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TECHNICAL NOTE—BANK RESOLUTION AND CRISIS MANAGEMENT

This Technical Note on Bank Resolution and Crisis Management for the euro area was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in June 2018.

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June 29, 2018

TECHNICAL NOTE

BANK RESOLUTION AND CRISIS MANAGEMENT

Prepared By

Monetary and Capital Markets Department and the Legal Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in the euro area. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

BPE	Banco Popular Español
BRRD	Bank Recovery and Resolution Directive
CMG	Crisis Management Group
DIS	Deposit Insurance System
DGSD	Deposit Guarantee Schemes Directive
D-SIB	Domestic Systemically Important Bank
EA	Euro Area
EBA	European Banking Authority
ECB	European Central Bank
ECJ	Court of Justice of the European Union
EDIS	European Deposit Insurance Scheme
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
EU	European Union
FMI	Financial Market Infrastructure
FOLF	Failing or Likely to Fail
FSAP	Financial Sector Assessment Program
G-SIB	Global Systemically Important Bank
IADI	International Association of Deposit Insurers
IRT	Internal Resolution Team
JST	Joint Supervisory Team
KAs	Key Attributes of Effective Resolution Regimes for Financial Institutions
LSI	Less Significant Institution
MOU	Memorandum of Understanding
MPS	Monte dei Paschi di Siena
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NCA	National Competent Authority
NCB	National Central Bank
NCWO	No-Creditor-Worse-Off than in liquidation
NRA	National Resolution Authority
SI	Significant Institution
SPE	Single Point of Entry
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SRMR	Single Resolution Mechanism Regulation
SSM	Single Supervisory Mechanism
TFEU	Treaty on the Functioning of the European Union
TLAC	Total Loss-Absorbing Capacity

EXECUTIVE SUMMARY

The euro area (EA) bank resolution and crisis management arrangements have been strengthened considerably over recent years, but work remains to complete and unify the regime. The adoption of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR), and the establishment of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) provide a foundation to deal with problem banks. The authorities remain committed to completing the banking union through the establishment of a backstop for the Single Resolution Fund (SRF) and a European deposit insurance scheme (EDIS) and other measures, many of which are in line with recommendations in this report.

The European Central Bank (ECB), the Single Resolution Board (SRB), and the European Commission (Commission) play key roles in the EA arrangements to deal with problem banks. The ECB in its supervisory capacity, with the assistance of national competent authorities (NCAs), is responsible for recovery planning and taking early intervention measures against problem significant institutions (SIs). The SRB, together with national resolution authorities (NRAs), is responsible for resolution planning and taking resolution actions against failing banks within its remit, with certain actions (for example, adoption of resolution schemes) being subject to endorsement/non-objection by the Commission (the EU executive) and, in some cases, the Council of the European Union (hereafter 'Council;' an EU co-legislator). The Commission ensures that government financial support to problem banks—also in resolution actions—complies with the state aid regime and includes loss sharing by private creditors; it does so with restructuring requirements and post-restructuring monitoring of intervened banks. The newly established SRF may provide resolution financing. The European Stability Mechanism (ESM) is available for bank recapitalizations.

Some lessons can be drawn from the interventions in SIs that have been carried out under the new regime. One case was resolved under the BRRD/SRMR framework, whereas the others were handled outside the resolution regime. These cases and earlier experience point to the need to align the conditions and triggers of the resolution, state aid, and liquidation regimes; to strengthen liquidity support before and in resolution; and to "pre-schedule" resolution.

Despite significant progress, the bank resolution and crisis management arrangements face transitional and structural challenges, and improvements are needed to enhance their effectiveness and feasibility:

- **The regime for early intervention and advance resolution preparation should be strengthened.** Most of the recommendations below build on the authorities' ongoing efforts and address the early intervention regime; financing and liquidity support from the SRF, Eurosystem, and others; resolvability impediments; the availability of bail-in-able liabilities and banks' loss-absorbing capacity; close coordination and pre-scheduling of "failing-or-likely-to-fail" (FOLF) determination and the "resolution weekend;" and cross-border cooperation.

- **Resolution decision-making procedures should be streamlined and the independence and powers of the SRB buttressed.** The authorities should explore options to strengthen the SRB's role in shaping crisis management policy and decision-making. Ultimately, if it were designated an independent EU institution, Commission or Council involvement in key decisions could be scaled back. Also, this status would allow the SRB to obtain a sufficiently high credit rating for the SRF (which would facilitate resolution funding), and to attain rule-making power (for example, to address system-wide resolvability impediments), inter alia.

- **Completing the banking union also requires a more unified, transparent, and predictable resolution regime.** Diverging national insolvency regimes as applicable to banks, subject to less stringent loss sharing requirements under state aid rules than in the SRM, deliver substantially different outcomes for bank creditors, and provide incentives for member states to resort to national insolvency regimes. Aligning loss sharing requirements under state aid rules with the more stringent SRM requirements in resolution would ensure that inconsistencies are not exploited to "escape" the resolution regime (especially bail-in requirements)—subject to alternative means of flexibility being introduced. To further harmonize the framework and reduce uncertainty, the SRMR should include an administrative bank liquidation tool for all banks within the SRB's remit and for banks that are considered systemic at the time of failure.

- **A financial stability exemption—to be used only in times of euro area-wide or country wide crisis and subject to strict conditions and governance arrangements—is essential to help mitigate critical constraints in the framework**. The SRM was designed to deal with idiosyncratic events. A financial stability exemption, subject to strict conditions and appropriate governance arrangements, would allow for departure from the 8 percent bail-in requirement for accessing the SRF and national public funds, and other limitations. Without such flexibility, the framework may become "time inconsistent" in circumstances where the risk of systemic contagion is severe. In the few scenarios where this flexibility might be needed, loss absorption by shareholders and subordinated debtholders should still be required as a minimum. The authorities should also consider an overarching system-wide crisis management framework, bringing together pertinent agencies to effectively cooperate in formulating feasible responses.

- **The banking union needs a common deposit insurance system and an SRF backstop.** A well-designed and adequately funded deposit insurance system would give confidence to retail depositors; a common system would address host countries' risk-sharing concerns. SRF funds will be limited even in the steady state after 2023; a credible backstop would reassure markets. The Commission's proposals for an EDIS and an SRF backstop (such as the ESM) are welcome.

- **Consideration should be given to paring back procedures for state aid oversight for resolution where decisions—including on resolution funding—are unlikely to affect competition or create an undue advantage.** Resolution decisions taken by the SRB rather than national authorities could be presumed to meet state aid rules (if outright exemption were not possible), considering the lower risk of distorting competition for national interest. Deposit and asset transfers funded by deposit insurance systems (DISs), when provided on a least-cost basis according to agreed fair and open procedures, could likewise be granted a presumption of compliance.

Table 1. Euro Area: Recommendations on Bank Resolution and Crisis Management

Recommendations and Responsible Authority	Timing*	Priority**
1. Expedite the BRRD conformity and implementation assessments, and map its transposition and pertinent other legislation. (EC; SRB; ¶8–9)	**ST**	**M**
2. Establish EDIS, with a backstop arrangement. (EU ***; ¶13–15, ¶76)	**ST**	**H**
3. Adopt policies, methodologies, and operational arrangements for SRF financing in resolution. (SRB, EC; ¶21)	**ST**	**H**
4. Clarify that the SRF's target level is at least 1 percent of covered deposits also after 2023. (EC; ¶21)	**MT**	**M**
5. Designate a backstop for the SRF (such as the ESM) supported by effective operational arrangements. (EC, SRF, ESM; ¶22)	**ST**	**H**
6. Fold the ESM direct recapitalization tool into its SRF backstop, possibly merging the ESM backstop and the SRF. (EU; ¶22)	**ST**	**M**
7. Clarify eligibility criteria and operational arrangements for using the ESM recapitalization tools. (SRF, EC, ESM, SRB; ¶22)	**ST**	**M**
8. Grant the SRB directly applicable resolution powers and the power to supersede relevant national legislation. (EC; ¶24)	**MT**	**M**
9. Strengthen and harmonize the solvency, financial stability, and public interest assessments for action across regimes (resolution, liquidity assistance, precautionary recapitalization, ESM, etc.). (EU, ECB, SRB; ¶25)	**ST**	**H**
10. Subject to a financial stability exemption, align the state aid burden sharing requirements in liquidation with the BRRD/SRMR. (EC; ¶26)	**ST**	**H**
11. Pare back state aid oversight of SRB resolution decisions and the use of the SRF and DIS funding on a least cost basis. (EC; ¶26)	**ST**	**H**
12. Introduce a flexible administrative liquidation tool in the SRMR. (EU; ¶28)	**ST**	**H**
13. Ensure adequate internal MREL. (SRB; ¶29)	**I**	**H**
14. Accelerate MREL build-up, prioritizing large banks. (SRB; ¶31)	**I**	**H**
15. Ensure strong investor protection for retail purchasers of MREL, and restrict MREL cross-holdings among banks. (SRB, ESMA; ¶31)	**ST**	**H**
16. Further harmonize the hierarchy of creditor claims in bank insolvency, also ensuring more consistency with the SRM bail-in regime. (EC, national authorities; ¶32)	**MT**	**H**
17. Designate the SRB as an independent treaty institution. (EU; ¶34–35)	**MT**	**H**
18. Introduce a financial stability exemption from (i) the 8 percent mandatory bail-in for accessing the SRF and public funds, (ii) the 5 percent cap on SRF funding, and (iii) the proposed stricter state aid burden-sharing rules. (EU; ¶37, 39)	**ST**	**H**
19. Ensure that financial stabilization tools (e.g., government guarantees, recapitalization) are available and can be effectively employed in all member states. (EC, national authorities; ¶40)	**ST**	**M**

20. Adopt a system-wide crisis preparedness and management framework. (SRB, EC, ECB; ¶41)	**ST**	**H**
21. Ensure that the staffing of the SRM and the ECB's Crisis Management Division is commensurate with their mandates. (SRB, ECB; ¶47)	**C**	**M**
22. Make full use of the toolbox, particularly the bridge bank tool, in resolution planning. (SRB; ¶49)	**I**	**M**
23. Finish revising the SRB resolution manual; add new guidance for resolution funding plans; test the manual; adopt complementary ECB guidance—all prioritizing the bridge bank tool and its feasibility. (SRB, EBA, ECB; ¶49–51)	**I**	**M**
24. Establish uniform practices for banks' disclosure of early intervention measures, allowing flexible use of financial stability delays. (ESMA; ¶52)	**ST**	**M**
25. Strengthen the SSM early action framework by (i) removing legal constraints on early intervention measures, (ii) making the FOLF determination more forward looking and controlling its timing, and (iii) adopting a quantitative escalation process for early intervention. (ECB, EC; ¶53–54)	**I**	**H**
26. Strengthen the SRM's advance resolution preparation by: (i) operationalizing its FOLF powers; (ii) making resolution preparation less dependent on early intervention measures; (iii) enhancing SRB access to prudential information, direct banks contacts, and relevant information on the availability of liquidity and collateral; (iv) suitably engaging with host authorities; and (v) ensuring that adequate liquidity will be available. (SRB, ECB; ¶54–55)	**I**	**H**
27. Mitigate resolvability impediments, and ensure continuity of resolution planning while addressing substantive impediments. (SRB; ¶62)	**I**	**M**
28. Conclude the SRB MOUs with the Commission and all nonbanking union NRAs; conclude SRB cooperation agreements with EA NRAs and on CMGs. (EC, SRB, EBA, NRAs; ¶64, 67–70)	**I**	**M**
29. Make the SRB a permanent observer on the ECB Supervisory Board. (EC, Council; ¶66)	**I**	**H**
30. Ensure that EU and national authorities consult the SRB on pertinent legislation. Make the ECB and SRB voting members of the EBA Board of Supervisors and the EBA Resolution Committee. (EC, Council; ¶66)	**I**	**M**
31. Operationalize in all EA countries lending facilities between DISs. (EC, EBA, national authorities; ¶72)	**I**	**M**
32. Formalize the EBA's role in DIS oversight and coordination. (EC; ¶73)	**MT**	**M**
33. Ensure effective DIS financing of deposit transfers in both resolution and liquidation. (EU, national authorities; ¶74–75)	**ST**	**H**

* C = continuous; I (immediate) = within one year; ST (short term) = 1–2 years; MT (medium term) = 3–5 years
** H = high; M = medium; L = low
*** EU here signifies the European Commission (EC), the Council, and the European Parliament.

BACKGROUND

A. Scope of the Review

1. This note sets out the analysis and detailed recommendations of the 2018 FSAP pertaining to the bank resolution and crisis management arrangements in the EA.[1] It summarizes the findings of the missions undertaken in November 2017 and February/March 2018, to Brussels, Frankfurt, London, Luxembourg, and Paris, where meetings were held with officials and senior staff of the Commission, the Council, the European Parliament, the SRB, the ECB, the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), the European Stability Mechanism (ESM), the European Court of Auditors (ECA), and several NRAs, industry associations, and think tanks. This review builds on recent EA country FSAPs, and it is informed by analysis of the relevant policy, operational, and legal arrangements. The authorities' detailed responses to a comprehensive questionnaire and recent ECA reports on the SRB and ECB operational readiness for crisis management, too, were helpful.[2] The note considers developments since the 2013 European Union (EU) FSAP and is forward-looking, especially because key components of the arrangements are relatively new and developing. The mission appreciates the many insights provided in the discussions and thanks the authorities for the constructive dialogue.

2. The EA bank resolution and crisis management arrangements were reviewed taking account of EA-specific challenges, international standards, and emerging best practices. While the note does not formally assess compliance with any standard, it is informed by the 2014 Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs; Key Attributes) adopted by the Financial Stability Board (FSB), the 2016 KAs Assessment Methodology, and the IMF's experience in implementing bank resolution and crisis management arrangements. The note aims to assist the authorities in addressing EA-specific challenges.

3. While the note focuses primarily on the arrangements that apply to SIs and other banks under the remit of the SRB, it does consider how oversight of other less significant institutions (LSIs) affects them. As of January 2018, the ECB directly supervised 118 SIs.[3] These banks are also within the SRB's remit. Additionally, the SRB is responsible for 13 cross-border LSIs. Some of the approximately 3,100 LSIs are sizable at the national level. Furthermore, the simultaneous failure of several LSIs could have system-wide consequences. The note's analysis takes this into account. The note does not address the resolution of other financial institutions such as central counterparties, investment firms, or third country bank branches.

