

*EUROPEAN COMMISSION CONSULTATION*

**AN EU FRAMEWORK FOR CROSS-BORDER CRISIS MANAGEMENT IN THE BANKING SECTOR**

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*Please note that the views expressed in this submission are those of the IMF's staff, and not necessarily those of the IMF's management or Executive Board. They do not in any way prejudice the outcome of the Executive Board's planned discussion on cross-border bank resolution issues.*

**General considerations**

1. We welcome the opportunity to contribute to this consultation.<sup>1</sup> We view an EU framework for cross-border crisis management and resolution in the banking sector as key to the successful completion of the EU's single financial market and to effective EU financial stability arrangements needed to prevent and contain future financial crises.<sup>2</sup> These

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<sup>1</sup> These comments have been prepared by the staffs of the European, Legal, and Monetary and Capital Markets Departments.

<sup>2</sup> In this document, we define resolution as the process of managing, restructuring, or liquidating an entity under the official administration of a public authority. Crisis management is a much wider concept that includes, for example, various forms of early intervention that leave an institution under private management.

comments should be seen in the context of the Fund staff's contribution to the development of enhanced frameworks for the prevention and resolution of (cross border) bank failures.<sup>3</sup>

### ***Objectives and constraints***

2. An EU framework for cross-border crisis management and resolution needs to provide a solid underpinning for the single financial market. It should allow financial institutions to operate across the EU's internal borders in ways that are economically efficient, serve the interests of home as well as host countries, and contribute to maintaining financial stability—including by allowing the orderly and timely exit of weak financial institutions. This means that it ought to provide a sound basis for the single passport, and in particular for the consolidation and rationalization of banks across the internal borders.

3. The framework also needs to credibly discipline large cross-border banks. The crisis has shown that “constructive ambiguity” is insufficient to deter banks from taking on excessive risks. It has also underscored the “too-big-to-fail”, “too-interconnected-to-fail”, and “too-big-to-save” problems, and shown the limitations of the existing deposit guarantee arrangements.

4. Key to addressing these challenges is the possibility to cost-effectively deal with a failing large cross-border bank, and transparency toward the financial sector and its counterparts about how this can and will be done. “Cost effectiveness” in this context should comprise several elements: (i) no losses to insured depositors, and minimal losses to deposit guarantee systems; (ii) minimal collateral damage to the economy; and (iii) minimal costs to government budgets. We underscore that such multi-dimensional cost-minimization is essential to make an EU resolution regime, and the cost sharing that entails, politically acceptable and sustainable.

5. The framework needs to be designed as an integral part of the overall system of financial stability arrangements, so that the various elements of this system optimally support and enhance each other's effectiveness. Notably, the crisis management and resolution framework needs to underpin the functioning of the ESFS and ESRB, and be designed in conjunction with the ongoing work on deposit guarantee arrangements and burden sharing.

6. Crisis management and resolution requires EU-specific solutions that are consistent with the objective of a single financial market and make full use of the opportunities that the EU's legal, institutional, and political context offers. At the same time, these solutions need to be designed to work smoothly within—and support—the global setup,

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<sup>3</sup> See International Monetary Fund / World Bank, *An Overview of the Legal, Institutional and Regulatory Framework for Bank Insolvency*, Washington, April 2009. Fund staff is also preparing an analytical paper regarding cross-border bank resolution at the behest of the G20.

which is also evolving. Solid arrangements will be needed to deal with financial groups that have extensive operations inside *and* outside the EU.

7. The EU's crisis management framework should be designed to implement and achieve commonly agreed principles and objectives. They should notably underpin the Crisis Management Principles adopted at the October 9, 2007 ECOFIN by the EU's Ministers of Finance and endorsed also by the financial supervisory authorities and central banks as part of the June 1, 2008 Crisis Management MoU. Key elements of these principles are:

- That the objective of crisis management is to protect the stability of the financial system **in all countries involved and in the EU as a whole** (Principle 1);
- That crisis management should minimize potential harmful economic impacts **at the lowest overall collective cost** (Principle 1); and
- That **direct budgetary net costs are shared** among affected Member States on the basis of equitable and balanced criteria (Principle 4).

While these principles are sound, the crisis has demonstrated that non-binding commitments insufficiently guarantee their consistent implementation, to the detriment of mutual trust and cooperation and—consequently—crisis outcomes. Therefore, in our view, these principles should be pursued through *binding and institutionalized arrangements*.

8. A multitude of fundamental legal, financial, operational, and—importantly— incentive difficulties impede cost-effective and equitable cross-border crisis management and resolution in the EU. These difficulties are largely inherent to the mismatch between, on the one hand, a single financial market that ought to transcend national borders and, on the other, country-level financial stability arrangements.

9. The scope for progress toward better crisis management and resolution frameworks in the EU depends on the willingness of member states to agree on fiscal arrangements to back up these frameworks. This means that some form of ex-ante fiscal commitment is needed in order to put in place the kind of cost-minimizing solutions that can best protect taxpayers. In practice, a variety of options is available to establish such a commitment, only some of which are mentioned below.

#### ***Recommended solution***

10. In our view, the EU's citizens would best be served by an *integrated EU-level framework for crisis prevention and management, crisis resolution, and depositor*

**protection.**<sup>4</sup> Such a framework would resolve the said institutional mismatch and offer the most effective avenue toward the objectives discussed above. With a focus on cost-efficient crisis management and resolution, and by providing an element of insurance against asymmetric financial shocks, it would also much better shield taxpayers from financial sector problems than is currently the case. The potential for a collective improvement in the well-being of the EU's citizens, relative to any conceivable second-best solution, is large and warrants tackling the considerable obstacles that admittedly would need to be overcome.

11. Establishing such an integrated EU level framework should follow a **two-pronged approach**: (i) a largely Regulation-based early intervention and resolution framework for all systemic cross-border EU banks (the "28th regime"), and (ii) a Directive-based framework for non-systemic cross-border banks and purely domestic banks. Banks that are not systemic in the home country, but that are systemic in one or more host countries, should be considered systemic in this context.

