 instruments ([see chapter 13](#) on WDCC).

The resolution regime provides for the means to finance the resolution of systemic banks without jeopardizing financial stability and minimizing the costs for the taxpayer if:

- i. the execution of the WDCC powers does not successfully restore viability;
- ii. there is no alternative privately financed solution; and
- iii. the prerequisites for resolution, especially the public interest test, are met.

If there is a realistic prospect of the institution's viability being restored, the bail-in tool may be applied by the authority to resolve the failing institution as a going concern (see chapter 15 on bail-in). Bail-in can also be used in combination with the other resolution tools where systemically important services are transferred to an acquirer or a bridge institution and the residual part of the institution ceases to operate and is wound up. Again, Common Equity Tier 1 capital instruments are the first to be permanently reduced, followed by Additional Tier 1 and Tier 2 capital instruments. Only thereafter will the remaining eligible liabilities be written down or converted into equity in line with the reverse hierarchy of claims in normal insolvency proceedings.<sup>1</sup> The amount of write-down and the eventual conversion rate is based on a fair valuation of the assets and liabilities of the bank under resolution by an independent valuer (see chapter 12). Covered deposits should not be subject to exercise of the bail-in tool. The deposit guarantee scheme (DGS) should instead contribute in lieu of protected depositors by absorbing losses to the extent of the losses expected in normal insolvency proceedings and when the bail-in tool is applied, the DGS is liable for the amount by which covered deposits would have been written down had covered deposits been included within the scope of bail-in.<sup>2</sup> DGS will however profit from the highest hierarchical order of claims covered deposits enjoy (see chapter 22 for the use of DGS for resolution purposes).

Under state aid rules, burden-sharing is required (i.e. the exhaustion of all capital-generating measures including contributions by hybrid capital holders and junior debt) before any public intervention – unless that would endanger financial stability, violate fundamental rights or lead to disproportionate results.

Creditors of the same hierarchy should be treated equally. Exclusions to bail-in are however possible within the same class of creditors in exceptional circumstances – to avoid spreading contagion or to maintain financial stability (see chapter 15). In such cases the level of write-down or conversion of other eligible liabilities may be increased to take account of such exclusions, subject to the NCWOL principle being respected (see chapter 20). If, in the case of an exclusion, the losses cannot be passed to other creditors, the resolution financing arrangement may contribute to the institution under resolution. This is subject to a number of strict conditions, including the requirement that losses totaling not less than 8 % of total liabilities including own funds have already been absorbed by bail-in, and that the funding provided by the resolution fund is limited to 5 % of total liabilities including own funds.

### State Aid and Minimizing Distortions of Competition

EU rules for state aid set out the conditions in which Member States can support banks with funding guarantees, recapitalizations or asset relief

<sup>1</sup> Higher-ranking liabilities are only affected if the reduction or conversion of lower-ranking liabilities are insufficient to achieve the required capital effect. Covered deposits of up to EUR 100,000, secured liabilities to the extent actually secured, certain liabilities to payment and settlement systems or employees, and liabilities to banks with an original maturity of less than seven days, excluding entities that are part of the same group, should not be subject to the bail-in tool. Deposits of natural persons and micro, small and medium-sized enterprises should have a preferential ranking. Otherwise creditors of the same hierarchy should be treated *pari passu*.

<sup>2</sup> The NCWOL principle applies

measures. These seek to ensure financial stability while minimizing distortions of competition between banks. The rules require that all measures are taken to limit state aid to the minimum necessary. This means full burden-sharing is required (i.e. the exhaustion of all capital-generating measures including contributions by hybrid capital holders and junior debt) up to the level of subordinated debt before any public intervention – unless that would endanger financial stability or lead to disproportionate results. The hierarchical order of loss absorption is also applicable under the state aid regime and the NCWOL principle should be adhered to.

This applies in respect of recapitalizations and impaired asset measures, including asset guarantees which are typically granted to cover a capital shortfall. A capital-raising plan, including burden-sharing measures, must be produced and is used in conjunction with an asset-quality review and a forward-looking capital adequacy assessment (for a bridge bank for example, if applicable) to determine the residual capital shortfall to be covered by state aid.

In exceptional circumstances, where the bail-in tool is applied, the resolution authority may exclude or partially exclude certain liabilities from the application of the write-down or conversion powers under certain conditions ([Art. 44\(3\) BRRD](#), [see chapter 15](#)). Before exercising the discretion to exclude a liability, the resolution authority has to notify the European Commission as competition authority. Where the exclusion would require a contribution by the resolution financing arrangement or an alternative financing source, the Commission may prohibit or require amendments to the proposed exclusion in order to protect the integrity of the internal market. This is without prejudice to the Commission's application of the state aid framework. Measures imposed to limit distortions to competition depend on the degree of burden-sharing: enhanced burden-sharing will imply a reduced need for accompanying measures.

Resolution decisions may involve the use of state aid beyond cases of explicit public support. Resolution funds or DGS with a public mandate and mandatory membership that are used to alleviate burden-sharing by private creditors may, for example, also require state aid approval (for DGS [see chapter 23](#)). Such cases are assessed on a case-by-case basis and prior approval by the EC DG Competition will be required.

### Relevant documents

- [Communication from the Commission on the application, from August 1, 2013, of state aid rules to support measures in favor of banks in the context of the financial crisis \("Banking Communication"\)](#)
- [C-526/14 – Kotnik and Others v Državni zbor Republike Slovenije \(Request for a preliminary ruling from the Ustavno sodišče Republike Slovenije\)](#)



# CHAPTER 21b:

## EX-ANTE FINANCED RESOLUTION FUNDS

By Dieter Huber

### ART. 99–109 BRRD

### KEY QUESTIONS

- How many resolution funds exist in the EU?
- Who contributes to resolution funds and how much?
- What are the conditions for use of the resolution funds? Who decides whether money from the fund can be used in a specific resolution case?
- Can the fund be depleted for one single resolution case?
- What if the losses are higher than the money available in the fund?

Resolution funds are built up by ex-ante contributions from banks and investment firms.

Banks and investment firms that are within the scope of the BRRD, and branches of third-country banks and investment firms established in a Member State, are obliged to contribute to national resolution funds. In general, the resolution financing arrangement should be established through a fund, which is at the disposal of the resolution authority. Such arrangements may, under specific circumstances however, also be established through mandatory contributions from banks which are not held in a fund (but for example through a levy) provided that the resolution authority is entitled to an amount that is equal to the amount of the contributions, which the government makes immediately available upon the resolution authority's request for resolution financing.

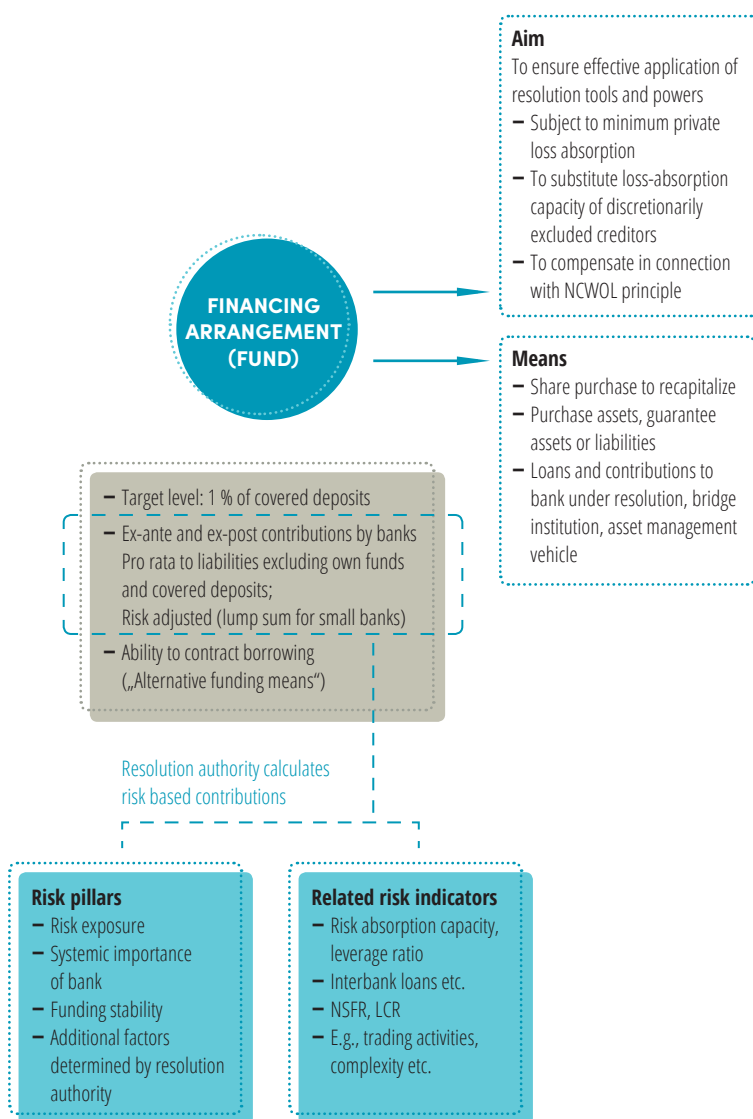
The resolution authority decides on the use of the funds. Funds should be used only to the extent necessary and subject to the preceding applicable minimum loss-absorption by private means (8 % prior bail-in).