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[1] Prepared by Atilla Arda (MCM); Maike B. Luedersen (LEG); and William Murden (IMF external expert, formerly U.S. Treasury and Federal Deposit Insurance Corporation).

[2] "Single Resolution Board: Work on a challenging Banking Union task started, but still a long way to go," (https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=44424); 'The operational efficiency of the ECB's crisis management for banks' (https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=44556).

[3] Unless stated otherwise, references to the ECB refer to its supervisory function.

4. The review is guided by certain interacting objectives, some derived from general principles and experience in managing banking crises, and some derived from the aims of the banking union. These objectives include:

- supporting the banking union and its completion, where banks from different euro area jurisdictions compete on a "level playing field;"
- minimizing moral hazard;
- attenuating the nexus from banks to sovereigns by reducing as far as possible implicit national government guarantees or other support for banks;
- minimizing the overall cost of dealing with a failing bank; and
- balancing the need for predictability in a rules-based system against the need for flexibility to deal with contingencies and ensure incentive compatibility.

Progress towards these objectives will contribute importantly towards reducing risks in the system.

B. Progress and Experience So Far

5. The 2013 EU FSAP concluded that much had been achieved to address the 2008–09 crisis, but vulnerabilities remained and intensified efforts were needed across a wide front. The EU FSAP noted that the absence of robust national and EA-wide crisis management frameworks had handicapped the initial response to the 2008–09 crisis; it recommended that the authorities anchor financial stability in the EA and establish a banking union to sustain the currency union and the single market for financial services. In particular, the 2013 EU FSAP called for a single crisis management framework, including the SSM, a KA-consistent resolution regime, a single resolution authority, and a common DIS with a common backstop, an ESM direct recapitalization tool, and strong supranational inter-agency cooperation arrangements to ensure policy consistency. Finally, the 2013 EU FSAP noted that more forceful ECB action and the will to act was warranted.

6. Since then, the EA bank resolution framework was strengthened considerably.

- The EU co-legislators—the Council and the European Parliament—on a proposal from the Commission, adopted the BRRD and the SRMR, and established the SSM and the SRM, which provide a foundation to deal with problem banks.[4]
- The Commission and the Council have crisis management procedures in place. The Commission's procedures effect coordination between its directorate-generals for competition (DG COMP) and financial stability (DG FISMA). Procedures of both the Commission and the Council aim to ensure prompt endorsement/non-objection of SRB resolution decisions.

[4] The BRRD definition of "resolution" is narrower than that used by the KAs. Under the BRRD, resolution is the application of one or more of the four default resolution tools. The KAs identify 12 powers, including notably the closure and orderly wind-down (liquidation) of a failing firm, which the BRRD considers to be outside of resolution.

- The ECB, with the NCAs' assistance, is responsible for recovery planning and early intervention of problem SIs. Its Crisis Management Division supports supervisors on crisis management issues to ensure ECB-wide consistency, and serves as liaison with the SRB.

- The SRB, together with NRAs, is responsible for resolution planning and resolution actions against failing banks within its remit, with the adoption of resolution schemes subject to endorsement/non-objection by the Commission and, in some cases, the Council.

- The newly established SRF may provide liquidity and capital support in resolution after putting in place supporting operational arrangements. The ESM continues to be available for bank direct and indirect recapitalizations.

- The EBA contributes through technical standards and guidelines, elaborating on the BRRD.

7. The resolution toolkit includes default, optional, and additional tools. The default resolution tools in the BRRD/SRMR include bail-in, sale of business, bridge institution, and asset separation.[5] The BRRD also allows two optional government financial stabilization tools: public equity support and temporary public ownership. The BRRD also allows additional resolution tools.

8. A comprehensive mapping of resolution tools and requirements is warranted. The national resolution handbooks should help in this regard. The authorities have not yet completed the mapping of the BRRD's national implementation. Annex I shows that consistency across EA countries is not complete. The SRB should maintain a thorough understanding of the BRRD's application and other pertinent national legislation, such as insolvency laws as applicable to banks.

9. The full set of tools should be available because developments in banking crises can be highly variable and require variable responses. Almost half of the EA member states have incorporated the optional government financial stabilization tools and about one-third established additional resolution tools. A few member states provide for additional MREL criteria.

10. The recent intervention cases against SIs in Italy, Spain, and Latvia demonstrated the challenges of the new regime—only one of these SIs was resolved by the SRB. Monte dei Paschi di Siena (MPS) received precautionary recapitalization support from the Italian government with Commission approval; the two Venetian banks were liquidated with state aid under Italian law and with Commission approval; and Banco Popular Español (BPE)—the only SRB resolution case so far—was sold. Box 1 summarizes these cases. The BPE resolution is being litigated in Spanish and EU courts, with cases against the ECB, the SRB, the Commission, the EU legislators, and the Spanish authorities. Reportedly, investors are also pursuing litigation in U.S. courts and international arbitration. The Latvian case is still ongoing.

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[5] The power to write down or convert relevant capital instruments may be exercised either independently of resolution action or in combination with a resolution action such as bail-in.

Box 1. The Recent Italian, Spanish, and Latvian Bank Intervention Cases: Chronology

In June 2017, banking union authorities took bank intervention decisions using three aspects of the BRRD: resolution by the SRB; liquidation under national insolvency laws; and precautionary recapitalization.[1] The SRB, the ECB, and the Commission have launched a "lessons learned" exercise to look at possible improvements in liquidity arrangements, early intervention, information exchange, and precautionary recapitalization.

The Italian Cases

On July 4, 2017, the Commission authorized the precautionary recapitalization of Banca Monte dei Paschi di Siena S.p.A (MPS) by the Italian government, after agreeing in principle with the Italian authorities on the restructuring plan for MPS, one of Italy's five largest banks, with total assets of more than €153 billion. On June 23, 2017, the ECB[2] determined that two mid-size Italian banks, Veneto Banca Società per Azioni (with assets of €28 billion) and Banca Popolare di Vicenza Società per Azioni (with assets of almost €35 billion) (collectively, "the Venetian banks") were FOLF. The SRB concluded, however, that it was not in the public interest to place the Venetian banks into resolution; consequently, the Italian authorities wound down the two banks under Italian insolvency law proceedings.

MPS has had a long history of recapitalizations, state aid measures, and restructuring plans. MPS received state recapitalizations in both 2009 and 2013 and was the worst performer in two subsequent stress tests in 2014 and 2016. Given the excessive amount of nonperforming loans (NPLs) on the bank's balance sheet, the ECB demanded a reduction of such loans to more manageable levels. This request together with the impending 2016 EBA stress test results led MPS to announce on July 29, 2016 its own solution to its bad loan portfolio. This proposal foresaw the sale of its bad loan portfolio (ca. €26 billion) through a securitization with the negative capital impacts covered by a capital increase of up to €5 billion (including voluntary liability management exercise). MPS' proposal set down year-end 2016 as the target date for completion. The capital raising attempt failed however in December 2016, leading MPS to request precautionary recapitalization from the Italian government. As part of the precautionary recapitalization process the ECB on December 23, 2016 confirmed to the Italian Ministry of Economy and Finance and the European Commission that there was a €8.8 billion capital shortfall in the adverse scenario of the 2016 stress test, but provided a point in time Pillar 1 solvency statement for MPS (based on Q3 2016 figures, the latest capital regulatory reporting date at the time) and confirmed the liquidity position of MPS.

On June 21, 2017, the ECB provided another point in time solvency statement for MPS, which was based on Q1 2017 figures (the latest capital regulatory reporting figures available). On June 26, 2017, the Atlante II fund agreed to purchase bad loans from MPS. With the fulfilment of these conditions, the Commission approved a precautionary recapitalization on July 4, 2017, of up to €5.4 billion. The approval prescribed a five-year restructuring plan to reorient the business to more retail business and to dispose of €26 billion of bad loans (value end of 2016). MPS has transferred the largest amount of these to a special purpose vehicle, partially funded by the Atlante II fund (fund had agreed to purchase the junior mezzanine and the junior notes of this securitization). A government guarantee on the senior notes under the Italian government guarantee scheme for NPL sales was also planned, the application process for which was still ongoing in June 2018.

Veneto Banca and Banca Popolare di Vicenza had a history of low profitability, high NPLs, and capital shortfalls. The ECB required capital raising plans when the banks breached their capital requirements in 2015. The plans failed in early 2016, prompting the private fund Atlante to take almost 100 percent stakes in the banks. Their financial situation deteriorated further in 2016, resulting again in capital breaches and further ECB-mandated capital raising plans. The Italian government provided €10 billion liquidity support to both banks in January and April 2017. After the ECB confirmed that the banks were technically solvent, the Commission approved both measures.

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[1] Drawn from various public sources (Annex IV), including non-confidential versions of ECB and SRB decisions and European Parliament briefings. Data are from SRB documents or bank annual reports.

[2] The reference to ECB refers to the ECB in its supervisory capacity and the reference to the SSM refers to the ECB and NCAs.

Box 1. The Recent Italian, Spanish, and Latvian Bank Intervention Cases: Chronology (concluded)

On June 19, 2017, the ECB concluded that the Venetian banks' merger proposal and associated business plan was implausible; after consulting the SRB on the draft FOLF decision, the ECB officially informed the SRB on June 23, 2017 that the FOLF determination was made. The SRB concluded that while there were no timely alternative measures to prevent the failure of the banks, the SRMR's public interest assessment was not met, since the banks did not provide any critical functions and their failure would not have any significant adverse financial stability effects. The next day, the Italian government formally notified the Commission that it intended to grant up to €16.8 billion in liquidation support to wind-down the Venetian banks, that Intesa would buy their performing business, and that the nonperforming business would be left in the residual entity to eventually be transferred to a government-owned asset management company. Pursuant to the 2013 Banking Communication, the Commission approved the state aid the next day.

The Spanish Case

On June 6, 2017, the ECB determined that Banco Popular Español (BPE), Spain's sixth largest bank with assets of almost €150 billion, was FOLF. Early on June 7, with the Commission's approval, the SRB decided that it was in the public interest to place BPE into resolution.

From the very beginning of ECB supervision of BPE in November 2014, the bank faced problems due to low profitability and high NPAs. In 2016, poor stress test results and losses for the year led to negative market reaction, rating downgrades, and voluntary management changes. The ECB pressed the bank to develop a strategy to reduce NPAs, but did not invoke any formal supervisory or early intervention measures.

In April 2017, the bank's situation deteriorated further. The CEO resigned after an internal audit revealed anomalies in the previous year's capital increase. Rating downgrades and uncertainty about the bank's capital position followed an announcement on dividend restrictions and capital raising, which in turn caused liquidity problems. The ECB increased its interactions with the bank, but bank's measures were unsuccessful in significantly improving its liquidity position. In early May, the ECB and the SRB launched several crisis management arrangements for the bank; they intensified their cooperation and information exchange. On May 23, the SRB hired an accounting firm to prepare a valuation for the bank, and on June 2, the SRB began its marketing procedures in preparation for a possible resolution.

On Tuesday, June 6, the bank suffered further large deposit outflows, could not provide sufficient eligible collateral to obtain further emergency liquidity assistance (ELA), and notified the ECB that it would have to file for bankruptcy the next day. The ECB, unable to keep the bank open until the weekend, declared the bank as FOLF. The next day, the SRB decided that there was no reasonable prospect that any alternative private sector or supervisory measures would prevent the bank's failure within a reasonable timeframe and that resolution was in the public interest. The SRB approved a resolution scheme using the sale of business tool; following SRB's instructions, FROB wrote down the share capital and additional Tier 1 instruments to zero, converted the Tier 2 instruments to new equity, and transferred BPE to Santander for €1.

BPE was the first bank to be declared as FOLF by the ECB and the first to be resolved by the SRB.

The Latvian Case

The case of ABLV Bank in Latvia is ongoing. On February 19, 2018, the ECB instructed the national supervisor to impose a creditor moratorium. On February 23, the ECB determined that ABLV (and its Luxembourg subsidiary) was FOLF, citing significant deterioration of the bank's liquidity situation; the SRB did not find resolution to be in the public interest. An extraordinary shareholders' meeting of the ABLV Bank decided to initiate voluntary liquidation in Latvia and this course of action was subsequently approved by the Latvian authorities on June 12, 2018. This case illustrates the uncertainties arising from the application of national insolvency regimes to a failing SI following FOLF determination but where resolution is not in the public interest.

11. These cases may indicate the need to reduce uncertainties as to the treatment of creditors in a failing bank, notably due to a misalignment between the conditions and triggers of the resolution, state aid, and liquidation regimes; the need to strengthen liquidity support before and in resolution; and the need to take early action against problem banks, and prescheduling the "resolution weekend." More specifically:

- **Solvency and Financial Stability Assessments:** The 2013 Banking Communication on the application of state aid rules does not provide guidance on solvency tests; the ECB's solvency test for precautionary recapitalization (within the Communication's remit) was not aligned with the FOLF test of the BRRD/SRMR. Similarly, financial stability assessments are not aligned. All of this risks delivering inconsistent outcomes.
- **Public Interest Assessment:** The geographic scope of the BRRD/SRMR's "public interest" test is not fully clear (e.g., national or banking union financial stability); the "common interest" test of the 2013 Banking Communication is not aligned with the BRRD's "public interest" test.
- **Parallel Frameworks:** DG COMP maintains a key role in solvency tests and bank restructuring plans, along with the ECB and the SRB. The Commission gives deference to member state authorities, potentially contradicting the SRB's approach.
- **Insolvency Regimes:** Insolvency regimes are not harmonized and directly affect the SRB's resolution decision; the SRB's toolbox is missing a liquidation tool, as called for by the FSB KAs.
- **Hierarchy of Creditor Claims and No Creditor Worse Off (NCWO):** The state aid burden-sharing requirements are weaker than those of the BRRD/SRMR; consequently, some creditors could be better off in insolvency with liquidation aid, making the NCWO test heterogeneous and weakening the level playing field between regimes.
- **Scenarios for Use of Public Funds:** In comparing resolution and insolvency outcomes, the SRB is not allowed to consider using public funds while making the public interest assessment, while a national government can consider that liquidation under the national insolvency regime requires public funds, which the Commission can—and did—approve under the 2013 Banking Communication. It is more difficult to use the industry-funded SRF under the SRMR than using public funds for precautionary recapitalization under the 2013 Banking Communication.
- **Resolution Preparation:** Without advanced preparation, the viability of the sale of business resolution tool may depend on the ready availability of a willing bidder. The use of the bail-in or bridge institution tools require more preparation.
- **Financing Resolution:** Liquidity support arrangements from the SRB/SRF or other sources were not in place for resolution.
- **Information on Liquidity Needs:** The Eurosystem did not always have timely information on the bank's ability to provide usable collateral for ELA, and could not anticipate well possible liquidity needs even over short horizons. The ECB—both its supervisory and monetary functions—did not always have timely information on some aspects of the provision of ELA by the respective national central bank (NCBs).