12. Such a framework should include some sort of **European Resolution Authority** (which does not necessarily have to be a new body, and could well be the European Banking Authority), which would be designed specifically to deal cost-effectively with the resolution of systemic cross-border EU banks. The need for quick decision-making leads us to favor an administrative approach over a court-led approach to crisis resolution. However, this requires clear mandates based on ex-ante agreed common principles and objectives (as discussed above), robust legal and accountability frameworks, and appropriate safeguards.

13. The EU-level 28<sup>th</sup> regime should comprise ***two pillars: one that focuses on individual banks and branch-based cross-border operations and a second that allows dealing in an integrated and coordinated manner with banking groups***. We welcome and support the Commission's efforts to facilitate group-wide crisis management and resolution. However, the issues are broader than that. As argued above, fundamentally the objective is the maintenance and strengthening of an efficient and sound internal market in banking services. This requires that banks can efficiently organize their cross-border operations, choosing freely whether to do so through branches or subsidiaries, but fully consistent with the legal implications of either approach. The crisis management and resolution framework needs to support both approaches. Concretely:

- We see fundamental legal and practical obstacles that will likely limit the scope for progress toward integrated insolvency proceedings for banking groups. Notably, we do not support the full consolidation of insolvency estates, as this seems to offer more disadvantages than advantages.

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<sup>4</sup> See also our comments dated August 12, 2009, submitted in the context of the Commission's public consultation on the Review of Directive 94/19/EC on Deposit-Guarantee Schemes (DGS).

- Recognizing banks' legitimate (and desirable!) wish to organize their cross-border operations efficiently within the internal market, it is of utmost importance that an effective framework be established for resolving individual banks, including their foreign (EU) branches. This would be the first pillar of our proposed framework.
- Our proposed second pillar would provide group-wide tools and mechanisms to organize integrated early interventions and coordinated resolution of troubled banking groups, including for non-bank entities of such groups, drawing on the first pillar as appropriate. This would enable group-wide operational integration up to, but no further than, that allowed by the fundamental legal nature of the subsidiary-based banking model.

14. This approach would also ideally involve *EU-level licensing, regulation and supervision for large systemic cross-border banks and banking groups*, so as to make the proposed resolution framework part of a “cradle-to-grave” EU-level prudential system.<sup>5</sup> (Non-systemic cross-border banks and purely domestic banks would continue to be governed by current arrangements.) This could be accomplished by making the EBA the lead supervisor for such banks and the consolidating and coordinating supervisor for such banking groups, drawing in either case on extensive delegation of tasks to national authorities for day-to-day supervision. Moreover, for early intervention, it is appropriate that the EBA take a leading role; so long as the bank of concern is clearly viable, the EBA's actions in this area will have to work closely with the respective college of supervisors. A European banking charter, which could build on the *Societas Europaea* statute, could be one way to facilitate such a framework and reconcile unconstrained intra-EU cross-border banking with efficient cross-border crisis management and resolution.<sup>6</sup>

15. The Directive-based framework for non-systemic cross-border banks and purely domestic banks, which would be the second prong of our proposed approach, should aim mainly at improving and harmonizing national frameworks as well as assuring consistency with the systemic EU-level regime. Substantially, the content of such Directive should be similar to the first pillar of the proposed Regulation, i.e. an adequate framework for official administration with appropriate resolution tools.

16. To be workable, this system would need a number of *key features* and adapted arrangements, including:

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<sup>5</sup> This would also require to enshrine the prudential framework for such banks in regulations rather than directives.

<sup>6</sup> For a specific proposal, see Čihák, Martin and Jörg Decressin, 2007, “The Case for a European Banking Charter”, IMF Working Paper 07/173.

- Efficient decision-making mechanisms at all levels, including for any required political decisions, since crisis costs tend to be a function of the speed and decisiveness with which interventions take place. Thus, there should be mechanisms to develop and implement technical solutions rapidly, while allowing political decisions to be made on policy directions.
- Provision of ELA by relevant central banks. If a European banking charter were introduced, it would be sensible for euro-denominated ELA to be provided directly by the ECB.<sup>7</sup> The provision of ELA should give rise to consultation with the EBA and/or the European Resolution Authority so as to ascertain appropriate supervisory follow-up in case the liquidity problem is indicative of deeper troubles.<sup>8</sup>
- An early intervention framework that provides the supervisory and resolution authorities with the tools and a mandate to stem losses at an early stage and prevent to the extent possible insolvencies from happening.
- Clear loss allocation rules that allocate losses to shareholders first.
- Mechanisms for the rapid financing of resolution efforts, including but not limited to (pre-funded) deposit guarantee schemes. The IMF's ongoing work in this area, at the request of the G-20, could provide elements of such a financing mechanism. The prudential framework will also need to effectively counter any real or perceived incentives for excessive risk-taking by banks based on the presumption that they will be bailed out.
- Arrangements to minimize the socio-economic and political fall-out of bank failures, in particular by containing the impact on the clients of the failed banks. These arrangements could include, in addition to deposit insurance, systems to give unprotected retail depositors rapid access to the likely recovery value of their deposits, and measures to restore rapid access to payment systems and liquidity lines.
- Rules and efficient decision-making mechanisms for authorizing related fiscal exposure and allocating any net losses. While the system should be designed to

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<sup>7</sup> In case a banking group with operations in more than one currency area needs support, the central banks will need to coordinate their action.<sup>8</sup> Given the problem of US dollar liquidity shortages that manifested itself during the crisis, consideration should also be given to some sort of permanent swap or liquidity arrangements with the issuing central banks of the other major global currencies.

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minimize any need for recourse to fiscal resources, this option should be available in order to make the system robust.

This proposed framework is further elaborated below, in the detailed responses to the consultation questions.

### *Accompanying measures*

17. A solid framework for crisis management and resolution is a necessary but not sufficient condition to achieve the objectives outlined above. Such a framework needs to be embedded in a broader set of consistent arrangements that ensure that banks also in life conduct their business in ways that allow cost-efficiency in death. This implies reasonable but firm restrictions on the way banking groups organize themselves, the kind of activities they engage in, and the exposures they take on.