### **Purpose of the Resolution Fund**

Financing arrangements are used by the resolution authority to ensure the effective application of resolution tools and powers. Funds should be used only to the extent necessary and subject to the preceding applicable minimum loss-absorption by private means (8 % prior bail-in, see below and [chapter 15](#)).

As a general rule, a financing arrangement is established through a resolution fund and the resolution authority is entitled to trigger its use. The fund may be owned by the resolution authority or independently constituted (the BRRD is silent regarding the question of ownership). The financing arrangements should ensure adequate financial resources and the power to raise funds ex-ante and, where these are insufficient, to

## Resolution Financing Arrangement



Institutions pay contributions in proportion to their liabilities and risk profile and to the size of the national financial sector. The target level should be at least 1 % of the amount of covered deposits of all authorized banks in the Member State (the EBA is assessing whether reference to “total liabilities” might be more appropriate).

Financing arrangements may not be used directly to absorb losses of an institution under resolution nor can they be used to recapitalize such an institution.

receive ex-post contributions and also to contract borrowings (“alternative finance”, see below).

### **Target Level and Contributions to the Resolution Fund**

The BRRD requires that Member States set up financing arrangements to fund contributions from banks and investment firms in proportion to their liabilities and risk profile, and to the size of the national financial sector. The BRRD allows Member States to use existing ex-ante resolution financing arrangements in a different form than as a “fund”, as is the case of the UK bank levy.<sup>1</sup>

The target level set for available financial means of financing arrangements is at least 1 % of the amount of covered deposits of all the banks authorized in the territory of the Member State. Whether a reference to “total liabilities” is more appropriate than to “covered deposits” is the subject of a European Banking Authority (EBA) review (See EBA Report in the list of relevant documents below). Banks’ contributions to resolution financing arrangements are calculated pro rata to their liabilities, excluding covered deposits and own funds, and adjusted in proportion to their risk profile. Small banks are only asked to contribute a minor lump sum.

The BRRD allows a 10-year period for contributions to reach the target funding level of at least 1 % of covered deposits by 2024. Each Member State is responsible for financing the resolution of financial institutions within their territory.

Within the euro area, from 2016, national resolution funds are replaced by the Single Resolution Fund (SRF) owned by the SRB ([see chapter 2](#) on the SRM). There will be a transitional period of eight years where national contributions are still earmarked and held in national compartments after which the SRF will operate as a fully centralized fund, with no national elements in the calculation of its funding nor in the use of the fund itself. In a cross-border scenario, relevant authorities within the appropriate Member States will be required to pre-agree the proportions of their contribution to any financing plan. In addition, it is recognized that a Member State may not be capable of raising sufficient funds to finance the resolution of an institution or institutions within its own jurisdiction, in which case relevant authorities will be able to ask to borrow funds from the authorities of another member state or from the SRF.

### **Use of financing arrangements (resolution funds)**

The resolution funds may be used for the following purposes:

- To guarantee the assets and liabilities of an institution under resolution (including its subsidiaries), a bridge institution or an asset management vehicle;

<sup>1</sup> See: HM Treasury, [Transposition of the Bank Recovery and Resolution Directive, July 2014](#)

- To make loans to the institution under resolution, a bridge institution, or an asset management vehicle;
- To purchase the assets of an institution under resolution;
- To make contributions to (recapitalize) a bridge institution or asset management vehicle;
- To pay compensation to shareholders or creditors under the no-creditor-worse-off-than-under-liquidation (NCWOL) principle;
- To contribute in place of bail-in excluded creditors (in exceptional cases where the bail-in tool is applied and the resolution authority excludes specific creditors from its scope).

The general administration costs of the resolution funds may be borne by banks but only via separate contributions, not from the main fund.

Financing arrangements may not be used directly to absorb losses of an institution under resolution nor can they be used to recapitalize such an institution. If resolution actions indirectly result in losses being passed on to the resolution financing arrangement, the principles governing its use apply, including that an amount equivalent to 8 % of total liabilities (including own funds) must have been contributed by the shareholders and creditors ([Article 44](#)). [See chapter 15](#) for a detailed description of the 8 % bail-in requirement.

Within their scope, resolution funds may therefore purchase shares or other capital instruments to make a contribution to the institution under resolution (only when the bail-in tool is applied and the resolution authority decides to exclude certain creditors from the scope of bail-in under the above mentioned conditions including the 8 % prior bail-in rule); and to purchase assets, guarantee assets or liabilities, or make loans or contributions to the institution under resolution, a bridge institution, or an asset management vehicle.

Generally speaking, the contribution from the resolution financing arrangement may not exceed 5 % of total liabilities (including own funds).

In accordance with the NCWOL principle, shareholders, creditors, or deposit guarantee scheme that have incurred greater losses in a resolution than they would have incurred under normal winding-up proceedings are entitled to a payment amounting to the difference (including to absorb losses that would otherwise have been suffered by creditors discretionarily excluded from bail-in, if they cannot be passed on to other creditors).

### **Alternative Financing Resources and Financing in Cross-Border Resolutions**

In the case of cross-border group resolution, the national financing arrangement of each institution that is part of a group should contribute to the financing in accordance with a financing plan. This plan should be

The resolution financing arrangement may only contribute to (in) direct loss absorption for an institution under resolution where shareholders and creditors already absorbed losses of at least 8 % of the institution's total liabilities (including own funds).

The funding provided by the resolution fund is limited to 5 % of the institution's total liabilities.

In the case of a group resolution, a financing plan apportioning the contributions of individual resolution funds should ex-ante be agreed by the respective resolution authorities.

In extraordinary circumstances, the resolution authority may seek funding from alternative financing sources including from (supra) national public backstops.

Aligning depositor preference and creditor hierarchies between countries would support cooperation in cross-border resolutions.

part of the group resolution regime, set up by the group-level resolution authority and should apportion the contributions of individual resolution funds taking into account the distribution of losses within the group. The financing plan will be discussed and agreed within the resolution college, which is a forum in which all relevant resolution and competent authorities perform different tasks, with a view to reaching joint decisions.

In extraordinary circumstances, the resolution authority may seek funding from alternative financing sources. If these are also insufficient and ex-post contributions are not readily available governments could, as a last resort and in very exceptional circumstances, use government stabilization tools which should be fiscally neutral over the medium term. Supra-national backstops could also be drawn upon, in accordance with usual decision procedures.

Within the euro area, the financing of individual resolution cases will be dependent on national backstops or voluntary cooperation and support if the funds in the SRF provide insufficient. To this end the SRB has set up a system of national credit lines to support the respective compartments of the fund in order to replenish the SRF until 2024 when it will be fully loaded.

Use of resolution funds, especially the latter alternative sources, highlight the delicate nature of decisions relating to burden-sharing and exclusions from bail-in, particularly in cross-border resolutions outside the euro area. Aligning depositor preference and creditor hierarchies between countries would be supportive of achieving cooperative results in cross-border resolutions.

#### **Relevant documents**

- [Commission Delegated Regulation \(EU\) 2015/63 of October 21, 2014](#) supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to ex-ante contributions to resolution financing arrangements
- [Council Implementing Regulation \(EU\) 2015/81 of December 19, 2014](#) specifying uniform conditions of application of Regulation (EU) No 806/2014 with regard to ex-ante contributions to the Single Resolution Fund
- [EBA/OP/2016/18, Report on the appropriate target level basis for resolution financing arrangements.](#)

# CHAPTER 22:

## USE OF DEPOSIT GUARANTEE SCHEMES UNDER RESOLUTION

By Georg Merc

### KEY QUESTIONS

- What can Deposit Guarantee Schemes (DGS) funds be used for?
- Is there a limit for DGS contribution to resolution financing?
- What is the ranking of the DGS in the hierarchical order of creditors?
- May the DGS be called upon a second time if the applied resolution tools prove insufficient (and the bank is finally sent into liquidation)?
- What is the role of the European Commission when DGS funds are used?

[ART. 108–109 BRRD](#)

Deposit guarantee schemes (DGS) create solidarity between all the institutions operating in the same financial market. The current EU Directive harmonizing national DGS stipulates that each EU country must have at least one DGS, and all deposit-taking credit institutions as defined under EU capital requirements legislation (CRD IV/CRR) are required to join. They offer a harmonized level of protection for depositors in the event of bank failure, with deposits held by individuals and companies at any given bank guaranteed up to EUR 100,000.

