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THE EU REGULATORY FRAMEWORK FOR BANK RESOLUTION*

Ginevra Bruzzone[1], Miriam Cassella[2] and Stefano Micossi[3]

1. Introduction

The financial crisis of 2008-09 and the ensuing sovereign debt and banking crises within the eurozone exposed the presence of massive moral hazard within banking systems, that led to over-borrowing and excessive risk-taking by many large banks. In order to avoid the meltdown of financial systems, national governments were forced to underpin the balance sheets of these banks and take up large losses, eventually borne by taxpayers. The regulatory response was masterminded at the international level by the G-20 and its offspring, the Financial Stability Board (FSB);[4] it was mainly centred on improving the governance and risk management of the banks, reducing regulatory forbearance, and eliminating or at least greatly reducing legal and institutional incentives that had fostered excessive risk-taking.[5] Among the latter measures, a paramount role would be played by the new rules on bank capital (the Basel III Accord) and bank resolution. The former are meant to provide banks with ample cushions to absorb losses, thus reducing the frequency of bank failures; the latter, to ensure that when a bank is failing or likely to fail it can be resolved without systemic repercussions on the financial system, while minimizing reliance on public support. The system would be

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[1] Assonime and LUISS.

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[3] Assonime, College of Europe, LUISS and CEPR.

[4] The Financial Stability Board was established in 2009 as an upgrade of the Financial Stability Forum, with the task to monitor the evolution of the global financial system and to make recommendations to improve global financial stability. It works as a fourth pillar of the global economic governance, alongside with the IMF, the World Bank and the WTO. The membership of the FSB includes all G20 countries, international institutions like the European Central Bank and the European Commission, as well as financial centers such as Hong Kong and Singapore.

[5] G20, *Declaration of the Summit on Financial Markets and the World Economy*, 15 November 2008.

completed by strengthened deposit insurance – which is a lynchpin of the preservation of confidence in banking systems – with higher coverage and pre-paid, risk-based insurance fees. With these measures, the banks would be charged the full cost of deposit protection and other advantages from the banking charter, which therefore would no longer incentivise excessive risk-taking.

The need for special rules for the resolution of failing banks arises from the special nature of these institutions which operate based on trust and may become quickly unviable were their customers and counterparties to lose confidence in their ability to meet their obligations. The problem is compounded by the interdependencies between institutions, which entail the risk that problems in one bank may cascade onto other financial institutions with snowball effects, thus endangering the entire financial system. Fear of these destabilizing consequences has an important side effect, which is to feed the belief that certain institutions will always be rescued by their government, as they are 'too big to fail'. This belief is a major source of moral hazard to the extent that shareholders and creditors of large financial institutions may expect to be shielded from the consequences of reckless risk-taking.

Resolution plays a fundamental role in eradicating moral hazard from the financial system by establishing the credible promise that shareholders and creditors of the bank will suffer the full consequences of reckless management through bail-in; to this end it must provide transparency and predictability regarding the treatment of the different parties involved in the procedure. At the same time, resolution is meant to preserve value that might otherwise be destroyed in bankruptcy. An effective system to manage bank crises must possess two features: it must keep depositors safe and reassure counterparties on the continuity of basic functions of systemic relevance of the failing institutions. Ordinary bankruptcy procedures managed in court will in general not do, because they are too slow and they typically involve the suspension of all claims on the failing entity, without regard to their relevance for the continuing viability of the financial system. Moreover, large banking institutions have overly complex structures that make the assessment of their effective capital position, especially under stress, an unwieldy task. The way out is to entrust resolution to special administrative procedures managed by competent authorities – typically but not necessarily banking supervisors – which can maintain the continuity of basic banking functions while sorting out counterparties' positions and the capital effectively available to meet emerging losses.[6]

Thus, resolution offers an effective alternative to normal insolvency procedures providing the means to manage the crisis when a bank is failing or likely to fail and its failure would threaten overall financial stability, while contributing to minimize the involvement of taxpayers in covering bank losses.