18. Supervisors need to seek alignment between a financial group's legal and operational organization on the one hand and the crisis management and insolvency framework on the other. As recommended in the Basel Core Principles and by the Basel Committee's Cross-Border Bank Resolution Group (Recommendation 5), financial groups need to organize themselves in ways that facilitate supervision and resolution. This should be the subject of regular reviews and discussions between a group and its supervisors.

19. Prudential policies also need to aim specifically at containing the costliness of bank failures, by addressing complexity and concentration exposures on banks' balance sheets. In addition, prudential policy in such areas as liquidity management needs to be modernized with a view to reducing the likelihood and severity of banking crises.

20. At the same time, the framework must balance the need for accountability and the right to judicial review with the need for legal certainty, expediency and the protection of taxpayers from unreasonable damage claims resulting from crisis management and resolution decisions. One means toward this objective could be to establish a specialized financial chamber at the European Court of Justice or Tribunal of First Instance, staffed with judges that are experts in financial law and organized to convene and decide in very short order. Within reasonably established time limits, such a chamber could settle disputes that arise during a crisis management and resolution process. In general, possibilities to appeal resolution decisions should be carefully defined, not have suspensive effect, and be time-efficient. The standards for judicial review should be based on deference to the administrative decisions taken by the European Resolution Authority, and should allow a balancing of the public interest against private rights.

### *Interim measures*

21. Our recommended solution will take time and political will to be realized. In the meantime, significant steps can be taken to facilitate crisis management and resolution through a more integrated EU framework.

22. Even in the absence of a full-fledged EU resolution regime, the complexity and the scope for conflicts of interest in cross-border crisis management within a single market necessitate the close involvement of an EU-level body (e.g., the EBA), with a mandate to provide an independent perspective guided by the commonly agreed principles and objectives, to provide expertise, and to facilitate the quick decision-making that is needed for cost-effective crisis management and resolution. To this end, the EBA would play a lead role in the Cross-Border Stability Groups.

23. More specific arrangements for burden sharing, and any steps toward increased private sector funding, would be very helpful. In this regard, we support the work of the EFC Ad-Hoc Working Group on this topic and keenly look forward to its final conclusions.

24. Consideration could be given to the introduction of a legal duty on national resolution agencies to consider the consequences of early remedial and resolution actions for other member states and to seek cooperative solutions, where possible, i.e., as a “European mandate.”<sup>9</sup>

25. Within the EU, reforms should be considered in conjunction with the other components of the EU regulatory framework (CRD, Deposit Guarantee Scheme, Insolvency regime, Company Law), which are also in the process of being revised. For instance, it should be clarified whether and to what extent the applicable Deposit Guarantee Scheme (nationals or pan-European) would be involved in the winding-up of a cross-border institution.

26. Regardless of the institutional arrangements and the existence or not of an EU-level framework, crisis management and resolution would be greatly facilitated by greater harmonization of national frameworks. Most of these frameworks face similar reform needs in any case to protect their domestic financial stability and taxpayer interests.<sup>10</sup> In some cases, this may require significant amendments to national laws through EU directives harmonizing substantive bank resolution laws (in addition to the Winding-Up Directive for Banks, which focuses on private international law).

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<sup>9</sup> See Hardy, Daniel, “A European Mandate for Financial Sector Supervisors in the EU,” IMF Working Paper 09/5.

<sup>10</sup> For an in-depth discussion, see Čihák, Martin, and Erlend Nier, 2009, “The Need for Special Resolution Regimes for Financial Institutions—The Case of the European Union”, IMF Working Paper 09/200.



## Specific Answers to the Questions of the Consultation Documents<sup>11</sup>

### 3. Early intervention by supervisors

#### 3.1 *Early intervention tools (Chapter 2 of the Working Document)*

**Q: Which additional tools should supervisors have in order to address developing problems?**

**WD Q(4): Do supervisors need additional tools and powers for early intervention, and if so, which?**

27. As the Commission has recognized in these and other publications, it is hard to draw firm lines between “early intervention”, “crisis management”, and “crisis resolution” measures. What matters is that the authorities in charge of supervision, crisis management, and resolution have a continuum of tools available and the powers to use them in a timely way in order to limit losses, defend the public interest, and achieve the principles and objectives that underlie the financial stability framework. These tools can best be harmonized across the EU.

28. The tools envisaged in the communication are appropriate. In addition, consideration should be given to the following additional powers:

- The possibility to require a capital increase, the conversion of contingent capital into equity, and to call on any form of capital insurance or other legally-binding support commitments (e.g., from shareholders or group members). This should be in addition to the possibility to require a group restoration plan, as from public policy and financial stability perspectives a restoration of capitalization has very different implications depending on whether it happens through an increase in capital or a decrease in (risk-weighted) assets;
- The possibility to impose temporary limits on compensation when compensation pay-outs risk weakening an institution (these emergency intervention powers should be in addition to a more comprehensive overhaul of compensation practices as is currently under discussion). These powers should focus on variable pay components and high pay packages;
- The possibility to require the divestment or winding-down of activities that are deemed to pose excessive risks to the soundness of a banking group, be unviable, be

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<sup>11</sup> Questions from the main document are preceded by “Q.”; those from the working document by “WD Q(x)”, with x being the number of the question.

beyond the group's capacity to manage or support, or represent a fundamental conflict of interest;

- The possibility to put limits on the growth of an institution or veto expansion plans;
- The power to require a reduction of the refinancing risks in a banks' funding structure, through a lengthening of maturities and reduced reliance on wholesale markets; and
- The power to demand changes to legal group structures and/or operational organization in order to facilitate supervision and ensure consistency with crisis management and resolution arrangements.

29. A prerequisite for the effective use of these tools is high-quality supervision. Moreover, as pointed out by the De Larosière Group, there is also a need for stronger sanctions and enforcement regimes to ensure compliance with regulations and supervision. Such a regime could be integrated with the early intervention framework.