DGS are financed by banks via ex-ante contributions. By 2024, DGS in the EU must have available financial means of at least 0.8 % of the amount of the covered deposits of its members (target level). Contributions reflect individual banks' risk profiles; i.e. riskier banks have to pay more. For the possible creation of a European Deposit Insurance Scheme (EDIS) [see chapter 2](#) on Banking Union.

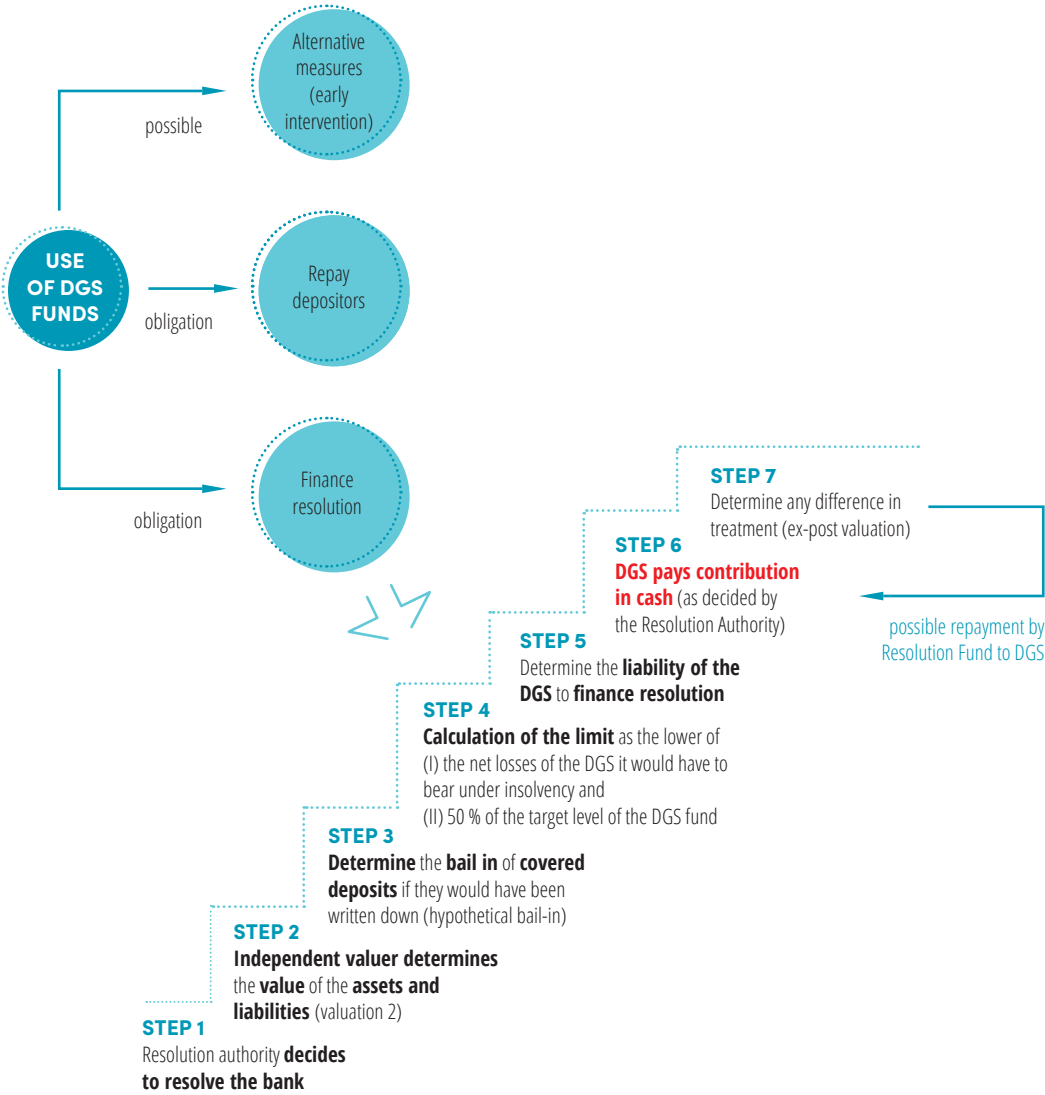
### Overview of Possible Uses of DGS funds

DGS funds are designed to reimburse depositors in the case of a bank failure. DGS are traditionally triggered by the start of insolvency proceedings and compensate depositors by paying out the insured amount to the respective account holders (repayment function). They may also finance measures to preserve depositors' access to covered deposits in the context of national insolvency proceedings other than a direct payout, such as a transfer to an acquiring bank (an alternative way to protect depositors in an insolvency scenario besides the repayment function). In some

Each EU country must have at least one DGS, and all deposit-taking credit institutions are required to contribute ex-ante according to their risk profile. DGS offer protection for depositors up to EUR 100,000 in case of a bank's failure.

DGS funds compensate protected depositors by paying out the insured amount in case of a bank's liquidation. Additional failure prevention functions may be provided for.

Possible Use of DGS Funds and Contribution Limit



countries, DGS can also use their available funds for alternative measures in order to prevent the failure of a credit institution under strict conditions for early intervention (failure prevention function).

Where a bank is resolved through the application of special resolution tools rather than liquidation, the BRRD together with Directive 2014/49/EU on deposit guarantee schemes (DGSD) extends the possible use of DGS to finance the resolution of credit institutions (contribution to resolution function).

### **Use of DGS for Resolution Purposes and Safeguards**

A general precondition to use of the financial means of the DGS in resolution is that the resolution action ensures depositors continued access to their deposits, in line with the IADI Core Principles for Effective Deposit Insurance Systems.<sup>1</sup>

The use of DGS money for resolution purposes is foreseen for the following purposes:

- To subrogate bail-in-excluded protected depositors and pay the amount for which they would have been bailed-in (DGS bail-in in lieu, as provided in [Article 109\(1\)a](#)), which is limited by the hypothetical insolvency loss calculation under the no creditor worse off than under liquidation (NCWOL) principle ([see chapter 20](#)).
- To pay the amount DGS would have lost under a hypothetical liquidation scenario (NCWOL principle) in case bail-in is not applied ([Article 109\(1\)b](#)).

### **Calculating the DGS Contribution to Finance Resolution**

The resolution authority, after consulting the DGS, determines the amount by which the DGS is liable based on the independent ex-ante valuation of the assets and liabilities of the bank undertaken prior to or in connection with the resolution decision ([see chapter 12](#)). The resolution authority cannot exercise any discretion on the use of DGS for resolution purposes.

The ex-ante valuation is used to calculate:

- the amount by which covered deposits would have been written down if included in a bail-in, or
- the amount DGS would have paid under the application of one or more resolution tools other than the bail-in tool under the insolvency counterfactual i.e. the losses that covered depositors would have suffered had covered depositors suffered losses in proportion to the losses suffered by creditors with the same level of priority under the national law

The resolution authority determines the amount by which the DGS is liable based on the independent ex-ante valuation of the assets and liabilities of the failing institution.

<sup>1</sup> [See International Association of Deposit Insurers \(IADI\) Core Principles for Effective Deposit Insurance Systems CP.9 EC.8.](#)



governing normal insolvency proceedings (net payout amount: covered deposits minus hypothetical recovery rate).

The DGS will never pay more than it would have paid under a hypothetical liquidation (net payout amount).

This hypothetical amount is then compared with the NCWOL and the 50 % cap described below. In all cases the contribution is limited to the lower of the two limits.

The contribution from the DGS must be made in cash. If the available means are not sufficient to fulfil the resolution financing obligation, DGS may be required to collect ex-post contributions from member institutions and to call for cash contributions regarding payment commitments<sup>2</sup> (the same as for a pay-out under liquidation).

### **NCWOL Safeguards and 50 % Cap**

Any difference in treatment between the amount DGS had to contribute under resolution compared to the hypothetical liquidation loss will be assessed by an independent valuer. The resolution financing arrangement will compensate the DGS if the limit has been exceeded (safeguard provision under the NCWOL, [see chapter 20](#)).

To limit the possible depletion of the DGS for resolution purposes the BRRD anticipates a 50 % cap of the DIF target level.

Although the probability of DGS use under resolution is low, the risk exists that financing of resolution measures might deplete the scheme and endanger its capacity to pay-out for normal insolvencies. This is of concern especially in cases where, for example, a large bank with a huge retail deposits base is bailed-in and losses under liquidation are assumed to be relatively high, and the hypothetical recovery rate is very low.

To limit the possible depletion of the DGS for resolution purposes the BRRD anticipates another element of limitation in addition to hypothetical net pay-out amount under insolvency: A cap on financing resolution actions in terms of the DGS target level. For Member States with one DGS this will be set at an amount equal to up to 50 % of the Deposit Insurance Fund (DIF) target level. In Member States with more than one DGS, the target level will be lower and the liability of the individual DGS reduced. However, the BRRD allows Member States to set a percentage which is higher than 50 % taking into account the specificities of their national banking sector.