- **Litigation Risk:** The involvement of multiple authorities and the decentralized implementation of resolution decisions opens multiple avenues for litigation both at the EU and national levels, which demonstrates the challenges arising from the incomplete harmonization of the framework. The legal implications triggered by their use—and a conservative approach to minimizing litigation risk—reportedly might have induced some hesitancy in using early intervention measures and making the FOLF determination sooner.
- **Uncertain outcome:** It is possible that the ECB determines a bank FOLF and the SRB decides that resolution is not in the public interest, whilst the conditions for initiating national court-based liquidation are not fully aligned with the grounds for a FOLF determination or the banking license cannot be withdrawn, thus possibly leaving the bank in limbo.

C. Legislative Proposals

12. EU co-legislators are considering strengthening the SSM and the SRM underpinnings. In November 2016, the Commission proposed risk reduction measures. A key component aims to integrate the FSB requirement for Global Systemically Important Bank (G-SIBs) to maintain total loss-absorbing capacity (TLAC) into the EU's MREL framework, including by confirming the SRB's power to set binding internal MREL targets and requirements. A complementary proposal to partially harmonize the hierarchy of creditor claims in bank insolvency was adopted late 2017. Around the same time, the Commission proposed that the ESM (or possibly a future European Monetary Fund) backstop the SRF, and revamped its 2015 EDIS proposal. These proposals were under discussion at the time of writing.

"COMPLETING" THE BANKING UNION

A. European Deposit Insurance Scheme

13. Deposit insurance plays a crucial role in financial stability. A well-designed and well-funded DIS assures retail customers that they are protected in a bank failure.[6] As a senior DIS official recently wrote, "At its most basic level, deposit insurance serves the goal of financial stability in three ways—protecting retail and other small depositors, minimizing the risk of depositor runs on banks, and mitigating the risk of contagion."[7] If depositors trust a DIS, they are less likely to run on the bank and withdraw their funds in times of bank distress. This can help stabilize the bank's liquidity position and facilitate recovery or resolution. If depositors lose confidence, as happened in the 2008–09 crisis, runs contribute to contagion and instability. As noted by the International

[6] On the importance of post 2008–09 crisis global initiatives to strengthen DISs and how the role of deposit insurance in promoting financial stability has been emphasized over concerns about moral hazard, see "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience" (2008; http://www.fsb.org/wp-content/uploads/r_0804.pdf), and 'FSB Thematic Review on Deposit Insurance Systems: Peer Review Report' (2012; http://www.fsb.org/wp-content/uploads/r_120208.pdf).

[7] Diane Ellis, Director, Division of Insurance and Research, Federal Deposit Insurance Corporation, "Building Credible and Effective Deposit Insurance Systems", November 2016. These are also the public policy objectives for DISs under the IADI Principles.

Association of Deposit Insurers (IADI), "The evolution of the crisis showed the importance of maintaining depositor confidence in the financial system and the key role that deposit protection plays in maintaining that confidence."[8]

14. The Five Presidents have called for the establishment of a common DIS. Their 2015 report observed:[9] "As the current set-up with national deposit guarantee schemes remains vulnerable to large local shocks…common deposit insurance would increase the resilience against future crises. A common scheme is also more likely to be fiscally neutral over time than national deposit guarantee schemes because risks are spread more widely and because private contributions are raised over a much larger pool of financial institutions." In response, the Commission proposed to establish, after a transition period, an EDIS managed by the SRB (Box 2), though the national DISs would continue to be the local interface with banks and depositors for contributions and payouts. The Commission's 2015 EDIS proposal was structured in several stages: re-insurance; co-insurance; and full insurance. To address some member states' concerns about risk reduction, in late 2017 the Commission suggested introducing EDIS in a more gradual manner and subject to more conditions. The liquidity and loss-absorbing phases would be split with the aim to have a fully functional EDIS by 2024. Risk reduction and risk sharing should move in parallel.

15. The authorities are encouraged to agree on EDIS. Risk pooling through a banking-union-wide DIS would help member states avoid disruptions that may overwhelm their individual capacities; risk sharing would also be more effective in protecting confidence and in diversifying risks across banks.[10] Moreover, EDIS would help address host authorities' concerns about "their" subsidiaries in the event the group to which these subsidiaries belong would need to be resolved.

[8] IADI, Core Principles for Effective Deposit Insurance Systems, November 2014.

[9] "Completing Europe's Economic and Monetary Union," report by: Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, and Martin Schulz, 2015.

[10] 'A Banking Union for the Euro Area,' IMF, SDN/13/01, January 2013.

Box 2. European Deposit Insurance Scheme: Key Features

Building EDIS gradually. In 2015, the proposal for EDIS was presented by the Commission as a set of amendments to the SRMR designed to reduce depositors' vulnerabilities to large local shocks and to break the bank-sovereign nexus. EDIS is structured in several stages: re-insurance, co-insurance, and full insurance. During re-insurance, up to 20 percent of the liquidity shortfall and excess losses of a national DIS may be covered by EDIS. In co-insurance, the threshold increases to up to 80 percent of the liquidity need or losses (in a staggered approach), with the full insurance stage reached in 2024. Unless the EDIS resources solely contribute to the pay-out of depositors, state aid provisions apply in the context of resolution.

Risk-based contributions and funding. The target ratio of 0.8 percent of covered deposits will be built up over time by national DISs channeling the contributions collected from participating credit institutions directly into the Deposit Insurance Fund (DIF) in EDIS. DIF resources will increase according to a funding path until the target level is reached. The SRB establishes each credit institution's contribution level in accordance with risk-based calculations. This approach requires a robust methodology to determine the specific risk of each credit institution relative to all other credit institutions in the euro area.

Clarification of legal obligations. While the EDIS proposal envisages contributions collected in EDIS, the pro-rata approach for simultaneous pay-out events in case of an underfunded DIF could be problematic as national DISs remain fully liable for depositor payouts. At the full insurance stage, there should be a clear obligation for EDIS to provide the funding to meet depositors' claims. Moreover, if the Commission decides to disqualify a national DIS from coverage, it is not clear how contributions already channeled into EDIS would be made available to the respective DIS.

Criticism of EDIS. The EDIS proposal has been met with significant criticism, especially for being perceived as potentially offering solvency support during the early re-insurance period while risk reduction measures are still pending. Other concerns include the design in the final stage of EDIS, the timing of set up, legacy issues such as high NPLs and holdings of sovereign debt, the need to mitigate moral hazard, and the absence of a backstop.

Possible modifications and the way forward. Recent considerations by the Commission to reinvigorate the discussions include introducing EDIS more gradually by starting with a shorter re-insurance period for liquidity (and not solvency) support in case national DIFs are depleted (e.g., by means of temporary funding to be recouped from the relevant national banking sector rather than loss-sharing). In 2019, 30 percent of the relevant liquidity shortfall would be made available, increasing to 90 percent by 2021. Moreover, moving from the re-insurance to the co-insurance period would depend on certain conditions, such as a targeted asset quality review (by 2022) and specific thresholds for NPL levels and level III assets. Measures for portfolio reductions could also be considered. In the co-insurance period, solvency support would be provided by means of loss coverage with ratios starting at 30 percent (with subsequent increases), with a view to full liquidity and loss coverage by 2024.

B. Financing Resolution

16. **Liquidity support while dealing with a failed bank including through resolution, remains challenging in the banking union.** In resolution, there are three potential liquidity sources: (1) the Eurosystem, from regular facilities or in the form of ELA; (2) DISs—covered below in a separate section; and (3) the SRF, which, in addition, can also provide capital support and NCWO compensation of shareholders and creditors. Each of these liquidity sources faces serious constraints. A recent report commissioned by the European Parliament ECON Committee concluded

that, while approximately 80 percent of the roughly €2.5 trillion that national governments and central banks injected into the financial system was aimed at strengthening banks' liquidity positions, liquidity was "inadequately addressed in the legislative overhaul following the global financial crisis."[11]

17. The SRF facility is being built up. To date, the SRF has collected about €17 billion in funds from the industry. By end-2023, the SRF should stand at one percent of covered deposits in the banking union (approximately €55 billion), at which point it will stop growing, even if deposits keep increasing. The contributions collected by national resolution funds prior to the establishment of the SRF (based on the BRRD), and the contributions collected up until the end of the build-up period (based on the SRMR), are transferred to the SRF (based on an intergovernmental agreement). The SRF comprises national compartments, which are increasingly—now over 60 percent—mutualized; mutualized funds may be used after exhausting certain parts of the non-mutualized funds in the respective national compartments. End-2023, national compartments will be fully mutualized and cease to exist.

18. The SRB decides on the use of the SRF, subject to Commission and Council approval and subject to certain constraints. The SRF can only be used in combination with other resolution tools.[12] SRF capital support to a failed bank is (i) conditional upon the bail-in of at least 8 percent of total liabilities (including own funds); and (ii) limited to the lesser of 5 percent of the bank's total liabilities (including own funds), or the available SRF funds plus any amount that could be raised through ex post contributions in three years.[13] The 8 percent and 5 percent restrictions do not apply to liquidity support from the SRF. The SRF is considering issuing guarantees or bonds that banks can use as collateral for private sector funding or ECB liquidity. This will require a sufficiently high credit rating; without such rating, SRF bonds would be 100 percent risk weighted, potentially rendering them too costly to access external funding.

19. SRM participants have agreed to transitional bridge funding arrangements for national compartments. In February 2017, the SRB concluded loan facility agreements with all 19 banking union member states, whereby SRM participants agreed to transitional credit lines of up to the estimated target level of €55 billion. These credit lines are only available to back the SRF's national compartments in case of a funding shortfall and after having exhausted all other financing sources, including the SRB's external borrowing capacity. Funding made available under these agreements is repaid within two years by industry contributions in the country where the resolution took place.

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[11] Willem Pieter de Groen, "Cash outflows in crisis scenarios—Do liquidity requirements and reporting obligations give the Single Resolution Fund sufficient time to react?" (March 2018).

[12] The SRF is owned and administered by the SRB. The banking union authorities advised that the SRF would not be available to support government financial stabilization tools which are understood to be outside the SRMR scope.

[13] A larger SRF contribution may be possible if all unsecured, non-preferred liabilities (other than eligible deposits) are written down or converted in full, and bail in would impact on liabilities, which could jeopardize financial stability.

20. Subject to strict conditionality, the ESM can provide direct financial assistance to banks experiencing or threatened with severe financial distress. The ESM has a lending cap of €500 billion, paid-in shares of €80 billion, and €620 billion of callable shares, and could finance itself from the market and from member states. ESM assistance will only be granted when the recipient member state proves that it has exhausted all recapitalization options and when ESM assistance is indispensable to safeguard the financial stability of the EA or its member states. Until December 2014, the ESM could only indirectly recapitalize banks by providing loans to a member state to on-lend to its undercapitalized bank(s).[14] To break the sovereign bank linkages, a direct recapitalization instrument was adopted in December 2014, up to a maximum of €60 billion. This tool can only be used to fund bank recapitalizations or resolutions when the 8 percent bail-in rule is met, when the SRF 5 percent contribution has been disbursed, and when all unsecured, non-preferred liabilities (other than eligible deposits) are written down or converted in full. Member states are also required to co-finance the ESM contribution to ensure that the full capital requirements are met. ESM valuations and stress tests could take a minimum of two weeks. The Commission would also adopt a bank restructuring plan for use of ESM funds and set up post-resolution monitoring. The instrument would require advanced operational planning and has never been used as it became less relevant with the lessening of the financial crisis and the establishment of the SRM and the SRF.

21. A backstop for the SRF would enhance its credibility. According to some estimates, if write down and bail-in of creditors had been applied in full during the 2008–09 crisis, then no SRF contributions would have been needed. However, considering the size of the largest SIs and the possibility that severe contagion could prevent bail-in, the SRF is relatively small even at its target level of €55 billion by end-2023. Policies, methodologies, and operational arrangements should promote prompt mobilization of SRF financing of resolution measures. It should be clarified that the SRF target level will be adjusted to maintain at least a one-percent ratio to covered deposits on an ongoing basis, also after 2023.

22. To enhance the financial resources available, the authorities are considering a credit line from the ESM (or possibly a future European Monetary Fund) to the SRF. The thinking on how the backstop would work is starting, including on how the SRF's own funds could be used for bonds and guarantees in the absence of a credit rating. The authorities could consider folding the ESM's direct recapitalization tool into the SRF backstop and merging the two into a single fund,[15] rather than two funds that can only be used sequentially, after depleting the SRF. Such a merger would though require some adjustments since the ESM is designed with more of a systemic focus drawing on public resources, whereas SRF resources are contributed by the industry. The use of the ESM's direct recapitalization tool should be clarified now that the SRF has been established and if

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[14] Article 1(2) Indirect Recapitalization Guideline. This was used to disburse €41 billion to the Spanish banking sector (originally via the ESFS and then the ESM when the latter came into effect in September 2012).

[15] The Five-Presidents report stated that "In due course, the effectiveness of the ESM's direct bank recapitalisation instrument should be reviewed, especially given the restrictive eligibility criteria currently attached to it." ("Completing Europe's Economic and Monetary Union," Report by: Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, and Martin Schulz", 2015, p.11.)

the ESM becomes the SRF backstop. The ESM's direct and indirect recapitalization instruments should also be aligned in terms of processes, eligibility criteria, etc.

C. Further Unification of the Regime

23. Despite the establishment of the SSM and the SRM, fragmentation along national lines persists. Both the BRRD and the DGSD allow many national transposition options (Annex I and Annex II). Furthermore, the application of the SRMR diverges between countries. For example, SRB decisions are addressed to the relevant NRA (rather than applied to individual banks). Some NRAs can implement the SRB resolution scheme directly; others are required to follow national administrative procedures and issue their own resolution decisions. National divergences, for example, in labor and procurement laws complicate a uniform application of the bank resolution regime, affecting, for example, MREL enforcement and resolution preparation and implementation.