In the European Union, on the basis of international commitments undertaken within the G-20 and the FSB, the European Commission has brought forward some thirty packages of measures to strengthen financial markets regulation and supervision and preserve the integrity of the Internal Market. Common rules for banks in all 28 Member States have been included in a Single Rulebook and specific rules have been adopted for the banks in the euro area and any non-euro Member States that would want to join (the "Banking Union"). In particular, in June 2012 the European Council acknowledged that in the euro area, in order to break the vicious circle between sovereign and bank debts, there was a need to establish a

[6] Cf. Financial Stability Board (2010), *Reducing the moral hazard caused by systemically important financial institutions*; Financial Stability Board (2011), *Key Attributes of Effective Resolution Regimes*. Both documents are available on the FSB website (www.financialstabilityboard.org). The declarations of the G20 summits are available on the G20 institutional website (www.g20.org).

centralized management of the rules for both the supervision and the resolution of banks.[7] This led to the adoption of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM); the latter complements the directive for the recovery and resolution of banks (BRRD), and is accompanied by the establishment of a Single Resolution Fund (SRF).

The new system was legislated at record speed by the end of 2013 and will be fully in force at the beginning of 2016. In the meantime, during the transition to the new regulatory regime the European Commission resorted to State aid control as a coordination instrument at the EU level to maintain a level playing field in the internal market and encourage distressed banks to restructure and return to viability, thus excluding the need for further public support in the future.[8] State aid control, aimed to avoid distortions of competition, was employed as a temporary substitute for a European regulatory and supervisory system for the management of distressed banks.

In this chapter we analyse the main features of the EU regulatory framework for bank resolution, its strengths and weaknesses, and discuss the remaining challenges for the effective operation of the system.

2. The rules on bank resolution within the EU regulatory framework for financial stability

The EU regulatory framework for the banking sector provides a rich toolbox for crisis prevention, early intervention and bank resolution. The Single Rulebook represents a substantial upgrade of the previous EU banking directives; its aim is to establish a fully integrated regulatory framework, with no loopholes, ensuring a level playing field for all financial institutions in the EU. In the banking sector, its main pillars are the new rules on prudential requirements and prudential supervision,[9] the BRRD[10] and the recast directive on deposit guarantee (DGS).[11] The shift from decentralized enforcement to the SSM and SRM is meant to bring about greater effectiveness and consistency in the application of banking rules.

The European Commission maintains that this new framework "will put an end to the era of massive bail-outs paid for by taxpayers and will help restore financial stability. Confidence in all banks will increase. Banks' market credibility will not depend on the financial strength of the Member State in which they are located but on their specific risk profile. This, in turn, creates the right conditions for all banks – on equal terms depending on their financial situation, to lend to the real economy, spurring economic recovery and job creation across the

[7] European Commission, communication *A roadmap towards a Banking Union*, 12 September 2012.

[8] See European Commission, *Report on Competition Policy* 2011.

[9] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

[10] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

[11] Directive 2014/49/EU of the European Parliament and the Council of 16 April 2016 on deposit guarantee schemes.

EU".[12] A remaining weakness of the system is the fact that the EU Council eventually decided against the creation of a centralized deposit insurance, centrally managed by a new European agency entrusted with the management of a European deposit guarantee fund, and opted instead for a directive to strengthen and improve coordination of national deposit insurance systems.[13]

Before describing the BRRD and the SRM Regulation in detail, there are some features of the new system's architecture that deserve attention.

a) A centralized system with no harmonization of insolvency laws

It was soon clear that any attempt to harmonize insolvency laws in the Member States would have met un-surmountable legal and technical difficulties with attendant risks of huge delays. The solution that was adopted was to establish common rules and tools for administrative resolution procedures and centralize the decisions on starting resolution, while entrusting their implementation to national authorities based on national legal systems.

Normal insolvency proceedings, which remain regulated at the national level, shall be considered by the national competent authorities as a benchmark when deciding whether to resort to the resolution procedure, since resolution action should be taken "only where necessary in the public interest".[14] As explained by recital 45 of the BRRD, "a failing institution should in principle be liquidated under normal insolvency proceedings. However, liquidation under normal insolvency proceedings might jeopardize financial stability, interrupt the provision of critical functions, and affect the protection of depositors. In such a case it is highly likely that there would be a public interest in placing the institution under resolution and applying resolution tools".