This limitation to the use of the DGS under resolution is applied when the amount of the DIF's expected loss under normal insolvency proceedings is higher than is allowed by the cap. For example: if the target level of DGS is 1,000 money units, and the hypothetical loss under normal insolvency proceedings for DIF is 800, with a cap set at 40 % (meaning the DIF cannot be depleted more than 60 % of the target level) the DIF's liability will only be 400 (40 % of 1,000).

<sup>2</sup> The DGSD allows banks to fulfill their payment obligations via payment commitments for up to 30 % of the total amount of the DGS available financial means.

These safeguards also limit the risk of the DIF being depleted when called upon twice to fund resolution and/or liquidation actions with the same institution (e.g. if the restored entity to which the DIF already contributed is sent into liquidation later and the DIF is this time required to pay out the same insured deposits).

### **Ranking of Covered Depositors in the Creditor Hierarchy**

The use of the DGS in resolution is justified by the fact that resolution and the use of resolution tools avoid a payout case. Not providing for the involvement of DGS would constitute an unfair advantage with respect to other creditors which also have to absorb losses under the provided safeguards (NCWOL).

The BRRD provides for covered deposits and DGS, being subrogated to the rights and obligations of covered depositors, to have a rank ahead of eligible deposits of natural persons and small and medium-sized enterprises (SMEs) that would have been deemed to be covered deposits if they had not exceeded the coverage level and of ordinary unsecured non-preferred creditors. This treatment is aimed at safeguarding the funds of deposit guarantee schemes for fulfilment of their primary pay-out function when deposits are unavailable. This super preference under liquidation, based on the assumption of an expected high recovery rate, largely reduces the DGS function to a liquidity provider under liquidation. That high ranking also typically significantly reduces the contribution of the respective DGS during resolution. Resolution financing by DGS is therefore only likely if the losses are high and/or the bank is strongly deposit-financed (see example calculation).

### **Relationship to Resolution Planning and to the Resolution Fund**

Possible DGS financing should be considered when drafting the resolution plan (financing the resolution) and setting the MREL. A potential DGS contribution to resolution financing may reduce the MREL. The financial resources of the DGS do not compete with, nor can they replace, the resolution financing mechanism. The decision of a resolution authority to, in exceptional circumstances, exclude or partially exclude certain eligible liabilities from bail-in under the conditions laid down in the BRRD and a potential use of the resolution financing mechanism to cover the losses that have not been absorbed does not have any impact on the liability of the DGS. The financial resources of a DGS are to be used in addition to those of a resolution mechanism.

### **Role of the European Commission**

The use of DGS to assist in the resolution of failing institutions should comply with the relevant state aid provisions if it goes beyond simple loss absorption limited with the net payout amount in lieu of insured depositors under hypothetical liquidation. The state aid regime does not apply to the repayment of depositors (paybox function) and the standing-in for

The BRRD provides for a “super preference” of the DGS in the hierarchical order of creditors, followed by the eligible deposits of natural persons and SMEs that would have been deemed covered deposits if they had not exceeded the coverage level.

EU state aid rules do not apply to the use of DGS to assist in the resolution of failing institutions in lieu of bail-in-excluded depositors.

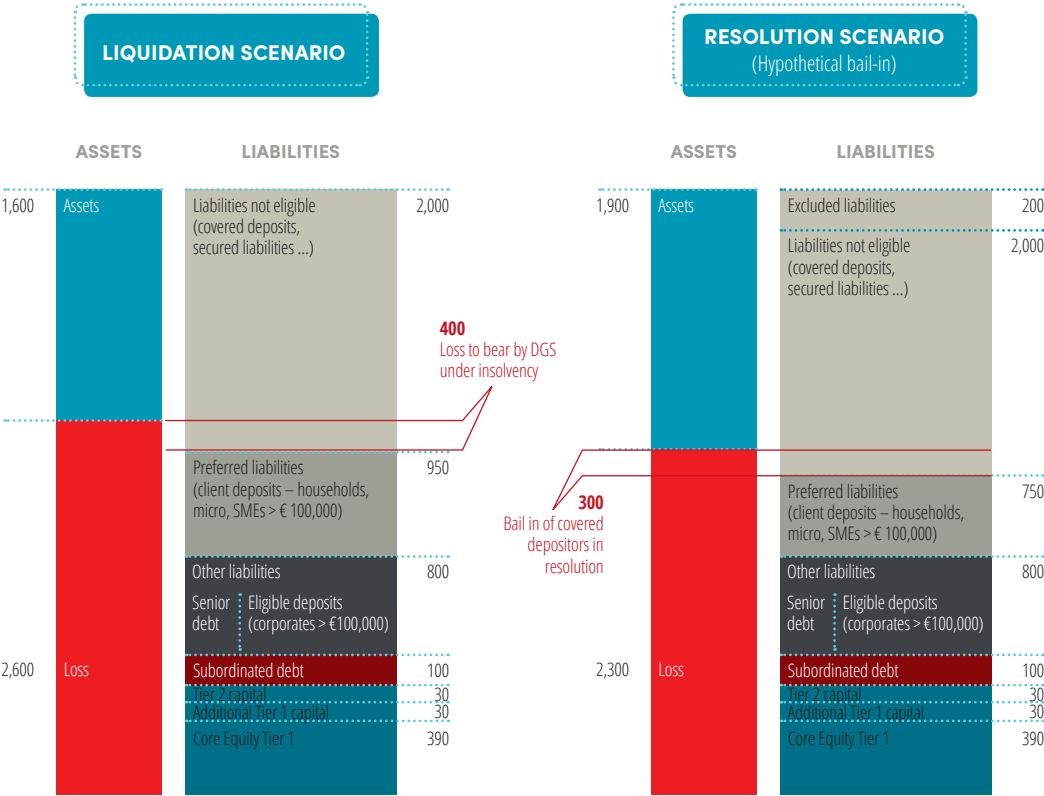
covered depositors under resolution (under the bail-in and/or the transfer tools as foreseen under [Article 109 BRRD](#)). The possible financing of alternative measures by the DGS (support measures during early intervention) outside the BRRD is subject to state aid rules and needs the approval of the European Commission.

Relevant documents

[Directive 2014/49/EU on deposit guarantee schemes Text with EEA relevance and MEMO/15/6165](#)

Example Calculation

- The target level of the DGS fund lies at 900. The liability of the DGS is limited with 50 % of the target level (450).
- The loss as determined by the supervisory authority on a going concern basis amounts to 2,400. The book value of the remaining assets therefore lies at 1,800.
- An independent gone concern valuation shows a remaining asset value of 1,600 thereby increasing the loss by 200 to 2,600 in total. Based on this independent valuation the net losses of the DGS have to be calculated.
- Liabilities at the amount of 200 will be excluded from bail-in during resolution. According to the Liquidation Scenario the limit for DGS financing in resolution lies at 400. This limit, as it is lower than 50 % target level limit, needs to be compared with the Resolution Scenario. Under the resolution scenario 300 have to be paid by the DGS. This amount lies below the relevant limit.



# JUDICIAL REVIEW

## CHAPTER 23: JUDICIAL REVIEW OF RESOLUTION ACTION

By Matthias Haentjens

### KEY QUESTIONS

- Is a court decision required before a resolution authority can take action?
- What are the effects of an appeal against a resolution decision?
- Can the court create new economic facts?
- Where is an appeal lodged against a Single Resolution Board decision that is executed by national authorities?

[ART. 85–86 BRRD](#)

Many jurisdictions have drastically overhauled their rules governing bank insolvencies in reaction to the global financial crisis that started in 2008 ([see chapter 1](#)). Previous bank insolvency regimes, which mainly consisted of either direct or indirect application of general insolvency law, have been replaced with an administrative resolution regime. In this administrative regime, government authorities have wide-ranging powers to resolve banks in financial distress. Thus, if any court is involved, it is usually an administrative court (whilst it ultimately depends on the relevant national law of procedure which court is competent). This is also true for the regime implemented by the BRRD but, as a consequence both of limitations imposed by BRRD itself (to be discussed below) and of the nature of European administrative review, the administrative court can play only a limited role. The Court of Justice of the European Union (CJEU), for instance, has held that: "The review by the European Union judicature (...) is necessarily limited and confined to verifying whether the rules on procedure and on the statement of reasons have been complied with, whether the facts have been accurately stated and whether there has been any manifest error of assessment or misuse of powers".<sup>1</sup>

Post crisis resolution regimes are not judicial but administrative based

<sup>1</sup> [Judgment of the General Court \(First Chamber\) of 2 March 2012, in cases T-29/10 and T-33/10 \(ECLI:EU:T:2012:98\), nr. 103.](#)

Under the BRRD Member states may stipulate that Courts ex-ante review resolution decisions within 24 hours.