**Q: *How should their use be triggered?***

**WD Q(5): *Should the application of early intervention measures only be the result of supervisory (joint) assessment of emergency situations, or would there be any advantage in structured or automatic triggers for early intervention?***

30. The definition among supervisors of common early intervention thresholds, operating also at an early stage, is crucial to effectively addressing problems of a troubled cross-border bank. We agree that narrowly-defined, automatic triggers would not be satisfactory because it is impossible to specify in advance all relevant circumstances. However, certain other elements would be desirable:

- There should be a clear escalation of supervisory interventions, according to the principle of proportionality;
- The management and shareholders should normally be given the opportunity to redress the situation, subject to strict deadlines and oversight, and provided that the institution is not at imminent risk of insolvency or subject to rapid loss of value;
- An indicative list of triggers and thresholds (in terms of capitalization, liquidity difficulties, etc.) should be established and published in advance, so that regulatory uncertainty is reduced, and accountability and coordination are facilitated;
- The use of ELA should always trigger a supervisory investigation and should, when warranted, trigger a set of supervisory actions that may escalate to intervention;

- Supervisors should be accountable both for action taken, and for action not taken. In particular, not reacting to the breach of an (indicative) threshold should require explanation at least to the relevant college and Cross-Border Stability Group, the EBA, and any potential EU-level Resolution Authority. This should reduce the risk of forbearance, enhance information sharing, and improve the allocation of responsibility;
- A decision not to take action should be contestable by the members of a supervisory college and the EBA (and, if applicable, the European Resolution Authority). It should be handled under the EBA's procedures for emergency situations;
- The EBA should have an explicit mandate to oversee the consistent application not only of regulations and supervisory standards, but also of early intervention principles and actions.

**Q: *How important are wind-down plans ("living wills") as a tool for crisis management?***

**WD Q(7): *The Commission Services invite views on a requirement for 'wind down' plans. In particular:***

- *Would 'wind down' plans provide useful information to managers and supervisory authorities?*
- *What kinds of institution should be required to prepare them?*
- *What should be the content of wind down plans?*
- *Should the development of wind down plans be closely linked to the design of a cross-border resolution framework?*

31. Contingent Resolution Plans ("Living wills") could be an effective tool for crisis contingency preparedness for large and complex financial groups. Notably, if established in an interactive process between management and supervisors, they could help in fostering a common understanding on the structures of the group and their implications for crisis management and resolution. However, as argued in our introductory comments, group structures should be subject to regular review and discussion in any case. When this happens, the value added of living wills may be much reduced. Nonetheless, supervisors should have the power to require a banking group to formulate an acceptable winding-down plan if the supervisor so chooses.

32. Significant practical limitations need to be taken into account. In this regard, we would emphasize:

- Coordination among supervisors in their approval and implementation should be organized through the supervisory colleges and, where applicable, the Cross-Border Stability Groups;
- The confidentiality of the plans needs to be preserved; and
- A banking group may have to adjust any “living will” very frequently as its business evolves, and supervisors may find it difficult to assess such adjustments.

**WD Q(6): *Is any modification of the current framework for the supervision of branches necessary or desirable?***

33. In our view, the single passport is the essential element of the single financial market and needs to be preserved. However, the current arrangements underpinning the single passport have proven their limitations. Going forward, we do not think that large-scale cross-border branching can continue to be based on the supervision, resolution framework, and deposit guarantee systems of the home country alone. Moreover, a situation in which in practice only banks based in large countries can benefit from the single passport (because only large countries can credibly provide adequate resources to back-up resolution) is inequitable and at odds with the level playing field dimension of the single market.

34. As argued in our introductory comments, a sound basis for the single passport of large, systemic cross-border banks can best be provided through an EU-level cross-border crisis management regime and deposit guarantee scheme, which would have to be matched with EU-level supervisory arrangements. In addition to lead supervision by the EBA as proposed above, options include establishing colleges of supervisors also for branch-based cross-border groups (at least for consultative purposes between home and host authorities), putting supervision by the home authority under the oversight of the EBA and/or the EU-level resolution authority, and increased use of delegation between home and host authorities. In contrast, cross-border branching on a scale that raises concern in neither home nor host country could still happen under the existing arrangements.

35. Such an EU-level system would much better safeguard the interests of host countries. Further safeguards should be provided by ensuring that host country supervisors have adequate access to information on the activities of foreign banks in their domestic market and that they can bring any concerns they have to the attention of the EBA and ESRB, for mandatory follow-up.

### **3.2     *Intra-group asset transfers (Chapter 3 of the Working Document)***

#### **WD Q(10): *Is the concept of 'banking group' worth exploring further?***

36.            We support the concept of “banking group”, based on clear and transparent criteria, notably to facilitate an integrated approach to intra-group crisis management and a coordinated approach to resolution.

37.            A well designed legal concept of “banking group” would be an essential element of the supervision and financial stability framework. More specifically, this concept of banking group could represent the legal underpinning of a coordination mechanism identifying a lead supervisory authority entitled to initiate intervention in the group. This entails a precise definition of a banking group, based on objective criteria such as the component of the banking activity within the group, and susceptible of being then monitored by the authorities and disclosed to third parties. (See our considerations below in relation to the institutional arrangements underlying such a framework and to the substantive provisions of law which would be applicable in this case).

38.            Not only would such a concept be relevant in the context of crisis management, its scope and function should fall coherently within the supervisory system and be closely aligned with the other relevant provisions of the EU legal framework for banks. The enhancement of a concept of banking group could entail, for instance, stronger obligations of the parent company—valid also towards minority shareholders and creditors—for the sound management of the group. This entails a heightened suitability test of the significant and controlling shareholders, responsible for the financial stability and duly capitalization of the group, to be performed by the supervisory authorities. Enabling such authorities to request the submission of a restoration plan of the group as a whole, and to enforce such plan, may represent another beneficial tool.