24. To overcome the fragmentation, the SRB should be granted directly applicable resolution powers. The obstacles listed above should be removed, and/or the SRB should be granted powers consistent with KA 3.2 to be able to supersede contracts or national legislation that may hamper resolution implementation or distort a level playing field.

25. Important concepts such as solvency, financial stability, and public interest assessments should be aligned across regimes. A single, forward-looking solvency test for FOLF and precautionary recapitalization would be welcome.[16] The geographic scope for financial stability should also be harmonized: the SRM's public interest test focuses on financial stability at the national and banking union levels, while the Commission also considers sub-national financial stability.[17] Furthermore, more deference could be given to the SRB's judgment on these matters.[18]

26. Greater harmonization with the state aid rules would support a more predictable resolution regime. To the extent that interventions entail use of state (or state-controlled such as DIS or SRF) resources, they are subject to the state aid regime (Box 3).[19] The Commission's function as "gate-keeper" and the state aid regime were instrumental in overseeing the crisis response of EU member states in the aftermath of the global financial crisis. The Commission and the state aid

[16] This test for recapitalization should be codified in the 2013 Banking Communication. The Eurosystem should use the forward-looking solvency test also for ELA decisions.

[17] This also depends on the interpretation of what constitute 'critical functions.' A report commissioned by the EP ECON Committee concluded that "This is rendered more difficult by the multitude of authorities involved in the process, each one probably having a different policy objective." Rosa M. Lastra, Rodrigo Olivares-Caminal, Costanza A. Russo, 'The Provision of Critical Functions at Global, National and Regional Level—Is there a need for further legal-regulatory clarification if liquidation is the default option for failing banks?' (November 2017)

[18] Currently, "outside the European banking resolution framework, it is for Member States to decide whether they consider a bank exit to have a serious impact on the regional economy." (Commission Fact Sheet, June 25, 2017: http://europa.eu/rapid/press-release_MEMO-17-1792_en.htm)

[19] Precautionary recapitalization is provided to solvent banks and is not considered a resolution tool.

regime continue to play a critical role in bank restructuring and resolution, in parallel with the SRB and the ECB. Reconciling the SRM and state aid regimes is important in three areas:[20]

- *Equalizing burden-sharing*—Imposing losses on shareholders and subordinated creditors under the state aid regime since the 2008–09 crisis represented an important paradigm shift for the region. But since the tighter loss absorbing requirements in the BRRD were introduced, the parallel existence of less stringent state aid requirements results in the treatment of creditors potentially varying considerably if banks are deemed systemic and resolved by the SRM, or not systemic and liquidated under national law (with creditors potentially treated better in liquidation than resolution). Aligning the state aid burden-sharing requirements in liquidation with those in the SRM—after alternative flexibility with a financial stability exemption has been introduced in the framework—would reduce uncertainty and diminish current incentives for member states to find ways to deal with failing SIs under national liquidation regimes.

- *Favoring European solutions*—Consideration should be given to paring back procedures for state aid oversight (or a presumption of clearance) for resolution decisions taken by the SRB rather than national authorities, given the lower risk of distorting competition for national interest.[21] The use of the SRF by the SRB involves supranational (rather than national) decisions using common funds paid for by the industry and subject to a financial stability mandate.

- *Cost reduction*—Deposit and asset transfers in resolution funded by a national DIS (or EDIS when in place) provided on a least cost basis—minimizing the risk of distorting competition—should also be considered for pared-back procedures. Such "sale of business" operations can be a very cost-effective way of resolving banks, to the benefit of insured depositors, especially if they are undertaken on a commercial basis.[22] However, potential purchasers of the bundle of assets and liabilities are likely to be severely discouraged if the application of state aid rules to the transaction is potentially burdensome, drawn-out, and uncertain. At a minimum, it could be clarified in the 2013 Banking Communication that, subject to the least cost safeguard, such a transaction would be considered compatible with the state aid rules. To this end, "fair and open" procedures for sale of business operations could be determined in advance among the Commission, resolution authorities, and DISs.

[20] The 2013 Banking Communication was meant to be temporary: "to ensure a smooth passage to the future regime under the Commission's proposal for a [BRRD]" (paragraph 13); and allowing state aid in liquidation "in the absence of mechanisms allowing for the resolution of credit institutions without threatening financial stability" (paragraph 66).

[21] This would be similar to earlier treaty changes in the state aid rules to introduce new exemptions (Treaty of Maastricht, 1992), unless Article 107(3)(e) of the Treaty on the Functioning of the European Union (TFEU) could be used for this purpose, which provides that "such other categories of aid as may be specified by decision of the Council on a proposal from the Commission" may be deemed compatible with the internal market.

[22] Typically, the resolution authority offers for sale by tender a bundle of deposits and assets. The DIS has an incentive to "sweeten" the deal to ensure that the net value is approximately zero. Commercial banks bid for the bundle on a commercial basis. The final transaction is mutually beneficial but the winner does not receive a subsidy.

Box 3. The Commission's Crisis Communications on State Aid to Financial Institutions

Article 107(1) TFEU prohibits "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States."

Article 107(2) provides for certain exemptions (e.g., social aid, natural disasters). Article 107(3) provides that some types of aid may be considered compatible with the internal market, among others, for "common European projects or to remedy a serious disturbance in the economy of a Member State" and for "such other categories of aid as may be specified by decision of the Council on a proposal from the Commission."[1]

Based on Article 107(3)(b), the 2013 Banking Communication was adopted, replacing the 2008 Banking Communication and complementing the other five communications: the 2010 and 2011 Prolongation Communications; and the 2009 Communications on Recapitalization, Restructuring, and Impaired Assets.

[1] The "serious disturbance" exception and not the more general exception is currently used. Paragraph 6 of the 2013 Banking Communication considers that "In those circumstances of persisting stress in financial markets and given the risk of wider negative spill-over effects, the Commission considers that the requirements for the application of Article 107(3)(b) of the Treaty to State aid in the financial sector continue to be fulfilled. The application of that derogation remains possible only as long as the crisis situation persists, creating genuinely exceptional circumstances where financial stability at large is at risk."

27. **Completing the banking union also requires a more unified bank liquidation regime.** SRM resolution involves assessments of public interest against potential outcomes under significantly diverging national insolvency regimes that are subject to less stringent loss sharing requirements under state aid rules than in the SRM. In some countries, the national insolvency regime as applicable to banks provides for a broad toolkit to support continuity of critical functions and a sale-of-business tool, minimizing the destruction of value in liquidation; in others, the application of national laws may lead to potentially less effective solutions such as 'voluntary-liquidation' (after an FOLF determination).[23] Moreover, the hierarchies of creditor claims in national insolvency regimes differ substantially; more alignment is needed in this area as it applies to bank insolvency. National insolvency law should be harmonized but this could be complex and time-consuming, also noting the EU's subsidiarity principle—unless specific provisions applicable to the banking sector could be carved out from national insolvency regimes and made more consistent.

28. **An administrative liquidation tool in the SRMR for all banks within the SRB's remit and for banks that are deemed systemic at the time of failure would offer important advantages.** The SRB would be authorized to apply this tool to all banks within its remit—irrespective whether

[23] A report commissioned by the European Parliament ECON Committee also noted that national insolvency regimes can be changed at the discretion of member states rendering resolution outcomes even less predictable. Silvia Merler, "Critical functions and public interest in banking services: Need for clarification?" (November 2017).

the public interest test is met—and banks considered systemic at the time of their failure.[24, 25] An administrative liquidation tool allows the resolution authority to appoint a liquidator and commence proceedings. The tool would be used by the SRB individually or in combination with other resolution tools, including an effective sale-of-business tool (such as the transfer of assets and liabilities), and supported by provisions for the continuity of critical functions, harmonized creditor hierarchy (applicable also for purposes of the NCWO regime), access to funding, and deposit insurance funding for the transfer of covered deposits. Thus, a supranational liquidation tool would help reduce destruction of value, level the playing field for creditors, and reduce the risk of member states "gaming" the system. Such a regime would be especially useful for ensuring that cases involving cross-border banks are dealt with at a euro area level, facilitating needed consistency. The SRB would need to build up operational capacity in this area. There are arguments for providing NRAs with a similar administrative liquidation tool to deal with banks deemed non-systemic at the point of failure (some already have some such tool).

D. Balancing Home-Host Interests

29. The authorities acknowledge that a yet incomplete banking union causes home-host tensions, which need to be carefully balanced in the interim.[26] In particular, the SRM should ensure the feasibility of resolution strategies for groups with domestic systemically important banks (D-SIBs). While the FSAP supports the single market, it is also mindful of national financial stability concerns while completing banking union.[27] The banking union framework aims to balance home-host financial stability interests (Box 4), and resolution decisions must consider the impact at the national as well as EA level.[28] Consistent with FSB and EBA guidance on the matter, internal MREL targets should support the group resolution strategy and enable recapitalization of material entities. For D-SIBs, subordination of eligible liabilities should be required for MREL purposes (similar to the TLAC requirements).

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[24] The KAs include liquidation in the resolution toolkit (in particular, see KA 3.2 (xii)), which could be used with bail-in or bridge bank tools. This liquidation tool should be exercisable by an administrative resolution authority—ex post judicial review and monetary compensation—as needed—would be possible.

[25] The fact that a bank is under the SRB's remit implies that it is significant or has important cross-border activities, and the euro area authorities have publicly taken some responsibility for its oversight. Hence, even if there is no strong public interest in supporting the bank's resolution, the SRB should be involved in liquidation.

[26] Issues arising when nonbanking union NRAs are involved are addressed in Annex III.

[27] See also items 2.3 and 3.9 of the KAs.

[28] Importantly, where the so-called Extended Executive Session of the SRB cannot reach a unanimous decision, the SRB Chair and the four other full-time SRB Members take a decision without a vote by the host authorities. Where non-banking union NRAs are involved, EBA mediation is available to reach a common approach.

Box 4. Home-Host Balance in Recovery and Resolution

EU law mandates due consideration for national interests in recovery and resolution (planning) decisions.

The BRRD (Art. 7) lists the following interests for recovery planning (but not for recovery measures):

- The group plan must identify measures at the subsidiary level.
- Competent authorities may require subsidiaries to submit individual plans.
- The group plan must aim to stabilize the group or any institution of the group, and restore the financial position of the group, while considering the financial position of other group entities.
- The group plan must identify impediments for recovery within the group, including at the level of individual entities covered by the plan, and whether there are substantial practical or legal impediments to the prompt transfer of own funds or the repayment of liabilities or assets within the group.

The SRMR lists the following interests for resolution (planning)—it is silent on recovery (planning):[1,2]

- impact of any decision or (in)action on the financial stability, fiscal resources, the economy, the financing arrangements, the DIS or the investor compensation scheme of any member state where a group operates (Art. 6.3);
- balancing the various member states' interests and avoiding unfairly prejudicing or protecting the interests of a member state (Art. 6.3);[3]
- minimizing a negative impact for any part of a group which is subject to a resolution (Art. 6.3);
- group resolution plans are not to have a disproportionate impact on any member state (Art. 8.11);
- group resolvability assumed if it can be wound up or resolved while avoiding significant adverse consequences for national financial systems in which group entities are established (Art. 10.4);
- the use of resolution tools and powers must minimize the impact on the group (entities), and minimize the adverse effect on, particularly, national financial systems in which the group operates (Art. 15.2).

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[1] Similar general principles can be found in Articles 12.5, 16.1, 87, and 92.2 BRRD.
[2] Article 17(3) of the SSM Regulation does require the ECB to respect (i) a fair balance between banking union members, and (ii) the balance between home and host countries in its relationships with other EU members.
Arguably, this includes the ECB JSTs' recovery (planning) work.
[3] Article 87 BRRD adds the following: "including avoiding unfair burden allocation across member states."

E. MREL

30. The build-up of MREL is of high priority. In late 2017, the SRB, together with the NRAs, published its MREL policy statement, which will inform consolidated MREL targets for SRB banks.[29] Starting March 2018, the SRB will set binding parent-level external MREL targets. It expects that about half of the banks will immediately meet the MREL requirements and that a quarter will have one to two years to meet the requirements; the remaining banks would have up to four years. Based on end-2016 data, the SRB estimates an aggregate €117 billion MREL shortfall, which may increase next year under revised MREL rules;[30] EBA estimates put the shortfall between €130−285 billion,

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[29] https://srb.europa.eu/en/node/465

[30] SRB's sixth Industry Dialogue, November 21, 2017: https://srb.europa.eu/en/node/431

depending on the final articulation of MREL eligibility criteria.[31] In the next resolution planning cycle, running through 2019, the SRB will set binding internal MREL targets, which will also be subject to transitional periods.

31. The authorities should explore the need and feasibility to expedite internal and external MREL build up, prioritizing large banks.[32] The availability of sufficient bail-in-able liabilities is critical to effective resolution—even more so in a regime that mandates the bail-in of creditors. Consistent with FSB and EBA guidance on the matter, internal MREL targets should support a group's resolution strategy, and enable recapitalization of material entities. Cross-holding among banks should be restricted to limit potential spillovers. Moreover, to facilitate effective bail-in, retail investors' exposure to complex bail-in-able instruments should be subject to strong investor protection (e.g., though rigorous requirements to disclose the risks or sufficiently high minimum lot sizes). Enforcement thereof would require reporting and database upgrades to make effective real-time monitoring possible.[33]

32. Legislative reform is needed urgently to make the use of the bail-in tool in resolution more feasible, especially in a cross-border context. The BRRD amendments on the hierarchy of creditor claims adopted in late 2017 are welcome. The amendments will bring about some harmonization in the creditor hierarchy in bank insolvency and particularly support efforts by banks in issuing TLAC/MREL-eligible debt instruments. To implement TLAC by 2019, most member states hosting G-SIBs already enacted national legislative reforms well in advance of the adoption of the Directive (Box 5).[34] The current changes, however, will only achieve partial harmonization and fail to address remaining national divergences in creditor hierarchies as applicable to banks. Better alignment is needed in the list of exclusions from bail-in, the treatment of deposits pursuant to Article 108 of the BRRD, and national insolvency regimes to mitigate the risks of potential legal challenges by creditors seeking compensation under the NCWO regime in case of a bail-in of creditors.[35] These challenges are likely to be especially complex in cross-border cases: under current legislation, similar creditors of a bank may be treated differently across jurisdictions.

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[31] "Bail-in in the new bank resolution framework: is there an issue with the middle class?" (BIS, March 2018; https://www.bis.org/speeches/sp180323.htm); "Quantitative update of the EBA MREL report" (EBA, December 2017; https://www.eba.europa.eu/documents/10180/1720738/Quantitative+update+of+the+EBA+MREL+Report.pdf).