In the Banking Union, the architecture of the SSM and the SRM are closely interwoven. In both cases the challenge was to establish an integrated system capable of ensuring an effective and consistent application of common rules in the Banking Union.

For the SSM, the initial proposal of the Commission contemplated a fully centralized supervisory system. Since Article 127(6) TFEU allows the Council, deciding under a unanimity rule, to give competences for financial supervision to the ECB, the idea was to substitute national supervision with supervision by the ECB. This solution, however, would have been ineffective: it would have entailed high costs related to the establishment of a huge new supervisory authority in Frankfurt and, moreover, for some tasks national authorities are best placed, due to their knowledge of the local markets, their resources and their language and proximity advantages, to carry out supervisory tasks. Therefore, the final solution adopted by the Council establishes a strongly integrated framework for the supervision of all banks in the

[12] European Commission, *Banking Union: restoring financial stability in the Eurozone*, MEMO 9 March 2015.

[13] On the central role of the system of deposit guarantee as a lynchpin for the preservation of confidence in the banking system, see Jacopo Carmassi, Elisabetta Luchetti and Stefano Micossi (2010), *Overcoming too big to fail*, Bruxelles, Centre for European Policy Studies. The 2014 DGS Directive preserves the harmonized coverage level of € 100.000 per depositor and per bank; accelerates the timing of repayments; strengthens the incentives against moral hazard by mandating the ex-ante funding of the scheme by the banks through a yearly risk-based fee aimed at achieving a target level for the insurance fund of 0.8% of covered deposits over a ten year period. Should ex-ante funds turn out to be insufficient, the DGS will collect ex-post contributions from the banking sector and, as a last resort, will have access to alternative funding sources such as loans from public or private third parties. Deposit guarantee schemes from different Member States will be allowed to borrow from each other, on a voluntary basis.

[14] BRRD, recital 13.

euro area, based on a network composed by the ECB and national competent authorities, in which the ECB is empowered to ensure the effective and consistent application of the rules.[15] In particular, the ECB has the power to take over the supervision of any bank when needed for the proper operation of the system (Box 1).

The SSM architecture is clearly inspired by the system of application of EU competition rules established by Regulation (EC) no. 1/2003, where the decentralized enforcement of Articles 101 and 102 TFEU is accompanied by the power of the European Commission to take over cases from national authorities when a centralized enforcement is needed to ensure a consistent application of EU rules.

Box 1

Competences within the SSM and mechanisms to ensure consistency

Pursuant to the SSM Regulation, the ECB is responsible for the overall functioning of the system and has direct oversight of the most significant banks, including banks with assets of more than € 30 billion, or constituting at least 20% of their home countries GDP if total assets exceed the €5 billion threshold (around 130 banks), as well as banks which have requested or received direct public financial assistance from the European Stability Mechanism. Banks are considered significant also if they are one of the three largest credit institutions in a Member State, or if they have a significant share of cross border assets and liabilities in more than one participating Member State. Finally, a bank may be considered significant by a decision of the SSM to this aim, whereby the ECB acquires the competence to directly supervise a specific institution.

The banks not included in the above categories remain under the oversight of national supervisory authorities. Moreover, for the significant banks only key supervisory tasks, related to financial stability, are transferred to the ECB (e.g. monitoring compliance with the prudential requirements set by the CRDIV package; taking measures, where necessary, to set higher requirements; carrying out stress tests to support the supervisory review of individual institutions). The ECB shall also prepare resolution plans and carry out, in coordination with resolution authorities, early intervention measures if a bank is in breach of, or is about to breach, regulatory capital requirements. National competent authorities remain in charge of the tasks not conferred to the ECB (for example, consumer protection, branches or cross border services of third country banks, money laundering, payment services, etc) and provide assistance to prepare and implement the ECB acts. Joint Supervisory Teams (JSTs), composed of representatives of the ECB and national competent authorities, conduct the day-to-day supervision of significant credit institutions and groups.

The ECB has the task to ensure consistency within the SSM. To this end, national authorities have a duty to inform the ECB of significant supervisory decisions and the ECB is empowered to issue instructions to its national counterparties and to take over the supervision of any bank when needed for the proper operation of the system.