**Q: *Is the development of a framework for asset transfer feasible? If so, what challenges would need to be addressed?***

**WD Q(8): *The Commission Services invite views on the advantages, if any, of designing a framework for asset transfers along the lines outlined above.***

39.            The concept of group interest, which the consultation documents propose could inform intra-group financial support to manage liquidity positions and stabilize group entities, raises related but distinct considerations, as it could be built upon the architecture and treatment of banking groups. We see the merits of such proposal, even though certain reservations should be carefully taken into account.

40.            Indeed, the benefits and burdens that a company draws from its belonging to a group should be appropriately acknowledged in the EU legal framework and inform the

analysis of the group interest. Transactions entered by group companies should not be viewed on a stand-alone basis but should rather be framed within the aggregate strategic interest of the group: the detriment suffered by one group company as a result of a particular transfer could be compensated by the restoration of the financial soundness of the whole, which ultimately brings benefits also to the transferor. Thus, intra-group asset transferability could represent a possible restructuring tool, aimed at avoiding contagion effects within the group: in this context, it serves an early intervention function, and should not be configured as a resolution mechanism dealing with insolvent entities.

41. The logic of the group concept and asset transfers is consistent with the objective of enabling a certain degree of operational integration within banking groups, and it could in certain cases significantly curtail the scope and cost of crises. To overcome the inherent legal challenges, one could consider requiring that such integration be backed up by contractual mutual support obligations that establish legally-binding joint and several liability for each other's commitments. As banking groups already claim that, in practice, they cannot allow a subsidiary to fail due to reputational risk, this would basically amount to formalization of a *de facto* already existing situation. It would greatly enhance transparency for all parties involved. We note that such or similar formal arrangements already exist within some cooperative and savings banking groups, and these appear to have functioned well.

42. We appreciate that this topic is raised in the context of early intervention. Nonetheless,, we have concerns about measures that might “pierce the corporate veil” and potentially weaken a healthy transferor in order to shore up a transferee company. An asset transfer framework would need to carefully consider how the expectations of creditors of the transferor could be affected. Risk management and due diligence would potentially become more difficult and more expensive for anyone that enters a contract with an entity whose assets might be depleted under an asset transfer regime. Additionally, to the extent that an asset transfer regime required modification of company or insolvency law in order for the transfers to be enforceable and effective, these modifications would have to be very carefully prescribed and limited, bearing in mind that the modification and adaption would need to be made to systems of national company and insolvency law which may not operate identically.

43. It could also be worth considering the interaction between the proposed intra-group asset transferability and the operation of branches and subsidiaries established by EU banks in non EU-jurisdictions, which may create different layers in a banking group. This could be especially relevant in light of the possible trend towards a “subsidiarization” of the extra-EU bank network.

44. Finally, it is not clear whether the consultation envisages asset transferability as a way to address liquidity problems of a group or, by contrast, as capital support given by a group company; different considerations, for instance on the granting of collateral, would apply in the latter case. Also, it would be useful to better distinguish between transfers made at the instigation of supervisors and those made at the instigation of the group's management.

A minimal approach, which would still be useful, would aim to facilitate the transfer of assets under the direction of, or with the approval of both home and host supervisors, when the group is still operating. For transfers across borders, consideration could be given to requiring the consent of both supervisors involved before a transfer is blocked, or at a minimum, the blocking supervisor should immediately inform other supervisors who may be affected. In any case, and regardless of whether transfers are made at the instigation of the management or of the supervisors, intra-group transferability should be underpinned by a robust and clear framework, in line with the safeguards outlined below.

**Q: *What safeguards for shareholders and creditors are needed?***

**WD Q(9): *What are the appropriate safeguards for creditors?***

45. There needs to be ex-ante transparency about the implications of any group concept and the possibility of asset transfers toward the counterparts of the various legal entities, including minority shareholders and creditors. Hence, the criteria allowing for intra-group transfers should be precisely circumscribed in advance. These criteria must take into account the conditions under which a transaction, although being prejudicial to the economic interests of a single group company if viewed on a stand-alone basis, can bring broader benefits to the aggregate strategic interest of the group and be part of a commonly understood system of mutual support. Such analysis could draw from the principles of “compensative advantages”, fair compensation and group interest, developed in some legal systems of Member States, and should also be linked with the overall benefits that a company draws from its belonging to a group.

46. Moreover, it could be an explicit requirement that any supervisor-mandated transfer be undertaken under a reasonable expectation that it will contribute to a least cost solution, the burden of which would then be equitably allocated. Such a requirement would reduce concerns that a transfer would greatly disadvantage creditors or taxpayers in one country, or be used to provide short-term support to a nonviable part of a group at the expense of viable parts of the group. This analysis should take into account that, while intra-group support could restore the financial stability of the group, certain nonviable parts may best be liquidated.

#### **4. Bank Resolution**

***4.1/4.2 Why is EU action on bank resolution needed? Objectives of a bank resolution framework.***

**Q: *What should be the key objectives and priorities for an EU bank resolution framework?***

47. The financial crisis has demonstrated the need for special resolution regimes for banks, outside of the framework for ordinary corporate insolvency. The main purpose of a

bank resolution regime should be to preserve financial stability and minimize the broader economic impact of bank failures by ensuring the continued smooth functioning of payment and settlement systems, protecting the depositing public, and preserving banks' important credit intermediation function. A bank resolution framework should permit early intervention in order to attempt to preserve value in a failing bank and to return it to viability or, where this is not possible, to ensure that the institution is liquidated in as orderly a manner and with as little impact as possible.

48. The resolution of cross-border banks poses more difficulties and complexities than the resolution of purely domestic banks. Any EU framework for bank resolution should have the financial stability of the EU and the individual Member States as its core objective, recognizing that financial stability within the single market for financial services is a community-wide public good, and that an EU framework should aim to make all Member States better off. Action on bank resolution is necessary at the EU level due to the mismatch between the common market for banking services and the different national approaches to bank resolution in Member States. On the one hand, the promotion of greater harmonization amongst national bank resolution frameworks could foster better coordination between different national supervisors who may be responsible for resolving legally distinct components of an EU banking group. On the other hand, for the largest most systemically significant EU institutions, there may be benefits in either placing resolution responsibilities in the hands of a single, unitary authority or a lead national supervisor charged with coordinating concurrent proceedings.