[32] The FSAP notes that the EU framework requires MREL while a substantial number of SIs have no or insufficient experience in issuing MREL eligible instruments.

[33] IMF Staff Discussion Note, 'Trade-offs in Bank Resolution,' SDN/18/02, February 2018.

[34] The new asset class of "non-preferred" senior debt instruments is designed to facilitate bail-in in resolution; adequate disclosure rules are critical to ensure investors are aware of the risks associated with their holdings.

[35] For example, short-term liabilities with an original maturity of less than seven days (e.g., interbank lending) are excluded from bail-in but they would rank in most national insolvency regimes *pari passu* with senior debt instruments (unless a general depositor preference applies). Moreover, certain eligible deposits of natural persons and smaller enterprises rank higher in national insolvency regimes in accordance with Article 108(a) of the BRRD but are not excluded from bail-in. The treatment of structured debt instruments is also inconsistent.

Box 5. Harmonizing the Hierarchy of Creditor Claims in Bank Insolvency and Bail-In Provisions

BRRD amendments adopted in late 2017 will partially harmonize the hierarchy of creditor claims in bank insolvency. By end-2018, member states are required to create a new asset class of "non-preferred" senior debt instruments issued by credit institutions that would be bailed-in during resolution after capital instruments but before other senior liabilities. "Non-preferred" senior debt instruments must meet the following conditions: (i) the original contractual maturity is of at least one year; (ii) they have no embedded derivatives and are not derivatives; and (iii) the relevant contractual documentation and, where applicable, the prospectus related to the issuance explicitly refers to the lower ranking. The new "non-preferred" senior class of debt instruments would rank lower among senior claims but would have a higher priority ranking than capital instruments or any other subordinated liabilities. Because of the subordination of senior unsecured bank debt instruments to other debt instruments of the same issuer, the new instruments are not eligible as collateral in Eurosystem monetary policy operations.

Several EU countries introduced national legislation prior to the EU initiative, aiming to foster effective and efficient resolution action. Diverging approaches in enhancing credit institutions' resolvability and facilitating the bail-in tool's application deepened national fragmentation and added to uncertainty for issuers and investors.

Germany: Statutory Subordination. The German authorities were among the first to draw attention to the need to strengthen the legal foundations of the bail-in regime under the BRRD. Legislation adopted in 2015 (and in effect since 2017) provides for the statutory subordination of certain senior unsecured debt instruments in bank insolvency, applicable to new and already issued debt instruments. In particular, senior unsecured debt instruments are subordinated on a statutory basis to other senior liabilities of the credit institution such as interbank deposits, corporate deposits, money market instruments, certain claims under derivative transactions, and structured notes with derivative-linked features. The subordination applies to existing senior debt instruments and credit institutions can use some of their existing debt instruments for TLAC purposes. In 2016, Slovenia, too, introduced statutory subordination (together with general depositor preference based on a tiered approach).

France: Statutory Recognition of Contractual Subordination. Legislation enacted in 2016 aims to facilitate the implementation of resolution by creating legal certainty about the loss-absorbing capacity of a newly created class of "non-preferred" senior debt instruments. This was achieved by establishing a statutory basis for the issuance of new (not yet existing) debt instruments (with an original maturity of no less than one year) which include contractual subordination arrangements. In the hierarchy of creditor claims, "non-preferred" senior debt instruments rank before subordinated debt but after certain specified preferential or secured claims; covered deposits and certain eligible deposits of natural persons and micro, small and medium-sized enterprises; and senior "preferred" debt instruments. In 2017, Spain and Belgium introduced similar systems.

Italy: General depositor preference and non-preferred senior liabilities. The BRRD transposition conferred a preference on claims arising out of covered deposits (including claims where the DIS is subrogated to depositor claims), certain eligible deposits above the guaranteed threshold of natural persons and micro, small and medium-sized enterprises, and, starting from 2019, on all other deposits (including deposits by financial institutions). This general depositor preference (based on a tiered approach) facilitates bail-in, and reduces the risk of potential NCWO challenges. However, for purposes of the TLAC requirements, the new rules do not consider that other operational liabilities, for example, due payments from derivative contracts, continue to rank *pari passu* to senior unsecured bank debt instruments. A category of "second level unsecured debt instruments" (non-preferred senior) ranking lower among senior claims but above all subordinated claims and shares was introduced in 2018.

Source: Euro Area FSAP Team; Niall J. Lenihan, Maike B. Luedersen, and Martin Schulte, "The hierarchy of creditor claims in bank insolvency - Recent developments and the advisory functions of the European Central Bank," *Revue de Droit Bancaire et Financier*, 2016/VI.

33. The merits of introducing a general depositor preference (based on a tiered approach) should also be explored because it could facilitate the bail-in of non-deposit creditors. With the introduction of a preference for all deposits as a third tier below the preferred status of covered and certain eligible deposits under the BRRD, deposits would no longer rank *pari passu* with senior unsecured bank debt instruments, thereby reducing the risk of potential NCWO challenges. Additionally, exclusions from bail-in established in national legislation (for example, liabilities to charities), in addition to the common list set out in the BRRD, underscore that action in this area is needed. Ensuring the feasibility of the bail-in tool is critical for the SRB.

INSTITUTIONAL CHALLENGES

A. Decision-Making Structure

34. Structures for resolution decision-making are inconsistent with the SRB's full operational independence and are complex and potentially lengthy (Box 6). The KAs prescribe operational independence for resolution authorities. However, certain SRB resolution decisions on individual banks (for example, adoption of resolution schemes) are subject to endorsement/non-objection by the Commission (EU executive) and, in some cases, the Council (EU co-legislator). Their involvement could diminish the SRB's independence, and may delay resolution decisions when time is of the essence. The authorities should explore options to enhance the SRB decision-making authority;[36] grant it rule-making authority;[37] and designate it as an independent EU institution.[38,39] This may require treaty changes. However, with that status, SRB could independently finalize resolution schemes and apply the scheme to a failing bank in a legally-binding manner. Its decisions would hold throughout the EA, diminishing the need for NRA implementation actions, and thereby limiting avenues for litigation.[40] The SRB would be able to design its own staff selection and compensation practices. Importantly, if the SRB were an independent institution, SRF could obtain a credit rating, allowing it to put in place feasible financing arrangements for resolution measures. The SRB would continue to be accountable to the European Parliament, the ECJ, and the ECA.

[36] For example, by clarifying what are considered to be discretionary powers subject to the Meroni doctrine and to seek clarification from the Court of Justice of the European Union (ECJ) on this doctrine that was established in 1956 under the European Coal and Steel Community and predates the complexities of the current European Union. Also, where a resolution scheme has been revised, it should be clarified whether there is a need for the Commission to endorse the revised resolution scheme.

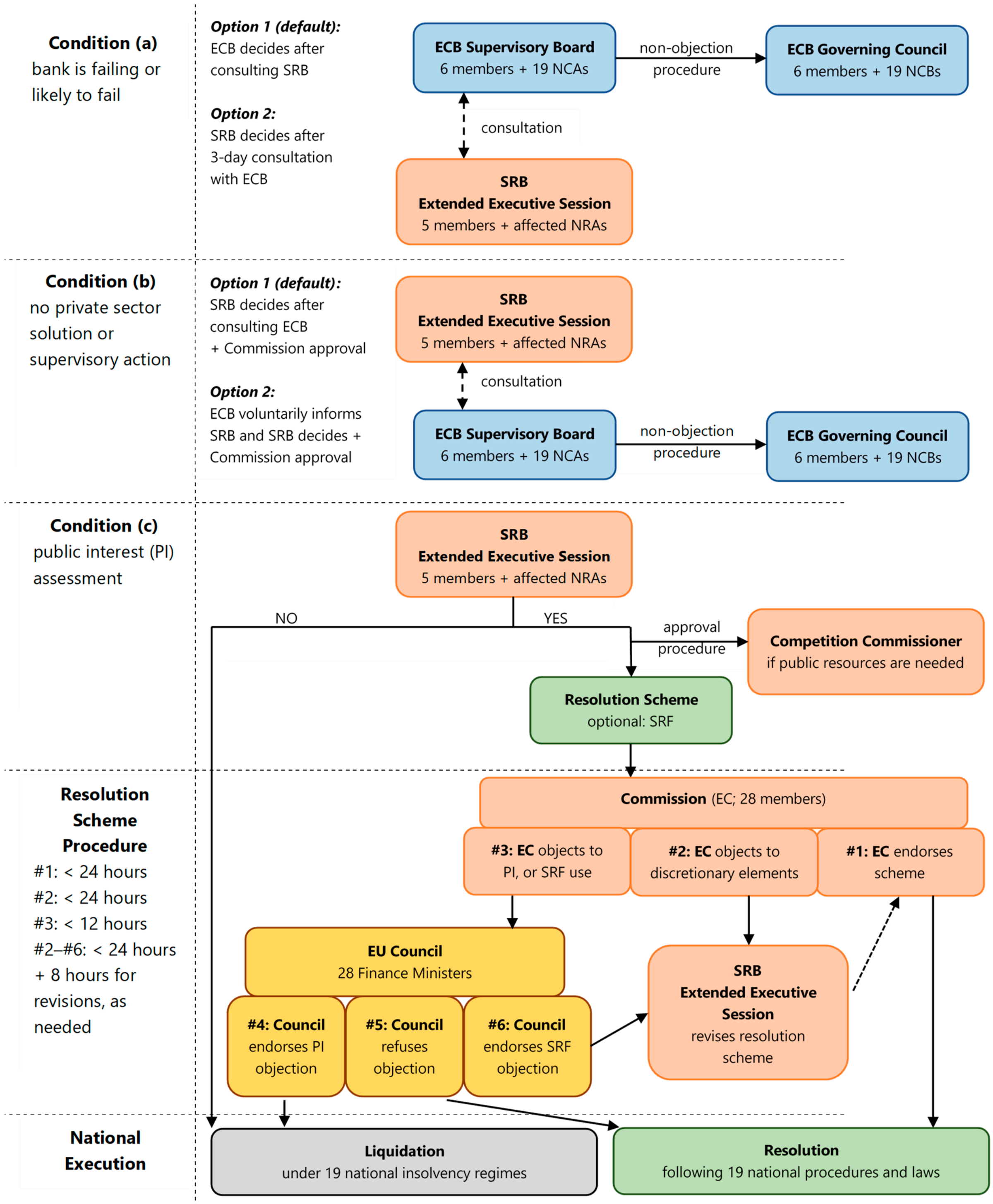
[37] Such power would allow the SRB, for example, to set system-wide rules to remove resolvability impediments.

[38] The co-legislators adopting the SRMR did not consider the SRB independent and mandated the Commission to consider whether the resolution functions allocated to the SRB, the Council, and the Commission, be exercised exclusively by an independent EU institution, and to propose Treaty changes to this effect (Article 94, SRMR). Designation as an institution would put the SRB on par with the ECB.

[39] This would be similar to the earlier designation as an independent "institution" of the ECB (Treaty of Lisbon, 2007) and the ECA (Treaty of Maastricht, 1992), which until the designations were 'agencies.'

[40] See also the SRB Chair Elke König's call to end the 'two-tier approach' in her speech on March 20, 2018, at the European Parliament (https://srb.europa.eu/en/node/508).

Box 6. Decision-Making Structure for Resolution



35. The resolution framework should be enhanced to provide for a more predictable judicial review of resolution decisions. The BPE case triggered two cases against the ECB and around one hundred legal actions against the SRB, of which around one-third is also against the Commission and one case is also against the EU legislators, all before the ECJ; approximately 250 cases were started in national courts against the Spanish authorities.[41] These cases question the SRM's legality and seek the annulment of the resolution scheme, damages, or access to information. This situation is unsustainable as the authorities will be increasingly tied-up in litigation, including the risk of significant costs for engaging external legal counsel. Publishing more detailed information in an accessible format and language may preempt some cases pertaining to access to information. Giving the SRB sole authority on resolution matters would reduce the risk of potential legal challenges in multiple jurisdictions and point to a single counterpart for litigation.

B. System-Wide Crisis Management

36. It is unclear whether the current bank-by-bank resolution framework would be able to effectively manage a system-wide crisis. The SRM arrangements may not provide sufficient flexibility, as the framework was not designed to deal with system-wide crises, rather with idiosyncratic events and the steady state in mind. The Commission noted that precautionary recapitalization provides some flexibility. While this is true for 'peace time,' it may not hold for crisis situations where banks' financial health may rapidly deteriorate, rather than under the precautionary recapitalization framework, which requires that banks be solvent and where their financial soundness is based on a stress test and asset quality review.

37. Certain constraints embedded in the current bank resolution and crisis management framework may become critical, especially in the event of a system-wide crisis. One constraint is the mandatory eight percent bail-in requirement for accessing the SRF and national public funds.[42] To facilitate bail-in, banks need to hold sufficient MREL-eligible liabilities. While other liabilities, too, could be subject to bail-in, some—particularly, uninsured deposits—are politically less palatable and bail-in thereof could weaken financial stability. This constraint manifests itself particularly during the transition period where the bail-in regime applies while banks are building up MREL. Bail-in could also be a problem in the steady state: bail-in of SIs could trigger contagion and exacerbate a system-wide crisis. Similarly, the simultaneous failure of several larger LSIs could necessitate resolution, while their resolution plans may have envisaged liquidation; without adequate MREL, it may not be possible to follow an optimal strategy. Another constraint concerns the five percent cap on SRF financing of resolution measures. To prevent contagion—especially during a system-wide crisis—a larger SRF contribution may be necessary. Neither the eight percent bail-in requirement, nor the five percent cap on SRF resolution financing allows for sufficient flexibility.

[41] Additionally, allegations of criminal conduct were brought against certain third parties.

[42] The combination of the NCWO safeguard and the requirement for 8 percent loss absorbency before the SRF can be used to meet any shortfall constrains flexibility. On the resulting constraints, see paragraph 33 of the Ireland FSAP "Technical Note—Financial Safety Net, Bank Resolution, and Crisis Management" (IMF, September 2016).