### Judicial review under BRRD: Article 85

Title 4 Chapter 9 BRRD contains only two but important provisions: [Articles 85](#) and [86](#). In Article 85(1) the BRRD recognizes the right (but no requirement) for ex-ante judicial review at the national level. The Article provides that Member States may require that a decision to take a 'crisis prevention measure' or a 'crisis management measure' (see below) is subject to ex-ante judicial approval. The national law procedure relating to the approval of a crisis management measure and the court's consideration of the same must be expeditious. Recital (92) substantiates that the court should give its decision within 24 hours and the relevant authority should take its decision immediately after the court has given its approval. However, interested parties can request the court to set aside the decision for a limited period after the resolution authority has taken the crisis management measure.<sup>2</sup>

Pursuant to [Article 2\(1\)\(101\) BRRD](#), a 'crisis prevention measure' means:

- the exercise of powers relating to recoverability ([Article 6\(6\) BRRD](#));
- addressing or removing impediments to resolvability ([Article 17–18 BRRD](#));
- the application of an early intervention measure under [Article 27 BRRD](#);
- the appointment of a temporary administrator under [Article 29 BRRD](#);
- the exercise of write down or conversion powers under [Article 59 BRRD](#).

Ex-post appeal against resolution decisions must be provided for but this should not result in automatic suspension of the challenged decision.

[Article 2\(1\)\(40\) BRRD](#) states that a 'crisis management measure' means:

- the decision to place an institution, its parent or subsidiaries under resolution;
- the application of a resolution tool;
- the exercise of a resolution power;
- the appointment of a special manager; and
- implementation of resolution decisions under [Article 72\(1\) BRRD](#) by a person appointed by the resolution authority.

Under [Article 85\(2\) and \(3\) BRRD](#), Member States' national laws must provide for a right of (ex-post) appeal against: a) a decision to take a crisis prevention measure or a decision to exercise any power, other than a crisis management measure; and b) a crisis management measure, respectively. 'Appeal' here is used as meaning any legal challenge of a decision, rather than taking a decision of a lower court up to a higher court. The terms 'crisis prevention measure' and 'crisis management measure' must be understood in the same sense as set out above.

[Article 85\(4\) BRRD](#) provides that the right of appeal against a crisis management measure shall be subject to two limitations. These limitations must be understood against the background that the Article intends

<sup>2</sup> See M Schillig, *Resolution and Insolvency of Banks and Financial Institutions*, (OUP 2016), p. 117, fn 58 on the possible friction of this ex-ante review and SRB decisions.

to address situations of extreme urgency, and that the suspension of any decision of the resolution authorities might impede the continuity of critical functions ([see chapter 4](#) and recital (90)). First, the lodging of an appeal shall not automatically suspend the effects of the challenged decision ([Article 85\(4\)\(a\) BRRD](#)). Second, the resolution authority's decision shall become immediately enforceable with a rebuttable presumption that a suspension of its enforcement would be against the public interest ([Article 85\(4\)\(b\) BRRD](#)).

In order to protect the interests of third parties acting in good faith who have acquired shares, other instruments of ownership, assets, rights, or liabilities of an institution under resolution, the annulment of a resolution authority's decision shall not affect any subsequent administrative acts or transactions concluded by that resolution authority on the basis of the annulled decision. Compensation for the loss suffered by the applicant caused by the decision or act is the only type of remedy available for a wrongful decision or action by the resolution authorities ([Article 85\(4\) BRRD](#)).

The rationale for [Article 85 BRRD](#) may be found in [Article 47 of the Charter of Fundamental Rights](#), according to which “the concerned parties have a right to due process and to having an effective remedy against the measures affecting them”.<sup>3</sup> On the other hand, BRRD requires that the ex-post judicial review of a crisis management measure must be ‘expeditious and national courts shall use, as a basis for their own assessment, the complex economic assessments of the facts carried out by the resolution authority’. Recital (89) adds that national courts should nonetheless examine ‘whether the evidence relied on by the resolution authority is factually accurate, reliable and consistent, whether that evidence contains all relevant information which should be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn therefrom.’

### **Judicial restrictions on other proceedings: Article 86**

[Article 85 BRRD](#) indicates the administrative nature of the proceedings to challenge ex-post resolution decisions (but again, this will ultimately depend on the relevant national law of procedure). Such proceedings may represent a shift from the tradition, existing in many Member States, in which insolvencies have always been in the domain of the bankruptcy or civil courts. This shift is further stressed by [Article 86\(1\) BRRD](#) which prescribes that, in short, national insolvency proceedings may not be commenced except at the initiative of the resolution authority if the relevant institution, its parent or subsidiaries are in resolution, or it has been determined that the resolution conditions have been met. Moreover, a decision placing an institution, its parent or subsidiaries into such

No other compensation can be awarded than damages.

Courts shall use the economic assessments of the resolution authority as a basis for their own assessment.

Normal bank insolvency proceedings – which may be court or administrative based under national law – should commence only upon decision by the resolution authority

<sup>3</sup> Explanatory Memorandum BRRD Proposal, 14

Resolution action can trigger a stay on Court proceedings.

national insolvency proceedings shall be taken only with the consent of the resolution authority ([Article 86\(1\) BRRD](#)).

Notably, [Article 86\(3\) BRRD](#) is of importance for any judicial actions or proceedings in which an institution is involved. If this institution is placed in resolution, resolution authorities have the power to request the court to stay the actions and proceedings. This is on top of the temporary 'resolution stay' that may be imposed on the enforcement of security interests ex [Article 70 BRRD](#).

### Judicial review in practice

In the new euro area regime of the BRRD and the Single Resolution Mechanism, the appropriate route to challenge ex-post the application of a resolution tool depends on the resolution authority employing the tool, and therefore on the category of bank subjected to the tool. For significantly important and cross-border operating banks, the tools are to be employed by the Single Resolution Board (SRB) by means of the adoption of a resolution scheme, while for other banks, the national resolution authority (NRA) is empowered to take resolution measures directly ([Chapter 2](#) and [Chapter 13](#)).

If a resolution tool is employed by the NRA then any appeal must be lodged under national (administrative) law ([Art. 85\(3\) BRRD](#)). Under Dutch law, for instance, an appeal against a decision of the NRA, i.e. the Dutch Central Bank, can only be lodged directly with the Administrative High Court for Trade and Industry, and the appeal is time-barred after ten days (Art. 8:1 General Administrative Law Act (*Algemene wet bestuursrecht*) and 3a:64(1) *Wft*). Ultimately, preliminary questions could be posed to the CJEU to obtain a decision on the application of EU law.

For cases where resolution tools are to be employed through the adoption of an SRB resolution scheme, appeal against the (adoption of the) scheme itself can probably not be lodged with the SRB Appeal Panel, due to its limited competences. Such appeal against the resolution scheme itself may be admissible directly at the CJEU under Art. 263 TFEU.<sup>4</sup> However, a resolution scheme instructs the relevant NRA to carry out measures under national law to implement the scheme (Art. 18(9) SRMR). It may be unclear where and under what law the bank in question should challenge the subsequent measures taken by the NRA. The answer would probably depend on the margin of discretion the scheme's instruction has left for the NRA. If the scheme's instruction to the NRA does not leave much mar-

<sup>4</sup> See Recital 120 SRM Reg. Art. 18 is not included in the list of articles under which administrative appeal with the SRB Appeal Board is admissible (art. 85(3) SRM Reg.). Also, such a scheme would be addressed to the national resolution authority (rather than to the failing bank in question). See S. Nuyten, Legal protection against actions under the Single Resolution Mechanism – or the lack of it, *NautaDutilh* paper 2015, p. 18–19 and 21 (available at <http://www.nautadutilh.com/>, accessed at 16 September 2016).

gin of discretion for the NRA, appeal against it must probably be lodged with the CJEU directly.<sup>5</sup> If, conversely, the scheme's instruction to the NRA would leave the NRA a substantial margin of discretion, the resolution tool must probably first be challenged with the NRA (should the applicable national law require such administrative review) or with the national (administrative) court.<sup>6</sup>

<sup>5</sup> T.M.C. Arons, *Judicial Protection of Supervised Credit Institutions in the European Banking Union*, in: *European Banking Union* (D. Busch & G. Ferrarini eds.), Oxford (2015), pp. 459–460.

<sup>6</sup> *Parliamentary Proceedings*, Tweede Kamer, 2014–2015, 34 208, nr. 3, pp. 31–33. See also, Nuyten (2015), p. 20 et seq. and Arons (2015), p. 433 et seq.