#### **4.3 What resolution tools are needed? (Chapter 4 in the Working Document)**

**WD Q(11): Which objectives should bank resolution tools seek to pursue? Which objectives should be prioritised?**

49. As argued above, bank resolution tools should be used to achieve resolution at the lowest overall cost. Resolution tools should also be applied to ensure that losses fall commensurately with the degree of risk assumed by different classes of creditors, it being likely that shareholders and unsecured creditors would bear the brunt of losses. Higher direct resolution costs may at times need to be made in order to contain this risk of disproportionate (indirect) socio-economic costs and achieve a better collective outcome for the Member States concerned.

**Q: What are the key tools for an EU resolution regime?**

**WD Q(12): What resolution measures are necessary? In particular, would the resolution tools outlined in paragraph 93 be appropriate and sufficient for an EU regime?**

50. The resolution tools listed in the Working Document are appropriate and should be part of an EU resolution regime. At a general level, though, in the resolution phase the



competent authorities should first and foremost have the possibility to take administrative control of a financial group (see also below) and exercise the powers normally reserved for management and shareholders. In addition, we suggest giving consideration to granting the administrator additional powers to allocate losses to shareholders (by taking write-downs on assets, thus reducing net equity, which will require capital increases that are likely to dilute existing shareholders); and, in cases of insolvency, to uninsured creditors (by applying “haircuts” to claims) in order to restore the book value of an institution to zero from negative levels. However, judicial oversight may be needed to mandate changes in contracts such as haircuts on creditors’ claims. Developing debt instruments that would facilitate uninsured creditors taking a loss would support such an approach.

51. In a severe systemic crisis, if a private solution is not feasible, nationalization may be necessary to preserve stability. Because of the systemic and complex nature of certain banks, there may be circumstances where authorities feel it appropriate to deal with a troubled bank outside the “traditional” bank resolution framework. An EU resolution regime should ideally provide the possibility, in such cases, to organize a “joint nationalization” under a streamlined ownership and governance structure involving the concerned member states, in ways that do not result in an unnecessary and potentially costly break-up of the group in question along national lines. However, nationalization should always be a temporary solution, nationalized institutions should be managed on commercial terms, and the objective should be to restore the institution to private ownership once it has been restored to health, systemic risks have abated, and market conditions have normalized.

**WD Q(13): *Would administrative reorganisation (as described) be a viable option for financial institutions – or might there be a risk that the appointment of an administrator could exacerbate liquidity problems due to loss of confidence?***

52. We see administrative reorganization as an essential element of a crisis resolution framework. In most cases, liquidity problems precede the administrative reorganization, not the other way around. Administrative reorganization, coupled with some form of liquidity support, can actually stabilize the situation.

#### ***4.4 Threshold conditions and timing for use of tools (Chapter 5 in the working document)***

**Q: *What are the appropriate thresholds for the use of resolution tools?***

**WD Q(14): *What threshold conditions would be appropriate for the use of resolution tools?***

53. A decision by competent authorities to intervene in a failing bank may well involve discretion and the exercise of subjective judgment, for example, as to possible the threat to financial stability which a particular failing institution might pose. Nevertheless,

such discretion ought to be exercised, to the extent possible, on the basis of objective and transparent criteria. Examples of such criteria are: (i) the bank is in serious and/or persistent breach of regulatory requirements; (ii) the bank is otherwise deemed (beyond reasonable doubt) to be no longer economically viable; (iii) the bank's capital buffer has shrunk to a level that risks not being adequate to cover the additional losses that can be expected to materialize during resolution proceedings; and (iv) early interventions (including restructuring plans agreed with the bank and/or possibly administration) have failed, after a reasonable period, to restore the bank to soundness. Other similar triggers may also be appropriate. To the extent that different national resolution regimes might apply in the context of the resolution of a cross-border group, it would be desirable for national regimes to have broadly harmonized triggers for intervention.

**WD Q(15): *Should different conditions be defined for the use of different tools, and in particular in the case of a graduated approach to resolution?***

54. As a general matter, the resolution authority should have the power to make full use of its toolkit once a bank has been put under official administration. Some degree of differentiation may, however, be useful depending on the urgency of resolution. In particular, thresholds for intervention might be correspondingly higher for more radical intervention measures; in particular any measure that potentially derogates from the property rights of shareholders.

#### **4.5 *Scope of the bank resolution framework (Chapter 1 of the Working Document)***

**Q: *What should be the scope of an EU resolution framework? Should it only focus on deposit-taking banks (as opposed to any other regulated financial institution)?***

**WD Q(1): *Should an EU regime focus exclusively on deposit-taking banks (as opposed to any other regulated financial institution)?***

**Q: *Should it apply only to cross-border banking groups or should it also encompass single entities which only operate cross-border through branches?***

**WD Q(2): *Should an EU regime apply exclusively to cross-border banking groups, or should it also encompass single entities which only operate cross-border (if at all) through branches?***

55. Under the two-pronged special regime that we propose as our recommended solution, the 28<sup>th</sup> regime should be applied to any bank with cross-border activities under the single passport that are of a magnitude and scope that raise legitimate concerns in host or home country. It should certainly apply to such institutions in cases when a home country may be unwilling or unable to back the institution with sufficiently capable and resourceful national crisis management, crisis resolution, and deposit guarantee arrangements. In

addition, we support the harmonization of Member States' frameworks for bank resolution through Directives.

56. The special regime for systemic cross border banks should first and foremost establish a modern and adequate framework for resolving a bank qua legal entity. As such, it should cover the operations in both the home country and host country of the bank (i.e. branches). Such regime—to be enshrined in a regulation—would thus need to include both substantive rules and elements similar to those currently included in the Winding Up Directive for Banks.

