Note drafted by the Eurofi Secretariat

DEVELOPING AN EU RESOLUTION APPROACH FOR SSM BANKS

Yet the Banking Union remains fragmented and incomplete, which weakens the global competitiveness of European banks and raises dysfunction risks in the face of a future shock.

Banking markets are still fissured along national borders. Ring fencing should no longer be an issue in the Banking Union as there is now a single supervision authority and a single resolution authority which together unite all the National Competent Authorities. However, Member States insufficiently trust the institutional set up of the Banking Union. Indeed, they believe that capital and liquidity will be trapped in individual Member States if a pan European banking group fails. It is therefore essential to address the concerns of "host countries" vis a vis the EU crisis management framework (see the Eurofi paper on "Optimising the Banking Union") in order to define prudential requirements for the pan European banking groups at the consolidated level and to abandon the "national and solo approach".

Beyond the current issues that are being discussed at the EU level (governance arrangements related to the the backstop to the Single Resolution Fund, liquidity after resolution, reduction of Non-Performing Loans ...), progress is required on several fronts.

Finding a pragmatic agreement between the SSM and host national authorities on ways to abolish ring-fencing

In this perspective, a pragmatic agreement must be found between the SSM and host national authorities on ways to abolish ring-fencing by agreeing to arrangements by which the host authorities have legal guarantees in case of banking difficulties. These guarantees, provided, as an option, by the parent company of transnational groups to their subsidiaries, should be agreed on now and in advance of possible future crises. In order to create a climate of confidence and trust, host countries should be associated with and involved upstream in the establishment of living wills.

Making more predictable the resolvability of failing banks whatever their size by a common application of the "public interest criteria"

Moreover, a common application of the "public interest criteria" by the Single Resolution Board, the EU Commission and the national Resolution Authorities would make more predictable the resolvability of failing banks whatever their size. As evidenced by some recent liquidation cases, whether the resolution of a bank (that has been deemed failing or likely to fail) is in the public interest or whether a bank should be liquidated in the absence of a public interest has however been assessed differently at the EU and at a national level based on the current legal framework.

The Veneto banks cases[1] have proved the importance of national insolvency law when triggering resolution actions. Depending on national insolvency law, resolution actions may be undertaken at a national level despite the absence of a 'public interest' determined at the EU level by the Single Resolution Board.

Balancing liability and control in the Banking Union

In terms of control or policy coordination, the SSM and SRM are responsible for bank supervision and resolution, while bank liquidation and government bail outs are still executed by Member States under national law for banks that are not considered of "public interest" by the Single Resolution Board. This can only reinforce the lethal link between the banks and the state and lead to a different treatment among the creditors of the same type in case of liquidation.

In terms of liability, the European level now bears part of the cost of bank failures: in addition to losses imposed on the private sector via bail-in, a Single Resolution Fund (SRF) and its backstop are being established. However, a part of the potential costs still lies with Member States since possible costs in the case of bank liquidation remain addressed entity by entity at the national level. Addressing this striking asymmetry between the supervision and the resolution at the EU level while, on the other hand, the liquidation of failing or likely to fail banks is managed at the national level (entity by entity) is therefore urgently needed.

Aligning the EU crisis management framework and national insolvency laws

The significant diversity of national insolvency regimes remains a key challenge for the EU. K. Knot in his interview for the Eurofi Magazine reminds us that "different frameworks imply different options and outcomes in insolvency for similar banks, dependent on the Member State in which they are located. And because the outcome

[1] The Veneto banks - which did not pass the SRB's 'public interest test' that is required for a bank to be 'resolved' at the EU-level - have been liquidated through a special insolvency procedure under Italian law. That special insolvency procedure involved resolution tools and state aid. Albeit the SRB concluded that the resolution was not warranted in the 'public interest', the Commission indicated that EU state aid rules foresee the possibility to grant State aid to mitigate any economic disturbance at the regional level. Those liquidation cases have highlighted the existence of what Andrea Enria, Chair of the European Banking Authority (EBA) called "two different definitions of "public interest" [...] one at the EU level and another one by national authorities".

of liquidation through insolvency can be different, it also confronts supervisors and resolution authorities with country-specific trade-offs in determining whether the application of resolution tools is warranted to safeguard the public interest in particular cases".

Given the impossibility of harmonising all insolvency laws, it would be as a minimum highly desirable and possible to align the outcomes of insolvency law in the EU to ensure their full consistency with the EU resolution regime.

We should indeed align the EU crisis management framework and national insolvency laws. Currently, a bank that is declared failing or likely to fail under the BRRD and the SRM Regulation does not always meet the conditions that would make it subject to national insolvency proceedings. In fact, under national legislation present and actual illiquidity is usually required if insolvency proceedings are to get under way. But at the European level, not only actual but even likely illiquidity can be grounds for declaring a bank failing or likely to fail.

In addition, the EU crisis management framework should avoid situations whereby creditors of the same type in subsidiaries are treated differently or be seen as discriminated against. Furthermore, it could happen that some medium size banks under the SSM supervision might have in difficulty in raising on acceptable conditions the required level of MRELs. In that case the relevant banks could in principle only be liquidated and the possible ultimate outcome might well be to resort again to the old national bail-out if governments fear a disorderly liquidation.

Completing the Banking Union

Following the EU political agreement on the backstop to the Single Resolution Fund, the European Deposit insurance Scheme (EDIS) remains one of the missing pieces of the Banking Union. All depositors should enjoy the same level of protection in the euro area. In this way, the European Deposit insurance Scheme would underpin stability in the banking sector by providing strong and uniform insurance coverage for all such depositors, independent of their geographical location in the Banking Union.

A possible way forward on EDIS is proposed in the Eurofi paper "The protection of deposits in the EU: Pros and Cons and a possible way forward" (see following note). Reaching an agreement on the deposit insurance mechanism would show inter alia that political commitments taken in 2012 have been fulfilled.

Such an agreement would increase the credibility of the Banking Union even if it would not solve all issues related to the strong differences in national insolvency regimes. ■