38. Thus, the bank resolution framework does not allow for temporary exceptions to preserve financial stability in a crisis, although such exceptions are common elsewhere in EU law. The EU treaties allow exceptions on the four freedoms (that is, free movement of goods, capital, services, and labor) for reasons of public policy or public security,[43] which could also cover economic measures. Similarly, for example, the stability and growth pact allows for deviations in case of severe economic downturns.[44] The treaty provisions on free movement of capital allow exceptions to ensure the application of prudential supervision of financial institutions.[45] The 2013 Banking Communication allows deviations from burden-sharing measures under state aid rules, where implementing such measures would endanger financial stability or lead to disproportionate results.[46] Yet neither the BRRD nor the SRMR provide for such temporary exceptions in exceptional circumstances for key requirements, such as the mandatory eight percent bail-in requirement for access to the SRF. Without such flexibility, the regime may not be "time consistent," that is, when shocks are realized, the prospective outcome given the constraints in the regime may be so economically or politically costly that authorities prefer to use national procedures to reach some other outcome.

39. Critical flexibility could be achieved by introducing a financial stability exemption subject to strict conditionality and governance arrangements that appropriately balances banking union and member state interests. The conditionality would be based on documented, extreme risks to the financial system of a member state as a whole, or of the euro area. The exemption would also have to apply to tightened restructuring and burden-sharing requirements under the 2013 Banking Communication as proposed above. The exemption could evolve while the banking union is further completed.

40. Exceptionally, the optional governmental financial stabilization tools should be available in the banking union in a crisis. During system-wide crises, extraordinary powers may be needed to maintain financial stability. As a general matter, the use of such extraordinary powers should be exceptional, and the authorities should have sound exit strategies in place. Almost half of EA countries have established powers for public equity support and temporary public ownership. These powers may be used after exploiting the other resolution tools to the maximum extent.[47] The

[43] For example, Article 65(1)(b) TFEU.

[44] Article 5, Regulation (EC) No 1466/97; Article 3, Regulation (EC) No 1467/97.

[45] Article 65(1)(b) TFEU.

[46] Paragraph 45 of the 2013 Banking Communication.

[47] Before using the government financial stabilization tools, the government and the resolution authority must determine that the application of the other resolution tools would not suffice (1) to avoid a significant adverse effect on the financial system, and (2) to protect the public interest, where extraordinary liquidity assistance from the central bank has previously been given to the institution; for the temporary public ownership tool, the government must also determine that the application of the other resolution tools would not suffice to protect the public interest, where public equity support through the equity support tool has previously been given to the institution.

authorities take the view that it is highly unlikely that these tools would be used to intervene in SIs.[48] However, it cannot be ruled out that the government financial stabilization tools are needed in a system-wide crisis. The authorities should consider all tools at their disposal, including the use of government financial stabilization tools should a wider crisis occur. At the request of national government, the SRB should be able to include the use of these tools in the resolution scheme.

41. To complement the bank-by-bank resolution framework, EU authorities should consider how a system-wide crisis would be managed—regardless of the financial stability exemption.[49] This will require an appropriate governance framework bringing together pertinent agencies to effectively cooperate in formulating credible responses to a system-wide crisis.[50,51]

ENHANCING OPERATIONAL CAPACITY

A. Introduction

42. The SRB is the banking union's central resolution authority. The SRB was set up in August 2014 and became operational on January 1, 2015. The SRB spent much of 2015 recruiting staff, finding office space, and undertaking other functions required of a new agency. On January 1, 2016, the SRB fully assumed its mandate. As of January 1, 2018, the SRB was responsible for 131 banks, comprising 118 SIs supervised by the ECB (including seven global systemically important banks) and 13 cross-border LSIs. In addition, the SRB has responsibilities for about 3,100 LSIs (counted on a solo basis).

43. The SRB has a dual governance structure. The SRB is governed by a full-time Board comprising a chair, vice-chair, and four other board members, taking decisions in two bodies:

- An *executive session*, comprising the chair and the four permanent board members—the vice-chair is non-voting. Commission and ECB representatives are permanent observers. The executive session generally meets monthly, takes resolution decisions, and approves bank

[48] In line with the position expressed by the Council Legal Service, it is understood that the government financial stabilization tools provided for in the BRRD are currently only available for use outside of the SRM (for example, by non-EA member states). Accordingly, such tools would not be available in member states participating in the SRM.

[49] In addition to the specific recommendations in this section, other recommendations in the Note would help in a system-wide crisis. For example, ensuring that the bridge bank tool is a feasible option would be useful; moreover, the authorities should consider what role the ESM backstop and possibly a new fiscal function could play in an overarching system-wide crisis management framework.

[50] The 2013 EU FSAP recommended that within the banking union it would be essential to establish a mechanism or a committee with a holistic perspective, integrating the crisis-related work of the ESAs, the ESRB, the ECB, the SRB, the Commission, and the banking-union funding facilities (that is, at a minimum, the SRF and the ESM).

[51] While the Commission's "endeavours to take a co-ordinated approach in its assessment of individual banks' restructuring plans so as provide for a system-wide response… where large parts of a Member State's financial sector need to be restructured" (paragraph 10, 2013 Banking Communication) would be welcome, it cannot be a substitute for a multi-agency arrangement.

resolution plans and other policies. When a decision is taken with respect to a specific bank, the executive session is then "extended" to include relevant NRA representatives;

- A *plenary session*, comprising the Board and a representative of each NRA. The Commission, the ECB, and the EBA are permanent observers. The plenary meets about six times per year and approves the budget of the SRB and takes other decisions affecting the SRB as an organization. The plenary must take decisions if the SRF has provided support exceeding €5 billion (or in the case of liquidity support exceeding €10 billion) for the resolution in question.

B. Staffing

44. While the SRB has staffed up well in startup, total SRM staffing remains tight considering its tasks. The SRB has grown rapidly from 101 staff at end-2015 to 255 staff at end-2017. The SRB plans to grow to a total of 410 staff by 2020, more than doubling its size in four years (Table 2). The hiring of staff has not gone as quickly as the SRB would have liked. The SRB had to compete with the NRAs, many of whom were also being set up from scratch; the SRB is also competing with the Commission (offering more mobility in a larger organization), the ECB (offering competitive compensation packages as an independent treaty institution), and the European Supervisory Authorities;[52] and the SRB must follow the Commission's recruitment framework, which is not tailored to the SRB's specific professional needs. Close to half of the planned SRB staff in 2020 will be responsible for drafting roughly 130 resolution plans, fewer on average than in other major jurisdictions. The staffing level varies across NRAs, given the different numbers of SIs and LSIs per member state. Some NRAs may be understaffed as noted in several EA country FSAPs.

Table 2. Euro Area: Staffing of the Single Resolution Mechanism

FTE Staff	End-2016	End-2017	2018 Budgeted	2019 Envisaged	2020 Envisaged
SRB	164	255	350	400/5	410/5
SRB SNEs/1	12	15	25	25	26
Total NRAs/2	332/3	374/4	405	414	422
Total SRM	508	644	780	838	858
Of which, SRB resolution planning	156	185	195	202	208

Source: "SRB Multi-Annual Planning and Work Programme 2018," pp. 46 and 65; internal SRB documents; Euro Area FSAP Team calculations

/1 Seconded National Experts
/2 numbers for 2018–2020 are estimated for some NRAs
/3 November 2016
/4 Budgeted
/5 subject to Plenary approval

[52] EBA, ESMA, and EIOPA (European Insurance and Occupational Pensions Authority)

45. The SSM is responsible for recovery planning and early intervention of SIs. A Joint Supervisory Team (JST), led by an ECB staff member and comprising representatives from the NCAs, is responsible for day-to-day supervision of each significant bank, including recovery planning and early intervention. DG Micro-Prudential Supervision IV includes a Crisis Management Division. This Division supports the JSTs on crisis management issues, ensures consistency within the ECB, and serves as liaison with the SRB.

46. The EBA staff capacity for resolution planning in the banking union is limited. The EBA is an EU-wide regulatory authority responsible for completing and managing the Single Rulebook for the banking sector; it sets out regulatory technical standards for crisis management. The EBA resolution committee, chaired by an SRB board member in his personal capacity, consists of all the member state NRAs. The ECB and the SRB are non-voting observers, but their role in early intervention and resolution should be recognized by granting them voting rights in the EBA's Resolution Committee and Board of Supervisors. The committee is supported by a small secretariat of about a dozen staff, which is too small for the EBA to fulfill all its crisis management responsibilities, including attending crisis management groups (CMGs) and resolution colleges.

47. Staffing of the SRB and the ECB's Crisis Management Division should be commensurate with their mandates. In times of intensified bank interventions, both organizations should ensure that effective arrangements are in place to ensure prompt surge staffing, with additional staffing from both within their organizations and from external sources. To the extent that the EBA receive additional mandates in the future for deposit insurance, staffing increases will be necessary. Similarly, when the SRB actively starts fulfilling its FOLF back-up authority, it will require additional staffing; and as noted earlier, with more resolution decisions, litigation against the SRB should be expected to increase, which will require additional staffing for the SRB legal services. Arrangements should be in place to promptly mobilize additional staffing in times of intensified bank interventions.

C. Operational Readiness

48. Recent financial crises demonstrated that preparation is critical to intervene decisively in response to emerging bank problems. Preparation includes detailed policies, manuals, playbooks, table-top exercises, recovery and resolution plans, resolvability assessments, and close inter-agency cooperative arrangements in the banking union and with non-EA EU and third countries. Crisis preparation should continuously adapt to new developments and techniques.

49. While the SRB has engaged extensively in crisis preparation, more can be done. The SRB Resolution Manual describes resolution plan sections and follows FSB and EBA guidance.[53] It discusses critical functions and, to a lesser extent, the public interest assessment. The Manual is being updated to make it more operational—this should be expedited. The proposed new sections on each of the four tools would be useful in strengthening the operational arrangements for

[53] These include: strategic business analysis; description of the preferred resolution strategy; financial and operational continuity; information and communication plan; and conclusion of the resolvability assessment.

resolution. As the SRM enhances its insights on the banks within its remit and develops its resolution policies, more resolution tools—and a combination thereof—should be considered in resolution planning (instead of focusing on the bail-in tool only). In particular, the bridge bank tool should be made more feasible and could be more often considered for SIs as it would allow more time to restructure the bank. To increase the feasibility of bridge banks, it should be easier to set up and operate bridge banks throughout the euro area, by advance preparation for sound governance and financial structures, and clarifying relevant national procedures. The SRM and the EBA should also consider how to incorporate a resolution funding plan into each bank's resolution plan, as recommended by the FSB in 2016.[54]

50. The SRB has made good progress, in a short time, to develop internal policy documents and templates. In 2016 and 2017, the SRB adopted guidance on resolution planning by Internal Resolution Teams (IRTs):[55] MREL; access to financial market infrastructures (FMIs); and critical functions. SRB cooperation with NRAs on LSIs takes place through the LSI Oversight Taskforce created in 2016. For 2018, the internal policy agenda includes: public interest assessment; solo/internal MREL and MREL calibration under transfer strategies; FOLF; and addressing substantive resolvability impediments. The SRB has developed or intends to develop reporting templates covering liability data,[56] critical functions, core business lines, and access to FMIs; this will help standardizing information for resolution planning and decision-making. To complement the SRB's guidance documents and to ensure the effectiveness of resolution measures from a supervisory perspective, the ECB should develop its own operational guidance for crisis management activities, prioritizing the bridge bank tool and its feasibility, and update its emergency action plan.

51. The SRB should continue to conduct table-top exercises. These can help identify changes to enhance operational readiness. The SRB held its first exercise in January 2016 with the Commission and the Council to test the procedures for preparing and deciding on a resolution scheme; in July 2017, the SRB participated in a Council exercise to test the adoption of a resolution scheme. In October 2016, the banking union authorities engaged in a principals' level exercise with the U.K. and U.S. authorities, which all parties found useful. The SRB is planning two exercises in 2018 with the NRAs. The exercises should also encompass the preparation period when, for example, available collateral is verified. The SRB should also test its revised resolution manual.

D. Resolution Preparation and Implementation

52. It is critical that the conditions for early intervention are clear and allow for decisive action. The ECB's supervisory measures are set out in Article 16 of the SSMR, Article 104 of the CRD;

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[54] FSB, "Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank," August 18, 2016. Further FSB guidance is under consideration.

[55] IRTs comprise SRB staff (IRT chair) and staff of the NRAs of those euro area countries in which the cross-border group's parent undertaking or subsidiaries are incorporated. There are 77 IRTs.

[56] In this context, it is important to assess potential implications of Brexit for debt instruments governed by English law. If the U.K. will be treated as "third country" post-Brexit, this would involve an assessment of the framework for the recognition of resolution measures and may have implications for the MREL-eligibility of these debt instruments.

early intervention measures are set out in Articles 27–29 of the BRRD—with some overlap. The choice by the ECB of which powers to engage hinges on several factors. First, when imposing supervisory measures, the ECB directly relies on EU law, whereas the use of early intervention measures depends on the diverging transposition of the BRRD in national legislation. Second, early intervention measures are deemed more intrusive and disclosure by the credit institution under market transparency rules may be more likely. Disclosure practices should be more aligned, allowing sufficient flexibility to delay disclosure as needed for financial stability reasons.[57] Finally, based on the notion of proportionality, there is a bias to first apply supervisory measures rather than early intervention measures. So far, the use of early intervention measures has been limited.

53. Legislative changes to remove constraints on the use of early intervention measures are needed. EU co-legislators are considering the ECB's call for amendments to eliminate overlap and to move certain early intervention measures to the SRMR. Proposed new SRMR provisions would allow the ECB, for example, to require recovery measures, remove members of senior management, change the legal structure, and appoint a temporary administrator to replace the management body. Moreover, the ECB is developing more quantitative early intervention triggers, which are welcome provided JSTs can impose such measures before the triggers have been met.

54. Early interventions in problem banks and advance preparation of resolution can prevent value destruction. In addition to the lack of clarity regarding early intervention powers, another concern is the close linkage between ECB early intervention and SRB advance resolution preparation. Where possible, the SRB should start preparations sooner (such as by reaching out to interested parties for a potential sale-of-business transaction). Such preparation should not be conditional upon formal early intervention measures. Further, the parameters for SRB on-site inspections should be clarified. Moreover, the ECB and the SRB should adopt policies and operational arrangements to ensure that the FOLF determination and 'resolution weekend' are closely coordinated and prescheduled to allow advance resolution preparation and a seamless transfer of the problem bank from the ECB to the SRB. This is a more effective approach to reduce the destruction of value and to prevent mid-week resolutions, than expanding moratorium powers as proposed by the Commission (Box 7), even if this was to be kept short and only available to the SRB as currently is being considered in negotiations between the Council and the European Parliament.