57. In addition, for banking groups, the 28<sup>th</sup> regime should ideally include coordination mechanisms for other legal entities of such groups (see below). This would entail that all bank subsidiaries of banking groups would be resolved according to the 28<sup>th</sup> regime. In contrast, the aim is not to generalize the substantive resolution rules of banks to non-bank components of banking groups. Indeed, each non-bank entity of a banking group should be resolved per the rules established for that type of entity. However, the legal framework should include coordination mechanisms whereby the lead resolution authority coordinates resolution of all entities of the group, working together as appropriate with specialized resolution authorities in case of non-bank entities. One option is to entrust the EBA or lead supervisor with this responsibility. Another option could be for Cross-Border Stability Groups to agree on a case-by-case basis how resolution will be approached and which tasks should be entrusted to the EU framework. As a minimum, the EU level should always provide some form of coordinating and enabling function (see above).

58. We recommend focusing in the first instance on credit institutions and groups of such institutions. However, alongside an EU regime for deposit-taking institutions, a separate regime might be needed for certain types of investment firm (e.g., broker-dealers). There is no equivalent of the WindingUp Directive for broker-dealers. If there were an equivalent of that Directive for broker-dealers it might help creditors of broker-dealers manage legal risk better by giving more certainty as to whose insolvency laws would apply in the event that a broker-dealer with many European branches becomes insolvent.

**WD Q(3): *Should an EU regime apply exclusively to, 'systemically important' institutions? If so, how should this concept be defined and how should the relevant institutions be identified?***

59. See above. We are of the opinion that a 28<sup>th</sup> regime should focus on systemic cross-border banks. Banks that are considered systemic in any host country should be considered systemic for this purpose regardless of their importance or lack thereof to the home country. While the definition of “systemic” can be debated, the judgment of the host country prudential authorities should carry significant weight in the assessment. At the same time, a Directive-based modernization and harmonization for resolution frameworks for other banks would also be useful.

**4.6 Stakeholders' rights in bank resolution procedures (Chapters 6 and 7 in the Working Document—Ancillary Measures / Company Law and Shareholders' Rights)**

**Q: Is it necessary to derogate from certain of the requirements imposed by the EU Company Law Directives, and if so which conditions or triggers should apply to any such derogation? What appropriate safeguards, review or compensation mechanisms for shareholders, creditors and counterparties would be appropriate?**

**WD Q(19): Is it necessary to derogate from certain of the requirements imposed by the EU Company Law Directives and, if so, what conditions should apply to any such derogation? If the scope of an EU special resolution framework extended beyond deposit-taking banks to cover other financial institutions (see Chapter 1), should such derogations from the EU Company law rules apply to all financial institutions covered?**

60. While we acknowledge the difficulty in striking the proper balance between public and private stakeholders' interest, we think the crisis has clearly demonstrated that existing crisis management and resolution arrangements often put insufficient weight on the former. As argued above, resolution proceedings should be initiated well before a situation of insolvency in book value terms is achieved. The resolution authority should not need the approval of private stakeholders to initiate these proceedings and apply its resolution tools. Also in the case of official administration, the administrator should have the power to exercise certain rights, titles, powers, and privileges of any stockholder or member of the bank. Relatedly, procedural requirements, such as those regarding the convocation of shareholders' meetings and the exercise of pre-emption rights, could be streamlined. The legal framework, including the EU Company Law Directives, should be adapted accordingly. In that regard, it should be noted that derogations from the property and company law rights of shareholders might be possible only when objectively justifiable on the grounds that such derogation is necessary in the public interest and in order to preserve financial stability. Conceivably though, in a systemic crisis, such criteria would almost invariably be satisfied.

**WD Q(16): What kind of specific protection and support measures are needed in the context of partial transfers or the splitting of a group, including measures for the protection of creditors?**

**WD Q(17): What changes to insolvency law would be necessary to support bank resolution measures (e.g. moratorium, post commencement financing, etc.)?**

**WD Q(18): What safeguards are needed for financial contracts and commercial arrangements that may be affected by partial property transfers?**

61. Any EU level framework for bank resolution would need to ensure that partial transfers could not upset netting and financial collateral arrangements or interfere with

payment flows in certain types of capital markets transactions, including covered bonds and securitisations. When breaking up a failing bank, competent authorities should not be able to “cherry pick” rights and liabilities that are protected under financial collateral arrangements. Additionally, partial property transfers should not be able to be used in ways which might interfere with a central counterparty’s ability to operate its default rules effectively. As the Working Document observes (at Paragraph 114) the UK Special Resolution Regime (in particular the Restriction of Partial Property Transfers Order 2009 (the ‘Safeguards’ Order) has explored the protection of netting and collateral rights in some detail. While any EU framework would need to be sensitive to different national laws of Member States, the UK regime may provide a helpful starting point for establishing best practices in the context of partial property transfers.

**WD Q(20): *The Fortis case has shown that requirements imposed only at the level of the national law, or allowed by it, can also impair effective measures to save an ailing bank. Is it therefore necessary to regulate at EU level to ensure that such national rules do not apply in where measures are taken under a bank resolution framework? If so, what conditions should apply to any such derogation from national rules?***

62. In cases covered by an EU-level bank resolution framework, the provisions of that framework would override national rules if they are enshrined in regulations. More generally, we see considerable merit in a significant degree of harmonization of national crisis resolution frameworks and relevant rules, also for banks that are not systemic and cross border.

**WD Q(21): *What kind of triggers or conditions are likely to best deliver the objectives set out in paragraphs 132-133, and to ensure that intervention in the field of shareholder rights is proportionate and justified? In particular, should these triggers or conditions be the same as those discussed in Chapter 5, or should the conditions for interference be stricter where shareholders' rights are at stake.***

63. Where resolution tools interfere with shareholders' rights in company and property law, the possibility and terms of such interference should be clearly prescribed in law. The interference ought only to be permissible in cases where the risk from financial instability outweighs the individual rights of shareholders. While the threshold for such interference would therefore be high, the determination as to whether the threshold had been met would necessarily involve the competent authorities making a subjective judgment. As such, any decision to resolve a failing bank ought to be susceptible to some form of judicial review albeit under the limitations discussed above.

