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A centralized administrative liquidation tool for banks

This year marks the SRB's fifth anniversary – an appropriate time to reflect on how the crisis management framework has worked so far and consider areas for improvement.

The public interest assessment (PIA) – i.e. the evaluation of whether a bank may be wound up under national insolvency proceedings or should be resolved to maintain its critical functions and protect financial stability – has triggered a lively debate. These criteria are laid down in the SRM Regulation and the SRB has published its policy on its website¹. In a nutshell: resolution is for the few, not the many. For smaller, less significant banks, insolvency will be the procedure at play if and when they fail.

Our experience to date has laid bare the need to find a solution for those medium-sized banks that are too “small” to meet the PIA, but possibly too “large” to be placed in insolvency.

The SRB has been clear² that the harmonization of insolvency regimes for banks is a necessary end-goal. However, it is unlikely to be achieved in the short-term. The creation of a centralized administrative liquidation tool may be more feasible in the short-medium term, and would address many of the issues identified for medium-sized banks, with insolvency tools remaining available for smaller banks.

Such a liquidation tool could be created by amending the BRRD, SRMR and DGSD, and could provide for the powers to transfer (some) assets and liabilities in an orderly liquidation, much in line with current resolution tools. In the Banking Union, this could be entrusted to a central authority. As a first step, the SRB's toolbox could be enriched with a «pre-liquidation tool», allowing the application of resolution tools to save the good part of a bank without entering into liquidation, or without requiring a specific liquidation regime at European level.

The FDIC is a useful comparison, as it highlights the advantages of the purchase and assumption tool (P&A) for liquidation, which was used for the majority of US bank failures in the last decade. The FDIC's experience also shows the benefits of having a centralized authority with harmonized resolution and insolvency procedures, P&A tools and Deposit Guarantee competences.

By contrast, in the current patchwork of DGSs operating in the Banking Union, only some allow transfers of deposits as “alternative measures” to pay-outs, raising

challenges around arbitrage, level-playing field and coordination.

A centralized authority could enhance coordination across DGSs and enable a more effective management of bank failures. As the US experience shows, the use of transfer tools could reduce the cost of failure and overall impact on the DGS system.

Finally, it would help reduce moral hazard, by removing the need for Member States to provide liquidation aid, thereby better protecting taxpayers' money. This does not come free. However, based on adequate capital levels and clear rules, authorities should be able to find solutions early enough to secure functions that are critical to the franchise and minimize losses.

A centralized liquidation regime in the EU would address the current gap in the framework for medium-sized banks and improve the overall system: a further step towards the completion of the Banking Union that policymakers ought to explore further. ●

¹ https://srb.europa.eu/sites/srbsite/files/2019-06-28_draft_pia_paper_v12.pdf

² <https://srb.europa.eu/en/node/622>