[57] Article 17 of the Market Abuse Regulation gives banks discretion; and delaying disclosure is possible for financial stability purposes, subject to the approval of national market authorities, which consult with the NCAs.

Box 7. Moratorium Proposal

The proposed moratorium powers raise concerns as to their scope, length, and conflicting authority. The Commission's 2016 legislative package on risk-reduction measures proposed suspension powers of up to five working days each for the supervisory and the resolution authorities. The moratorium would suspend the bank's payments (excluding covered deposits) and other delivery obligations. This could be read as permitting a maximum moratorium period of 10 days (or even 12 days, see Articles 69—71 of the BRRD) if applied in combination in pre-resolution and resolution—this is problematic. Moreover, as regards the treatment of certain financial contracts under the International Swaps and Derivatives Association 2015 Universal Resolution Stay Protocol (with a shorter stay),[1] credit institutions could opt-out in jurisdictions that amend the length of the statutory stay. For example, unless the new moratorium is deemed "substantially similar" for netting derivative positions, overseas banks would likely need to increase capital and margin requirements, reducing incentives to engage with euro area credit institutions.

Extending the proposed moratorium to covered deposits entails significant risks. To increase its effectiveness in stemming liquidity outflows, the ECB recommended that covered deposits, too, be subject to the moratorium, with limited discretionary exemptions. This approach raises concerns as prolonged deposit freezes would undermine confidence in the banking system and jeopardize financial stability, and the imposition of a pre-resolution moratorium could trigger deposit payouts. In the ECB's view, the pre-resolution moratorium tool (not considered an early intervention measure) would allow more time for the FOLF assessment and allows additional time for the resolution authority to start preparing for its resolution tasks in parallel. There is a risk, however that instead it will hasten the bank's demise with no prospect of recovery and trigger contagion to other banks. Moreover, a moratorium does not substitute for preparation well ahead of the FOLTF.

The merits of the moratorium tool should be reassessed, and its length kept to a minimum. Ongoing discussions focus on a resolution moratorium that would be imposed by the SRB for a period of two to five days, a two-day moratorium either before or in resolution, the inclusion of covered deposits in the scope, and contractual netting issues. The FOLF assessment should not be perceived as a "hand-over" from the ECB to the SRB but rather as one more step in a continuous process, buttressed by adequate liquidity provision. A fundamentally streamlined decision-making process in resolution, and more advanced planning to "choregraph" entry into resolution, would promote better sequencing of resolution actions, and reduce the need for an extended moratorium that could negatively impact on structured finance arrangements and derivative contracts with European banks, and cross-border recognition of temporary stay powers.

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[1] KA 4.3(i) notes that a stay should be strictly limited in time (for example, not exceeding two business days).

55. **Preparations for intervention in a problem bank must ensure the availability of liquidity during the intervention, while maintaining appropriate safeguards.** Liquidity needs in case of a major disturbance could be very large and sudden (as suggested by the FSAP stability analysis). The preparations would need to consider the need for, and availability of central bank refinancing and the applicable constraints; the liquidity component of the resolution plan needs to be made implementable. A bank emerging from resolution that is experiencing liquidity strains could have access to regular Eurosystem monetary policy operations; if not, it would need to request ELA. The ECB and NCBs should be prepared for such an eventuality, with ELA only being available at the Eurosystem's discretion and when all criteria are satisfied and safeguards are in place. All concerned (e.g., the ECB's monetary policy function, the respective NCB, the SRB) thus need to discuss the EA's approach to central bank liquidity support, along with required safeguards, boundaries of support, also in scenarios where, for example, assets eligible as collateral in monetary

policy operations or assets which the respective NCB is willing and able to take as ELA collateral may not be immediately available. Mutual understanding in this area would benefit from a memorandum of understanding (MOU). The intervention strategy and planning must respect these constraints.

56. Especially while the banking union is being further completed, host authorities of D-SIBs must play a major role in resolution planning, preparation, and implementation for the respective subsidiary or branch. This involvement will help to meet the imperative of maintaining critical functions in that jurisdiction, avoid unfair burdens, and promote cooperative approaches.[58] Involvement of host authorities is important whether the respective group is structured to facilitate a "single point of entry" or a "multiple point of entry" approach to resolution. Ex ante determination of which banks are of major importance for the wider economy is needed so that supervisory action, recovery planning, and contingency planning can be directed at reducing the probability and severity of difficulties in these banks.[59]

E. Recovery and Resolution Planning

57. The ECB is benchmarking SIs' recovery plans to improve their quality. Banks develop the first draft of their recovery plans. The ECB has developed internal tools to assess the recovery plans' quality and to identify material deficiencies. The ECB is now in its third cycle of recovery planning. The second cycle began in September 2016 and lasted until end-August 2017; this was the first cycle with full comparability among the plans. The ECB has observed substantial improvements in terms of completeness and quality of the recovery plans. However, about 20 percent of the plans either had or were close to having 'material deficiencies' in mainly three areas: inadequate governance and escalation procedures; lack of relevant recovery indicators or inadequate calibration of their thresholds; and inadequate recovery capacity, either for liquidity, capital, or both. In the case a plan is determined 'materially deficient' by the ECB, the bank is required to resubmit the plan within two months—with potentially a one-month extension. For plans determined to be close to 'materially deficient,' the ECB requires banks to develop and implement an action plan to ensure the key deficiencies are remediated properly.[60]

58. The ECB intends to make recovery plans more operational. The ECB's key objectives for its work on recovery plans during 2018 and 2019 are to make recovery plans more operational and reach a clearer view on banks' recoverability. The ECB is promoting playbooks and dry-runs to improve the usability of recovery plans in stress situations, which are welcomed.

59. The SRB's resolution planning process is still evolving so as to best deal with the diverse and complex issues that arise. Each IRT is responsible for the resolution plans for its bank(s). Typically, the NRAs prepare the plan's first draft for circulation within the IRT. In 2018, the

[58] This point was emphasized in several recent euro area country FSAPs.

[59] Some events may be of systemic importance just in the context of a system-wide crisis, but structural dependencies should be identifiable in advance.

[60] See further, the 2017 ECB Supervision Annual Report, Section 2.3 on recovery planning (https://www.bankingsupervision.europa.eu/press/publications/annual-report/html/ssm.ar2017.en.html).

SRB changed the approach it uses for resolution plans. Until end-2017, the SRB used a modular, five-phase resolution approach to progress through about 130 resolution plans that it had to draft—none of which is advanced past phase three:

- Transitional resolution plans (or phase one plans) focus on the strategic business analysis. They are not subject to approval by the SRB's extended Executive Session.
- Phase two plans are more comprehensive and cover financial/operational continuity and the preferred resolution strategy. They are subject to adoption by the extended Executive Session—and the resolution college, if there is any.[61]
- Phase three plans include MREL determinations at the consolidated level. They do not include determinations of substantive impediments or MREL. They are subject to adoption by the extended Executive Session—and the resolution college, if there is any.
- Phase four plans include a determination of substantive impediments and MREL at the consolidated and single entity level.
- Full resolution plans add measures to the phase four plans to remove substantive impediments, that is, the potential start of an impediments procedure, if necessary.

60. The SRB has adopted a new resolution plan system; full resolution plans for all banks are not expected until 2020. At end-2017, the SRB adopted a matrix approach, splitting the resolution plans by timeline as well as by risk to allow more time for resolution colleges to engage and to provide a more risk focus to resolution planning. In 2018, the SRB will split the annual resolution planning cycle of 12 months into two batches: (1) a January cycle for banks without a college; and (2) a September cycle for banks with college. The SRB will also split resolution plans into two categories, depending on the type (and risk profile) of the bank: (1) banks (with or without colleges) for which a fully-fledged resolution plan is relevant and necessary; and (2) "specific" banks that require a tailored approach to resolution planning because of their particular nature (for example, banks covered by a European resolution college,[62] those subject to simplified obligations, or those for which the SRB is host). For the 2020 resolution planning cycle, the SRB expects all banks, with or without colleges, to be covered by complete resolution plans with the most advanced set of policies.

61. The SRB intends to introduce proportionality in resolution planning. Banks with resolution colleges will be covered by the most advanced policies, which include binding MREL

[61] Group level resolution authorities must set up resolution colleges when a parent bank established in the EU has at least one subsidiary in another member state. There are 26 SRB banks with a college. These comprise representatives from the NRAs of all countries in which group entities are incorporated. Colleges also include representatives from EBA, the supervisory authorities, competent ministries, and authorities responsible for the deposit guarantee schemes in these countries. For groups with an IRT, the SRB represents the euro area in the colleges.

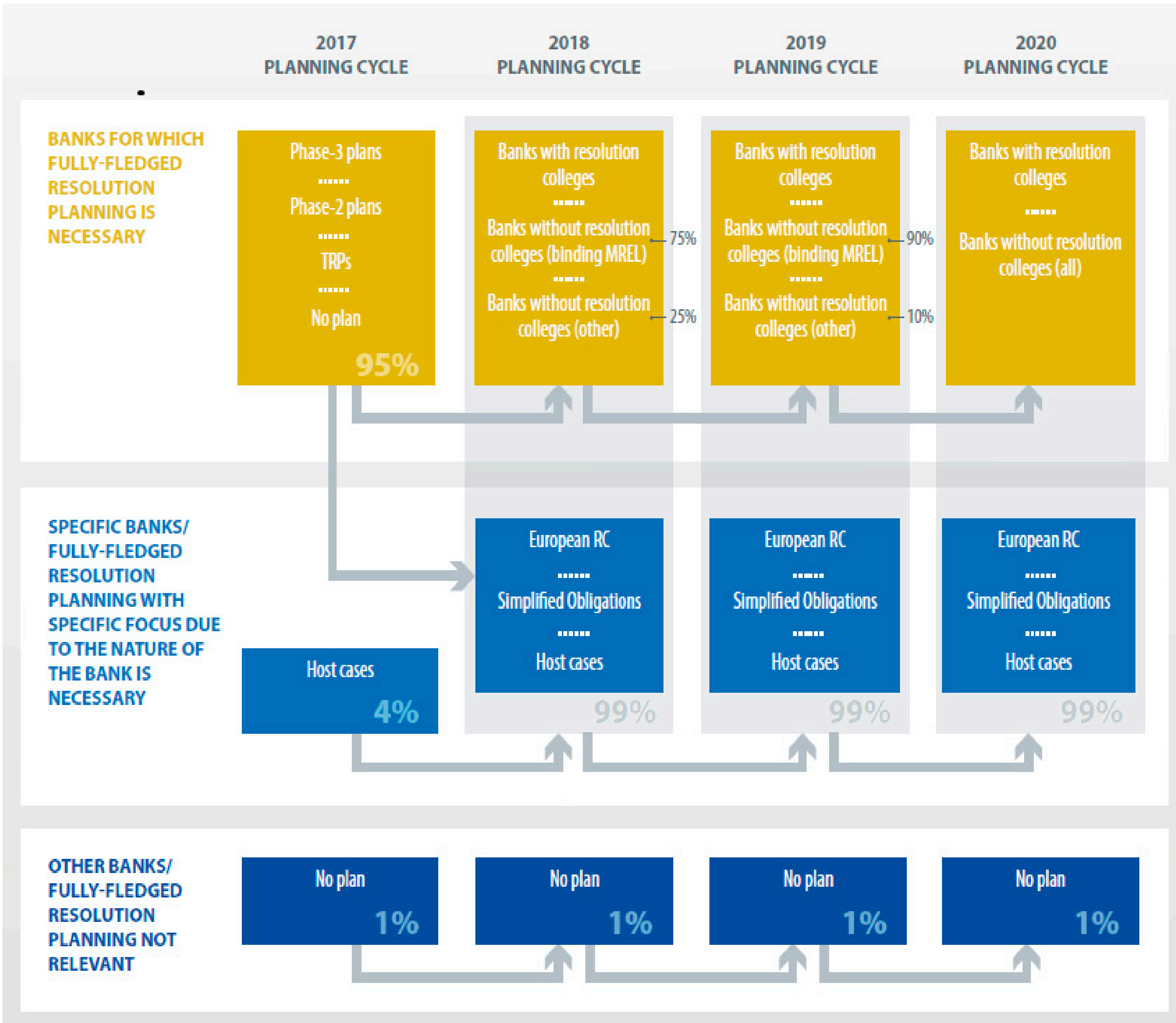
[62] A European resolution college must be established for a non-EU bank that has subsidiaries or significant branches in two or more member states within the banking union.

targets at the consolidated level and a first identification of internal MREL targets at material entity level. Banks without colleges will be subject to a two-tier approach depending on their degree of priority, as agreed by the SRB and the relevant NRAs, based on among other things the bank's size, complexity, and risk profile. The SRB intends to determine binding MREL targets at the consolidated level for the majority of the largest and most complex banking groups by mid-2018. In 2018, the SRB will also carry out a first identification of substantive impediments to resolution. Box 8 provides an overview of the resolution process for the banks under the SRB's direct remit, showing the types of plans, with an estimate of the percentage of groups for each type, along with a timeline showing the resolution planning cycle.

62. The SRB should adopt policies and take actions to mitigate resolvability impediments. One aspect of advanced resolution planning in which the SRM is still at an early stage is the assessment of resolvability, which should be a key chapter in the resolution plans. After only a few years of resolution planning, it would be too early to consider banks resolvable, but the SRB has not yet notified the EBA that any banks are "not resolvable," as required under Article 17 of the BRRD. The SSM has started informally identifying impediments to resolvability in its resolution plans, including on management information systems, service level agreements, access to FMIs, and banks' legal structure. However, if the SRB makes a formal finding that certain impediments are "substantive," Article 17(2) of the BRRD requires resolution planning to be suspended for a significant period (potentially four months or even longer). This feature of the BRRD should be changed to ensure decisive mitigation of resolvability impediments, while allowing progress on resolution planning to continue. Once impediments are identified, it will be even more important to develop and adopt policies to mitigate the resolvability impediments. Article 17(5) of the BRRD provides some very strong powers that the SRB should use if necessary in the case of a recalcitrant bank.

63. The SRB also reviews LSI resolution plans and measures. The SRB maintains an oversight function over LSIs by assessing NRAs' decisions for the adoption of LSI plans and other measures, including resolution decisions. In particular, the SRB has responsibility for reviewing all resolution plans prepared by the NRAs for the LSIs, including their MREL decisions. In 2017, the SRB reviewed 522 LSI draft resolution measures. In 2018, SRB staff estimates that the SRB will need to process approximately 800 draft resolution measures for LSIs.