# ANNEXES

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## ANNEX 1: CRISIS MANAGEMENT AND COMMUNICATIONS

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By Maria Hormaeche Lazcano

[ARTICLES 10.7](#) and [ANNEX of the BRRD](#)  
as regards communication under the resolution plans  
[ARTICLES 81, 82, 85, 88](#) and [97 BRRD](#)  
as regards communication among authorities  
[ARTICLE 83 OF BRRD](#) as regards external communication

### KEY QUESTIONS

- Should recovery and resolution plans include a resolution communications strategy?
- How are incoming information and outgoing messages coordinated in the event of resolution?
- What are the core messages to internal and external stakeholders at the point of resolution?
- Communication of what information is legally required by the BRRD?

### Effective Communications Are Vital in Times of Crisis

The resolution of a financial entity can create uncertainty both within the business and more widely. A well-planned and executed communications strategy is essential to:

- Instill confidence in the markets in which the entity operates, including retail customers;
- Avoid actions that could frustrate the resolution process;
- Ensure stakeholders have the information they need to continue to do business with subsidiaries or with the new bridge bank or asset management vehicle (AMV);
- Avoid contagion to other entities, markets or geographies; and
- Maintain financial stability.

Communications should be timely, well-coordinated and consistent, to effectively manage all the information generated from different sources and ensure stakeholders are sufficiently informed. Significant ex-ante planning between authorities and the financial institution is required to produce a comprehensive communication strategy that takes account of:

- a) the key stakeholders;
- b) which authority or entity should act as the main point of contact for each group of stakeholders;
- c) the timing for different communications during the resolution process;
- d) the core messages to each stakeholder; and
- e) the optimum channel for making each communication.

### **Communications Strategy During Resolution Planning**

[Articles 6](#) and [13 of the BRRD](#) require that recovery and resolution plans include a plan for communication with the media and the public. Plans must be revised at least annually.

The BRRD requires that Recovery and Resolution Plans include a plan for communication with the media and the public.

Communication plans should address the needs of both internal audiences – the employees and suppliers of the entity – and external audiences – the authorities, the market, and the wider public – for each resolution option. Different groups of stakeholders should be identified as part of resolution-planning and appropriate information material and documentation prepared and checked with legal and finance departments; for example, letters to customers and providers, press releases, Q&A, messages. Different languages must be taken into account.

The response to any leak during the resolution planning phase must be swift and well-coordinated at all levels and locations. It is very important that rumor does not trigger a contagion effect or provoke deterioration in the value of the franchise.

### **Communication Strategy During Execution of the Resolution**

Initial information presented by the resolution authority once the entity meets all of the three conditions for resolution should be clear and succinct. It should contain only the content of the decision taken, a brief description of the reasons, and the goals being pursued by the authorities. The additional release of information should be carefully controlled and managed in order to maintain the value of the franchise, and to avoid equity and deposit outflows.

During the execution of the resolution, any information released externally must also be communicated internally, in advance or simultaneously.

To help maintain financial stability, authorities may consider additional external messages emphasizing the efforts being made to avoid any operational or practical disruption to the bank and the protection for depositors. Any information released externally must also be communicated internally, in advance or simultaneously. Q&A factsheets might be circulated to managers to help them answer employee as well as external questions.

The BRRD requires the resolution authority to publish, or ensure the publication of, the order or instrument by which the resolution action is taken or a notice summarizing the effects of the resolution action, its effect on retail customers and the terms and period of suspension or restriction.

### **BRRD legal requirements**

[Article 83 of the BRRD](#) requires the resolution authority to publish, or ensure the publication of, the order or instrument by which the resolution action is taken or a notice summarizing the effects of the resolution action. This must include the effects on retail customers and, if applicable, the terms and period of suspension or restriction referred to in [Articles 69, 70 and 71](#). Publication should be: a) on its official website; b) on the website of the competent authority, if different from the resolution authority, and on the website of the European Banking Authority (EBA); and c) on the website of the institution under resolution. Where the shares, other instruments of ownership or debt instruments of the institution under resolution are admitted to trading on a regulated market, the means used for the disclosure of regulated information concerning the institution under resolution should be in accordance with the European Transparency Directive for listed companies ([Article 21 \(1\)](#) of EU Directive 2004/109/EC). If the shares, instruments of ownership, or debt instruments are not admitted to trading on a regulated market, the resolution authority should ensure that resolution documentation is sent to all known shareholders and creditors of the institution.

The resolution authority must make particular efforts to communicate information related to the resolution nationally, particularly regarding the implementation of tools such as bail-in, sale of business, bridge institution or asset management vehicle creation. All communications must be well-informed and well-coordinated at all levels: the entity, Single Resolution Board (SRB), the national resolution authority, Ministries, the European Commission, Deposit Guarantee Funds (DGF) and other relevant stakeholders.

### **Relevant documents**

- [Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC](#)
- [Commission Delegated Regulation \(EU\) 2016/1075 supplementing Directive 2014/59/EU](#) with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges

# ANNEX 2:

## OVERVIEW OF NATIONAL OPTIONS

<a href="#">Art 3</a>	Designation of resolution authority (central banks, ministries of finance, supervisory authorities/ ...) Requirement: public administrative
<a href="#">Art 3</a>	Limitation of the liability of RA, SA: of a Temporary administrator (Art 29), of a bridge institution (Art 40), of asset management vehicle (Art 42)
<a href="#">Art 4</a>	Simplified obligation and waiver for recovery and resolution plans incl. frequency of updates Additional info in Recovery plans, records of financial contracts
<a href="#">Art 32</a>	Determination of resolution trigger in addition to SA also by RA
<a href="#">Art 37 (9)</a>	Additional resolution tools and powers
<a href="#">Art 60</a>	Capital write down may be determined by SA or RA
<a href="#">Art 44</a>	Exclusion of liabilities from bail in
<a href="#">Art 45</a>	Additional criteria for MREL
<a href="#">Art 56–58</a>	Government financial stabilization: equity tool and temporary public ownership
<a href="#">Art 84</a>	Confidentiality – authorization of information exchange
<a href="#">Art 85</a>	Ex-ante judicial approval of crisis prevention or management
<a href="#">Art 89</a>	Waiver of resolution college
<a href="#">Art 97</a>	Entering into bilateral agreements with 3rd countries until Commission acts
<a href="#">Art 100</a>	Same administrative function of resolution fund (RF) and deposit guarantee scheme (DGS)
<a href="#">Art 102</a>	Higher target levels for RF/109: for DGS use higher than 50 %
<a href="#">Art 106</a>	Inclusion of ministry or government in decision on lending between RFs

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# ANNEX 3: OVERVIEW OF STATE AID IN THE FINANCIAL SECTOR AND BANK RESOLUTION