**WD Q(22): *Should mechanisms for compensation be set out at EU level, and if so how should this be done?***

64. See above. There is a strong argument for coupling EU-level bank resolution frameworks with EU-level arrangements for judicial review.

#### ***4.7 Application of resolution measures to a banking group***

***Q: How can cooperation and communication between authorities and administrators responsible for the resolution and insolvency of a cross border banking group be improved?***

65. The scope for conflict and disagreement in cross-border crisis resolution is such that, in our view, the involvement of a neutral party that acts as the guardian of the “common good” and of the common crisis management principles is needed. Such a party could be a European Resolution Authority, the EBA or a specific subcommittee or representative of the EBA, or one or more independent experts.

66. Given the low frequency of systemic crises, authorities typically lack expertise to deal with such situations. The kind of third party proposed above could therefore fulfill a useful role by pooling relevant expertise and making this expertise available to national authorities in resolution cases.

67. The role of such a party could take various forms: mediator, arbiter, initiator of proposals, and resolution authority.

68. One possible approach could be for such a neutral party to take the lead by drawing up a concrete proposal for a resolution strategy, including any necessary financing and the sources of that financing, based on the common crisis management principles. National authorities could then be required to approve this proposal (perhaps in the context of the relevant Cross-Border Stability Group) on the basis of a yes or no vote or to take this proposal as a starting point for negotiations. In the former case, ways should be foreseen to proceed without no voters as long as those represent a relatively small minority in terms of their weight in the economic interests at stake.

69. As argued above, consideration should be given to introducing a coordinated framework for the resolution of a banking group. Under this framework, a lead supervisory or resolution authority would be empowered to initiate intervention and manage the orderly resolution of the group companies, whether or not these companies are ordinarily supervised by the supervisory authority. Such framework could be built upon a clear definition of a banking group, which would include the subsidiaries of the group exercising a banking activity and other non-banks institutions, and would not collapse their separate legal personalities. A minimum approach of the described regime would allow for a procedural coordination of the resolution process, lead by an identified home country authority; however, its function and purposes could be more effectively sustained by a harmonization of the resolution framework applicable to the banking group, and eventually served by an EU agency.

***Q: Is integrated resolution through a European Resolution Authority for banking groups desirable and feasible?***

70. A European Resolution Authority could greatly contribute to the effective cross-border crisis resolution of systemic cross border banks. Acting on the basis of commonly agreed principles and objectives, it would likely be the first-best solution to overcome conflicts of interests and pursue the common good. At this stage, non systemic cross-border banks and domestic banks would ideally be resolved under existing institutional arrangements.

***Q: If this option is not considered feasible, what minimum national resolution measures for a cross-border banking group are necessary.***

***WD Q(23): Are mechanisms for cooperation and communication between authorities and administrators responsible for the resolution and insolvency of a cross border banking group desirable? The Commission services would also welcome views on the form that such mechanisms might take.***

***WD Q(24): Is a more integrated resolution and insolvency framework for banking groups feasible and desirable? In particular, should the Commission explore mechanisms at EU level for the extension of liability, contribution orders and pooling or substantive consolidation in relation to cross border banking groups.***

***WD Q(25): Would a "28th regime" be useful and feasible? If so, what would be the appropriate scope of its application, and the difficulties of applying it to existing entities?***

71. The harmonization of key substantive bank resolution rules is conducive to an orderly and predictable bank resolution framework. This should be kept clearly distinct from the debate on whether a coordination mechanism or a single resolution authority should be envisaged. This is why Fund staff supports EU wide harmonization and modernization of the rules for bank resolution both under its first and second best option. In particular, even under the recommended solution, we believe that a second prong aimed at harmonizing the Member States' frameworks for non-systemic or domestic banks by way of directives can significantly contribute to enhancing financial stability and the single market in the EU.

#### ***4.8 Financing a cross-border resolution***

***Q: What is the most appropriate way to secure cross-border funding for bank resolution measures? What role is there for specific private sector funding?***

***Q: Is establishing ex-ante crisis funding arrangements practical? If not, how could private sector solutions best address the issue? Is there scope to achieve greater clarity on burden sharing? If so, would the first priority be to define principles for burden sharing?***

72. The Communications suggests that a framework for intra-group financing after the commencement of an insolvency procedure may be drawn upon the UNCITRAL work on corporate insolvency. This solution could benefit from an analysis of its usefulness in the banking sector, where the focus is rather on prevention and restructuring than on the need to facilitate the continuity in the operations of the company already subject to insolvency. Perhaps this could lead to a different timeframe of the financing, possibly with a view at transferring the business of the bank to a private sector purchaser or at limiting public support.

73. An EU resolution authority would need access to financing. Given Treaty constraints, this financing may have to come from a consortium of national and European sources. It is worth bearing in mind that gross financing needs may be much larger than net needs, especially with a mandate to pursue cost-minimizing resolution approaches.

## **5. Insolvency**

***Q: Is a more integrated insolvency framework for banking groups needed? If so, how should it be designed?***

74. We cannot support such an approach. While we find valuable arguments in the recommendations made by the Commission aiming at a coherent treatment of a banking group—for instance in terms of its coordinated resolution—the proposal of an integrated treatment of corporate entities in insolvency poses a number of concerns. Further analysis could certainly be beneficial in establishing criteria to determine whether an intermingling of assets and liabilities or a fraudulent activity lead to a single enterprise. However, a substantive consolidation going beyond these cases could alter essential protections of counterparties, with detrimental effect to legal certainty and the predictability that is key to long-term economic relationships. Such proposal could also raise a number of complex challenges in its implementation, for instance in relation to the enforcement of security interest created in different jurisdictions. Moreover, there is a much superior alternative way to achieve whatever benefits could be derived from such an integrated insolvency framework, which is to establish a sound framework for branch-based cross-border banking under the single passport along the lines proposed above.

***Q: Should there be a separate and self contained insolvency regime for cross-border banks?***

See higher. Fund staff supports a separate and self contained regime for systemic cross-border banks as a first-best option.