Box 8. Timeline SRB Resolution Planning



Source: SRB Multi-annual Planning and Work Programme 2018.

F. Inter-Agency Cooperation

64. Information exchange between the ECB and the SRB has worked well in normal times. In December 2015, the ECB and the SRB signed an MOU specifying their cooperation and information exchange. The Chair of the ECB Supervisory Board and the SRB Chair meet regularly; additionally, other high-level exchanges take place. The ECB Supervisory Board has a permanent observer on the SRB Plenary and all SRB Executive Sessions. The SRB Chair is regularly invited to the ECB Supervisory Board meetings. JSTs and IRTs share relevant supervisory information on their banks. ECB supervisory staff participates in SRB committees, and SRB staff attends the SSM Crisis Management Network's quarterly meetings that discuss policy-oriented issues. SRB staff has automatic access to a wide range of supervisory information necessary for resolution planning and enhanced access to supervisory information in situations of financial deterioration in a bank. The SRB is consulted on banks' recovery plans and the ECB is consulted on the SRB's resolution plans.

65. Information exchange between the ECB and the SRB will be improved by their revised MOU. The SRB already receives enhanced information from the ECB on banks that have a score of four (or a score of three with at least one sub-score of four) in the supervisory review and evaluation process in addition to a broad range of information which will be shared for resolution planning purposes. As a problem bank advances within the ECB emergency action plan's stages, the cooperation would intensify and the SRB would access greater and more frequent information; it would participate in an institution-specific crisis management team. The SRB also receives the draft FOLF decision from the ECB for consultation three days before the ECB Supervisory Board acts.

66. Cross-agency representation would improve information exchange and coordination both in normal times and in crisis situations. The SRB should be granted permanent observer status on the ECB Supervisory Board. The SRB and the ECB should be voting members on the EBA Board of Supervisors and the EBA Resolution Committee. Also, the EU and national authorities should be required to consult the SRB on draft legislation in its field of competence.[63]

67. The Commission and the SRB should conclude their MOU. The SRB appears to have a close working relationship with the Commission (DG FISMA and DG COMP), which is reinforced by the Commission having a permanent observer on the SRB's Executive Session and Plenary. Nevertheless, the SRB and the Commission have been working on their MOU for several years and are encouraged to sign the arrangement as soon as possible.

68. Cooperation between the SRB and the NRAs/NCAs is improving. In June 2016, the SRB and the NRAs agreed on a cooperation framework agreement providing guidance for cooperation between the SRB and NRAs (for example, IRTs, resolution colleges, and LSI oversight). This agreement is currently being renegotiated and is expected to be completed in 2018. The SRB also has the remit for 13 cross-border LSIs that are not under the direct supervision of the ECB, so the SRB needs to negotiate MOUs with the competent authorities responsible for the cross-border LSIs.

69. Recent experience shows the importance of greater information on liquidity and collateral, especially when a bank is beginning to have difficulties and as contingency planning for intervention intensifies. Both the ECB and the SRB recognize the need to improve information exchange; their recently revised MOU will make information exchange in crisis situations more automatic.[64] However, information exchange on this crucial matter needs to extend to NRAs and NCBs.

70. International cooperation is good, but the SRB should sign its outstanding cooperation arrangements. In November 2017, the FSB updated its list of 30 G-SIBs, which includes seven G-SIBs from the banking union. Four thereof have significant subsidiaries in third

[63] This is similar to the duty to consult the ECB on draft legislation in its field of competence (Article 127(4) TFEU)).

[64] The BRRD notes that resolution authorities should have access to all supervisory information.

countries; as required by the KAs, each has a CMG (cross-border crisis management group). Most of the CMGs established under the FSB framework already have signed cooperation agreements) in place, so the SRB is encouraged to conclude these as soon as possible. The SRB is participating on behalf of the host jurisdiction in six foreign CMGs, and the SRB is encouraged to sign the cooperation agreements for these CMGs as soon as possible. The SRB has already signed general bilateral cooperation agreements with the U.S. and Canadian resolution authorities; it is working on similar cooperation arrangements with other third-country jurisdictions and MOUs with the ECB and non-EA NCAs and NRAs, which it is encouraged to complete. To date, the SRB has only taken a resolution action for one bank with a cross-border operation outside of the banking anion, and the cooperation with the third country seems to have gone well. If the U.K. is considered a third county after Brexit, the agreements and arrangements with the Bank of England will need to be updated. Consequently, the Bank of England would no longer have a seat on the resolution colleges, but could be invited to participate in the European resolution colleges for banks headquartered in the U.K. and operating in the European Union.

DEPOSIT INSURANCE

71. The DIS regime was enhanced in 2014. The amended DGSD seeks to harmonize the national DISs. It provides, inter alia, for the following:

- coverage up to €100,000 per depositor per bank (with higher coverage for certain life events);
- a seven-working-day payout of deposits (effective January 1, 2024), reduced from 20 working days in three phases—information on how member states are progressing was not available;
- risk-based premiums to be paid by banks into their national DIS to reach a level of 0.8 percent of covered deposits by July 3, 2024 (currently estimated at €45 billion for the banking union);
- alternative funding arrangements to obtain short-term funding to meet claims against their DISs (e.g., a line of credit from the finance ministry)—of which there are very few in place;
- voluntary arrangements among member states to allow DISs to lend to other DISs within the EU—of which there are only very few concluded; and
- protection for deposits taken at branch offices located in another member state.

72. National discretions, uneven implementation, and different national banking structures contribute to a still fragmented deposit insurance system in the banking union. Despite the significant improvements, the DGSD has over a dozen provisions providing for national discretion (Annex II), including provisions to reduce the target to 0.5 percent of covered deposits in certain circumstances, exceptions to scope and coverage, repayment periods, and calculations. Although the voluntary arrangements to allow DISs to lend to each other are meant to supplement the low balances in most DISs, and nine member states have taken advantage of the provision, not all have operationalized the lending arrangements, which should be remedied. Even for those areas where harmonization is the objective, different national banking structures and different speeds of implementation have meant that DISs operate differently across the banking union.

73. The EBA could be given a mandate to oversee DISs. Member states are required to inform the EBA about covered deposit amounts and contributions collected by their DISs. They must also inform the EBA of any depositor payouts—since 2015, 50 depositor payouts have occurred. The EBA has issued guidelines on and oversees the calculation of industry contributions to DISs. EBA conducts peer reviews every five years, which it will do in July 2019, to examine the resilience of DISs. The EBA could be mandated with overseeing and coordinating the DISs.

74. Use of DIS funds in resolution and insolvency proceedings is constrained in the banking union. The KAs require that the legal framework provide for both pay-outs to insured depositors and transfer of insured deposits to another solvent bank in either resolution or in insolvency. The power to transfer covered deposits in liquidation is optional under the DGSD and just a little over one-third of the member states have made use of this option (Annex II). In any case, since the SRB lacks liquidation authority, it is unclear how the SRB could use a national DIS for liquidity in an insolvency proceeding. Relatedly, the SRB does not consider DIS funding in resolution because it does not have legal authority to access DISs. Furthermore, it also holds a strict interpretation of Article 109 BRRD, which in combination with covered deposits' preference over other creditors in the BRRD prevent DISs from providing upfront support greater than its estimated cost (net of recoveries in liquidation) without taking recoveries from resolution into account.

75. The interpretation of relevant directives, etc. should be changed to allow DISs to disburse funds upfront in a resolution, if the estimated cost to the DIS, net of recoveries, would be no higher than its estimated net liquidation costs. The proposed change should allow a gross contribution from the DIS up to the value of covered deposits, that is, the amount the DIS would have paid out upfront, in cash in a liquidation. Without such flexibility the transfer and bridge bank powers may not work, especially in a precipitous failure when due diligence could be curtailed, or during a crisis where banking assets may not easily be sold, and cash must be injected instead to back deposits.

76. Moreover, not all DISs are well funded, raising questions about their effectiveness (including for payouts). A recent EBA analysis shows that while 32 out of 43 DISs in the EU have increased their funds in 2017, only 17 DISs have reached the target level of 0.8 per cent of covered deposits.[65] Several EA country FSAPs have noted that backup credit lines with national governments are not operationalized and readily available to DISs, which situation should be remedied. Similarly, a backstop for EDIS, too, should be put in place. Possibly that backstop could be provided by the ESM.

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[65] http://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/deposit-guarantee-schemes-data

Annex I. BRRD: Use of Selected National Options

	AT	BE	CY	DE	EE	EL	ES	FI	FR	IE	IT	LT	LU	LV	MT	NL	PT	SI	SK
Art 1(2): stricter/additional rules	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray
Art 4: simplified obligations	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray
Art 19(5)-(6): group financial support arrangements	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
Art 32(2): FOLF determination by NRA	Green	Green	Green	Green	Green	Orange	Green	Green	Green	Orange	Green	Green	Green	Orange	Green	Orange	Green	Orange	Green
Art 37(9): additional resolution tools and powers	Orange	Orange	Orange	Orange	Green	Orange	Green	Orange	Green	Orange	Orange	Orange	Orange	Orange	Green	Orange	Green	Orange	Green
Limits on liability:																			
- Art 3(12): safety net and staff	Green	Green	Green	Green	Orange	Green	Green	Orange	Orange	Orange	Green	Green	Green	Orange	Green	Green	Green	Green	Green
- Art 29(9): temporary administrators	Orange	Orange	Green	Orange	Green	Green	Orange	Orange	Orange	Green	Green	Green	Green	Orange	Green	Green	Green	Orange	Green
- Art 40(12): bridge banks	Orange	Green	Green	Green	Orange	Green	Orange	Orange	Orange	Green	Green	Orange	Orange	Orange	Green	Green	Orange	Orange	Orange
- Art 42(13): assess management vehicles	Orange	Green	Green	Green	Orange	Green	Orange	Orange	Orange	Green	Green	Orange	Orange	Orange	Green	Green	Orange	Orange	Orange
Art 45(2): additional MREL criteria	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Green	Orange	Green	Orange	Green	Orange	Orange
Art 56-58: government financial stabilization tools	Green	Green	Orange	Orange	Green	Green	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Green	Green	Orange	Green 1/	Green	Green
Art 85(1): ex-ante judicial review	Orange	Green	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Green	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange
Art 100(6): additional resolution financing arrangements	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Green	Orange	Orange	Orange	Orange
Art 102(1): higher target level for resolution fund	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray
Art 109(5): higher liability cap for deposit insurer	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray	Gray
Annex A: extra information for recovery plans	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange
Annex C: extra information for resolvability assessments	Orange	Green	Orange	Orange	Orange	Orange	Orange	Orange	Green	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange	Orange

Green: yes, made use of the option; Orange: no, did not make use of the option; Gray: no response

1/ Only public equity support tool; not the temporary public ownership tool.

Annex II. DGSD: Use of Selected National Options

	AT	BE	CY	DE	EE	EL	ES	FI	FR	IE	IT	LT	LU	LV	MT	NL	PT	SI	SK
Art 5(2): coverage pension schemes and local authorities																			
Art 5(3): immovable property loans excluded																			
Art 7(5): set-offs repayable amounts																			
Art 7(8): social purpose deposits excluded																			
Art 8(3): longer repayment period some deposits																			
Art 9(3): repayment claim period limited																			
Art 10(2): target level deadline beyond 2024																			
Art 10(6): target level below 0.8%																			
Art 11(3): using deposit insurance funds for alternative measures																			
Art 11(6): using deposit insurance funds in liquidation proceedings																			
Art 12(1): lending to other EU deposit insurers																			
Art 13(1): lower fees for low-risk sectors and IPS				1/															
Art 19(4): grandfathering higher coverage through 2018																			

Green: yes, made use of the option; Orange: no, did not make use of the option

1/ Except subparagraph 4.

Annex III. Recovery and Resolution Planning in the Absence of a Common Approach

Key RECOVERY Decisions	Substitute Decision Maker	EBA Mediation
Group recovery plan	Consolidating supervisor on group or parent plan[1/] NCA on subsidiary plan[2/]	Binding—only for (i) reducing risk profile, (ii) enabling timely recapitalization, and (iii) changing funding strategy[3/]
Remove material deficiencies and impediments	Consolidating supervisor on measures at group or parent level[4/] NCA on measures at subsidiary level[5/]	Binding—only for (i) reducing risk profile, (ii) enabling timely recapitalization, and (iii) changing funding strategy[5/]
Recovery action	Consolidating supervisor on the measures at parent level[7/] NCA on measures at subsidiary level[8/]	Binding—only for (i) capital and liquidity actions, (ii) own funds, (iii) restructuring business lines, and (iv) facilitating recovery [9/]
Intra Group Financial Support	Consolidating supervisor[10/]	Binding
Intra Group Financial Support	NCA of providing entity[11/]	Assistance
Key RESOLUTION Decisions	Substitute Decision Maker	**EBA Mediation**
Group resolution plan	GLRA[12/] on group plan[13/] NRA on subsidiary plan[14/]	Binding—unless fiscal impingement clause invoked[15/]
Group resolvability assessment	GLRA on measures at group level[16/] NRA on measures at subsidiary level[17/]	Binding—unless fiscal impingement clause invoked[18/]
Remove substantive impediments	GLRA on the measures at group level[19/] NRA on measures at subsidiary level[20/]	Binding
MREL	GLRA at consolidated level[21/] NRAs at subsidiary level[22/]	Binding
Resolution action departing from group resolution scheme	NRA at subsidiary level—for financial stability reasons[23/]	Assistance[24/]

Source: IMF staff.

1/ Articles 8.3 and 8.4.
2/ Art. 8.4.a.
3/ Art. 8.7.
4/ Articles 8.3 and 8.4.
5/ Art. 8.4.b.
6/ Art. 8.7.
7/ Articles 27.1.a and 30.4.
8/ Articles 27.1.a and 30.4.
9/ Art. 30.7.
10/ Art. 20.7.
11/ Art. 25.4.
12/ SRB is the GLRA in the banking union
13/ Art. 13.5.
14/ Art. 13.6.
15/ Art. 13.9.
16/ Articles 13.5 and 16.3.
17/ Articles 13.6 and 16.3.
18/ Articles 13.9 and 16.3.
19/ Art. 18.6.
20/ Art. 18.7.
21/ Art. 45.9.
22/ Art. 45.10
23/ Articles. 91.8 and 92.4.
24/ Articles 91.7 and 92.3.

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