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By Agnieszka Smoleńska

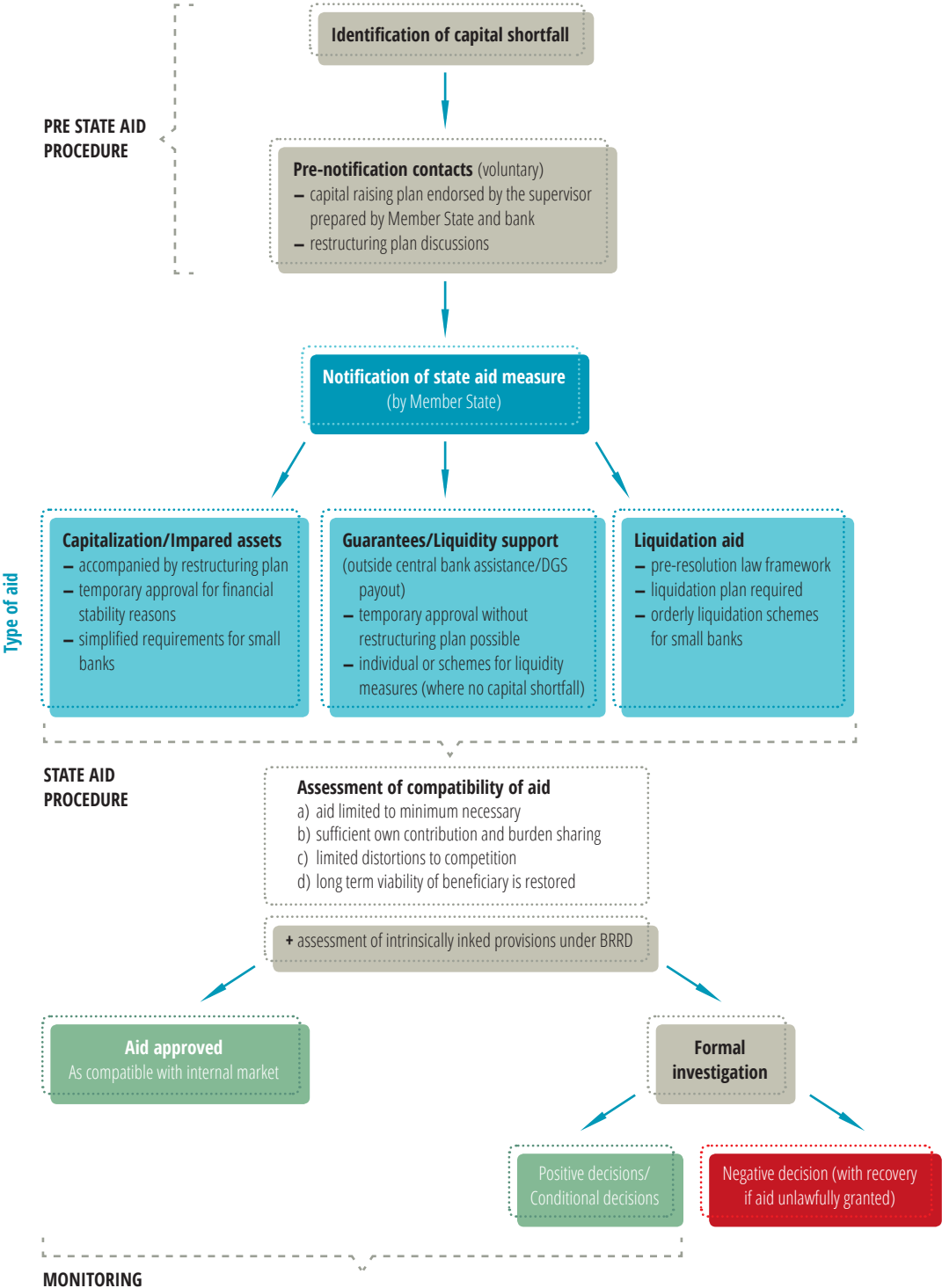
The state aid control framework has played a crucial role in financial crisis coordination and management at EU level since 2008, when it acted as de facto resolution policy. Following enactment of the BRRD, it continues to be relevant where 'extraordinary public financial support' can trigger resolution, and where any resolution action must comply with the principles of EU state aid law as outlined in the 2013 New Banking Communication. Both state aid and resolution law aim to secure competition and financial stability in the internal market and also to limit taxpayer's exposure to bank bailouts and curtail moral hazard in the sector as a whole.

## **Maintaining a level playing field**

[Articles 107–109 of the Treaty on the Functioning of the European Union \(TFEU\)](#) prohibit Member States from extending financial support to undertakings where this confers a selective advantage and potentially distorts competition or affects trade in the internal market. Treaty provisions are supplemented by secondary legislation as well as European Commission communications which outline its approach within the broad scope of its discretion.

Notwithstanding the potential harmful effects of state aid on competition, and the inefficiencies it can bring for the economy as a whole, a number of derogations compatible with the internal market are foreseen by the EU Treaties. These include for example aid having a social character or granted to make good the damage caused by natural disasters, to facilitate economic development of certain economic areas, or for the execution of projects of common European interest. State aid is thus oriented at ensuring a level-playing field between Member States and undertakings within the internal market. Public authorities may still operate and invest in the markets where any such action satisfies the market economic operator test, thus falling outside the scope of EU state aid control (e.g. Italian state guarantees to "Atlante", a NPL securitization fund, see accompanying case studies).

State aid approval procedure under New Banking Communication 2013



### **Providing financial stability during the crisis**

Bank bailouts were granted extensively over the course of the financial crisis to prevent unorderly liquidation and restore market confidence. Where bail-outs conferred an advantage on the beneficiary banks they constituted state aid and as such were cleared by the European Commission on the basis of hardly ever hitherto used [Article 107\(3\)\(b\) TFEU](#), which allows aid to “remedy a serious disturbance in the economy of a Member State.” The possible impact of bank failures – in terms of contagion, spill-over effects, or impact on lending – on the economy of the Member State as a whole was a necessary consideration in approving state aid. The systemic impact of the financial crisis has meant that state aid to fundamentally sound banks – also in the form of guarantees – was deemed compatible with the internal market. Furthermore, over the course of the crisis, financial stability considerations were considered the overarching objective of state aid control by the European Commission.

### **Development of a bank-specific state aid framework**

Despite the general nature of state aid law, the particularities of the banking sector required the European Commission to elaborate a bank-specific framework. Six crisis communications adopted since 2008 address recapitalizations, impaired assets, and bank restructuring, building on the pre-crisis approach to rescue and restructuring state aid cases. Three central principles form the core of the Commissions assessment of bank bailouts: return to viability, burden-sharing, and limitation of distortions to competition. Whereas the crisis communications are non-binding, Member States retain the right to notify to the Commission proposed state aid which does not meet the criteria laid down in the communications and the Commission may authorize such proposed aid in exceptional circumstances.<sup>1</sup>

By the end of 2016, 117 banks in 22 Member States representing approximately 30 % of EU banks by assets have been subject to state aid conditionality – 60 % being restructuring cases and 40 % liquidation cases. The European Commission took over 450 decisions. In terms of total amounts between 2008 and 2015 Member States have granted no less than EUR 465.6 billion in bank recapitalizations alone.

<sup>1</sup> Judgement of 16 July 2016, *Kotnik v Davnyi Zbor Republike Slovenje*, Case C-526/16, ECLI:EU:C:2016:570.

**Total amounts of state aid approved and used, EU-28 (2008–2015)**

Aid Instrument	Amounts of State aid approved		Amounts of State aid used	
	EUR billion	% 2015 EU GDP	EUR billion	% 2015 EU GDP
<b>Recapitalizations</b>	820.9	5.6 %	465.6	3.2 %
<b>Impaired asset measures</b>	604.3	4.1 %	188.6	1.3 %
<b>Guarantees on liabilities*</b>	3311.2	22.6 %	1188.1	8.1 %
<b>Liquidity measures, other than guarantees on liabilities*</b>	229.7	1.6 %	105.0	0.7 %

\*Amounts of aid approved and used are the maximum outstanding (annual) amounts for the period of 2008–2015.

Source: 2016 State aid scoreboard, European Commission

**State aid procedure**

In line with the EU Treaties and the recently revised Procedural Regulation, Member States are required to notify any aid to the European Commission for the assessment of compatibility with the internal market, except for aid specifically excluded from the regime (e.g. block-exempted schemes and aid below de minimis thresholds)<sup>2</sup>. Any unnotified aid automatically constitutes unlawful aid. On notification, the European Commission can decide not to raise objections or, where an initial assessment raises doubts as to the compatibility of the aid measure, an in-depth investigation is opened which allows for comments to be submitted by third parties. Such investigations can result in negative, positive, or conditional decisions. In the latter case the European Commission can make its compatibility assessment conditional on fulfilment by the Member State and/or aid beneficiary of commitments oriented at reducing distortions to competition, including of a structural (e.g. divestments) and/or behavioral (e.g. bans on price leadership) nature. Any commitments imposed initially on the bank can be revised in the light of crisis-specific market developments, as long as they continue to limit distortions to competition. Over the course of the crisis, the European Commission developed a specific procedure for the banking sector, including temporarily approving aid within 24 hours of notification, though increasing the monitoring and restructuring requirements as a second step. This emergency procedure, which allows for rescue aid in the form of urgent recapitalization or impaired asset measure to be approved on a temporary basis, has been maintained by the 2013 New Banking Communication (NBC) for exceptional cases warranted by financial stability considerations.<sup>3</sup> A restructuring plan is to

<sup>2</sup> See Commission Regulation (EU) No 651/2014 of June 17, 2014 declaring certain categories of aid compatible with the internal market; which exempts certain categories of aid – e.g. to SMEs and schemes below EUR 150 million – from notification obligations.

<sup>3</sup> See e.g. Commission decision of 06.09.2013 in State Aid Case SA.37314 “Rescue aid in favour of Probanka”.



be submitted within two months of the authorization of such rescue aid. As a rule, the NBC requires any individual aid to be accompanied by restructuring plans outlining the banks' strategy of returning to viability (or liquidation), prior to aid being granted.<sup>4</sup>

### **Aid measures over the course of the crisis**

The wide scope of the state aid definition implies that the following types of state measures can be held to fall within it, inasmuch as they apply in a selective manner and confer an advantage on the beneficiary bank(s):

- recapitalizations;
- impaired assets schemes;
- guarantees;
- liquidity support;
- interventions by resolution funds/other guarantee funds.

As state aid measures, their compatibility with the internal market in the crisis context is assessed by the European Commission in the light of New Banking Communications with specific conditions for individual types of aid.

Neither Emergency Liquidity Assistance (ELA) provided by central banks nor the depositor reimbursements via Deposit Guarantee Schemes (DGS) constitute state aid, unless – in the case of the former – central bank intervention is guaranteed by the State, or – in the case of DGS – the funds are used to restructure banks rather than ensure mere depositors compensation (payout). In fact, the use of DGS for recapitalization of an Italian small bank resulted in a recovery order, in the absence of a restructuring plan, sufficient burden-sharing, or measures to limit distortions to competition.<sup>5</sup>

State aid can be granted to an individual institution as well as in the form of a scheme approved by the European Commission. Schemes are typically adopted for smaller banking institutions to reduce the administrative burden. The NBC foresees the adoption of schemes in particular for liquidity guarantees and the liquidation of small banks. Where schemes do not entail individual restructuring plans approved ex ante by the European Commission, this requirement is substituted by monitoring and reporting obligations.

### **Conditions for compatibility under Art. 107(3)(b) TFEU**

Over the course of the crisis, the approach of the European Commission evolved substantially, both as a result of a learning process as well

<sup>4</sup> See for recapitalization aid measures points 34 and 53 of NBC allowing for temporary approval of aid without restructuring plan in exceptional cases for reasons of financial stability.

<sup>5</sup> Commission Decision (EU) 2016/1208 of December 23, 2015 on State aid granted by Italy to the bank Tercas (Case SA.39451 (2015/C).

as Court jurisprudence. Initially, the Commission relied on the general principles of the 2008 Banking Communication, which in particular required compliance with three conditions of appropriateness, necessity, and proportionality. Appropriateness required aid to be well-targeted in order to achieve its objective (“remedy a serious disturbance”). Necessity limited aid to the minimum necessary in both form and amount – even where the burden-sharing requirements were relaxed in the first phases of the crisis, given its unprecedented nature. Finally, proportionality was deemed when positive effects of the aid measure were balanced against any distortions to competition.

This approach was nuanced through the introduction of the restructuring plan requirement imposed by the Restructuring Communication 2009 (RC). Restructuring plans were to demonstrate in particular: the return to long-term viability, provide for equitable burden-sharing and allow for correction of excessive distortions to competition. The plans were composed of two parts: complete information about the bank’s business model, and measures oriented at restoring the bank’s long term viability. In particular, they should identify the causes of banks’ weaknesses and outline how the restructuring measures would seek to remedy the bank’s underlying problems. The requirement to present a restructuring plan was subsequently extended to all aid beneficiaries in 2011 (including fundamentally sound institutions). The NBC, under the overarching aim of financial stability, shifted the focus from the assessment of the aid measure itself towards measures to be taken by the aid beneficiary and the granting Member State once the aid is granted. The European Commission criteria for assessment of compatibility thus are: (a) aid must be limited to the minimum necessary; (b) distortions to competition must be limited; (c) there must be sufficient own contribution and burden-sharing; and (d) long-term viability of the beneficiary must be restored.

### **State aid and resolution law**

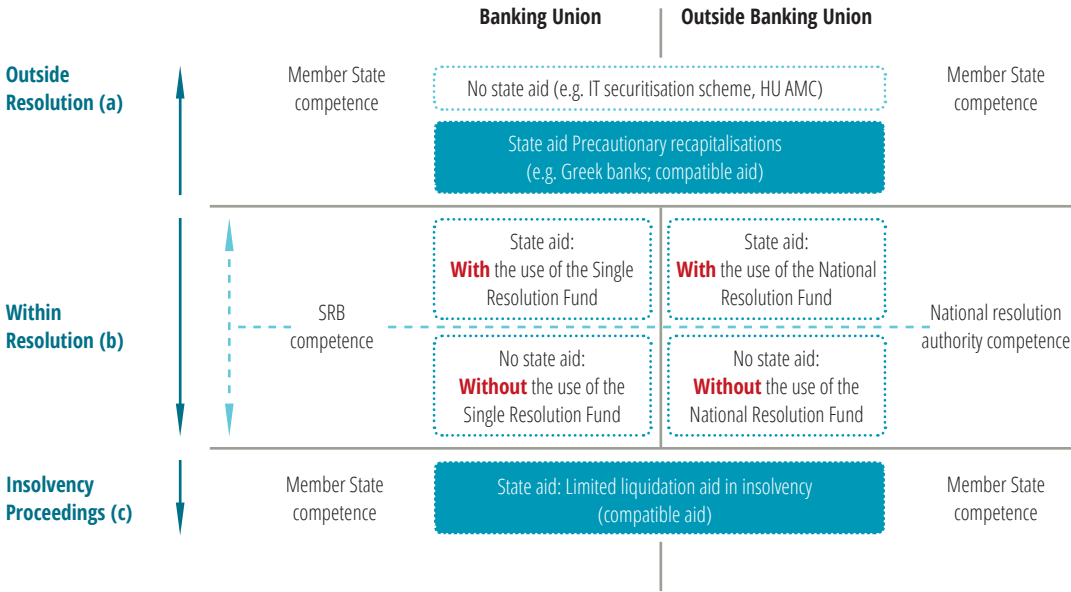
The BRRD requires that implementation of competition law, including state aid, and resolution law should be conducted by operationally separate authorities ([Art. 3\(3\) BRRD](#), chapter 6). Nevertheless, where resolution financing potentially constitutes state aid, resolution schemes require prior approval by the Directorate-General for Competition. Furthermore, since 2014, as part of its state aid decisions the European Commission assesses “indissolubly linked provisions” of the BRRD, even in cases which do not entail resolution but concern ordinary liquidation. To this end, the EU Courts have held that those aspects of aid which contravene specific provisions of the Treaty other than those of state aid may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately and that their effect on the compatibility or incompatibility of the aid must therefore of necessity be determined

in the light of state aid procedure.<sup>6</sup> The European Commission has thus sought to ensure that state aid measures comply with the general principles of resolution ([Article 34 BRRD](#)) or provisions related to specific resolution tools ([see chapter 9](#)).

The European Commission’s practice over the course of the crisis, in particular with regard to valuation of approaches to impaired assets (asset management companies, see [chapter 17](#) on bridge institution tool), has influenced both the general principles of EU resolution law and its tools ([see chapter 12](#) on valuation), though their different context – competition policy and internal market harmonization legal bases – should be borne in mind. To this end, state aid burden-sharing requirements and resolution law’s bail-in framework should be distinguished despite their similar features.

In addition to the substantive dimension provided for in the BRRD, the Single Resolution Mechanism (SRM) as the institutional counterpart created for Banking Union specifies new modes of institutional interaction between resolution and state aid authorities. In particular, the SRM Regulation requires the Single Resolution Board to refer to the European Commission where it considers that resolution actions – either through the Fund or complementary Member State action – could constitute aid ([Art. 19\(2\) BRRD](#), see also [chapters 6](#) and [14](#)).

State aid in the new regulatory framework



Source: European Commission

<sup>6</sup> Judgment of the Court of June 15, 1993, Matra SA v European Commission, Case C-225/91.

### State aid for financial stability and a level-playing field

State aid has been an integral part of EU competition policy since the 1957 Treaty of Rome. It plays an essential role in the pursuit of integration and broader internal market objectives of the Union – as made evident by the extent to which the European Commission has reframed its application of state aid law through the objective of financial stability in the context of bank bailouts, notwithstanding its overarching competition mandate. EU resolution law and state aid control seek to limit taxpayers' exposure to bank bailouts and curtail moral hazard, also through burden-sharing and bail-in requirements. However, their jurisdictional scope is not entirely the same, banks can still receive extraordinary public financial support without triggering resolution (see [Chapter 9](#)). Where the SRM is subjected to state aid rules, this ensures that Banking Union and other EU banks will be treated in the same way – thus protecting the level competitive field.

### Relevant documents

- [Council Regulation \(EU\) 2015/1589 of July 13, 2015](#) laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (Text with EEA relevance), OJ L 248, 24.09.2015, p. 9–29
- [10.07.2013 – Communication from the Commission on the application, from 1 August 2013](#), of State aid rules to support measures in favour of banks in the context of the financial crisis ("Banking Communication"), OJ C 216, 30.07.2013, p. 1.
- [01.12.2011: Communication from the Commission on the application, from 1 January 2012](#), of State aid rules to support measures in favour of banks in the context of the financial crisis, Official Journal C 356, 06.12.2011, p. 7
- [01.12.2010: Communication from the Commission on the application, after 1 January 2011](#), of State aid rules to support measures in favour of banks in the context of the financial crisis Official Journal C329, 07.12.2010, p.7
- [23.07.2009 Communication from the Commission](#) "The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules" Official Journal C195, 19.08.2009, p. 9
- [25.02.2009 Communication from the Commission on the Treatment of Impaired Assets in the Community Banking sector](#), Official Journal C 72, 26.03.2009, pages 1–22
- [05.12.2008 – Commission Communication Recapitalisation of financial institutions in the current financial crisis](#): limitation of the aid to the minimum necessary and safeguards against undue distortions of competition. Adopted on December 5, 2008, Official Journal C 10, 15.01.2009, p. 2–10

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