In the new supervisory framework, the European Banking Authority maintains its EU-wide powers and may exercise them also with respect to the ECB in its new role as supervisory authority in the eurozone. For the areas in which the EBA adopts binding decisions, voting arrangements have been modified to ensure a balanced decision-making structure, preserving the interests of all its members, whether participating in the SSM or not. For these decisions, a double majority is needed : the majority of Member States which are members of the Banking Union and the majority of other Member States.

[15] Council Regulation (EU) no 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. See also ECB, Regulation (EU) no. 468/2014 of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation), (ECB/2014/17); ECB Decision of 17 September 2014 on the implementation of separation between the monetary policy and supervision functions of the European Central Bank (ECB/2014/39); ECB Guide to Banking Supervision, November 2014.

After the establishment of the SSM, the SRM becomes a necessary step to correct the misalignment between the supervision of banks within the framework of the SSM, and their national treatment in the resolution proceedings pursuant to the BRRD; supervision and resolution are two complementary aspects of the establishment of the internal market for financial services whose application should be at the same level and is "regarded as mutually dependent".[16] The SRM was established by regulation no. 806/2014 (the SRM Regulation)[17] only a few months after the adoption of the BBRD, on the model of the SSM.

Looking at the scope of application, the SRM applies to all institutions supervised by the SSM; any Member State which joins the SSM will also join the SRM. Similarly to the SSM, the architecture of the SRM is based on a network composed of a central agency and national authorities. However, since resolution goes beyond financial supervision, the SRM entrusts the task of managing the system not to the ECB but to a new Union agency, the Single Resolution Board (SRB), in cooperation with national resolution authorities (NRAs). The Commission and the Council are part of the process, with specific tasks relating to the most politically sensitive issues.

As for the allocation of competences, the SRB will act as the resolution authority for banks directly supervised by the ECB. Its tasks are carried out in close cooperation with the national resolution authorities which also carry out the activities relating to the implementation of the resolution schemes. On their part, national resolution authorities directly exercise resolution powers in relation to the institutions supervised by national competent authorities within the SSM. The BRRD leaves it to Member States to designate the national resolution authorities; it expressly provides that NRAs may be national central banks, competent ministries or authorities entrusted with public administrative powers; they may exceptionally coincide with the competent national authorities for the purposes of the SSM, subject to a number of requirements aimed to ensure operational independence and avoid conflicts of interest between the supervision and resolution functions.

The exchange of information within the network and some mechanisms aimed to ensure consistency, including the power of the Single Resolution Board to take over cases from national competent authorities, play a central role in the SRM. Participating Member States can in any case decide to give the SRB all the relevant powers and responsibilities provided by the SRM Regulation with regard to any institution or group.

b) The 'no creditor worse off' principle

Since the use of resolution tools and powers provided for in the BRRD may impinge on the rights of shareholders and creditors enjoying strong national legal protection, the Directive contains some principles aimed to ensure that resolution action is compatible with the Charter of Fundamental Rights of the EU and the safeguards provided by the legal systems of the Member States. Accordingly, the BRRD establishes that the shareholders bear first losses; that creditors bear losses after them, in accordance to the reverse order of their priority claims under national insolvency law; that creditors of the same class are treated in an equitable manner and any differential treatment is strictly justified in the public interest and non discriminatory; and, finally, that no creditor shall incur greater losses than he would have

[16] SRM Regulation, recitals 11 and 14.

[17] Regulation (EU) no 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) no 1093/2010.

incurred if the institution had been wound up under normal insolvency proceedings.[18] This last principle (the 'no creditor worse off principle') acts as backstop provision, intended to fill any lacunae resulting from the application of the preceding principles. In any case, deposits covered by harmonized deposit protection are fully protected (while the deposit guarantee fund may be called in by the bail-in procedure).

c) Financial support for resolution

The BRRD requires that when medium term financial support is needed to enable a bank to continue operating while being restructured, the additional funds will be taken from financial arrangements (resolution funds) financed by banks. Under the SRM regulation, these resources will be provided by a Single Resolution Fund (SRF), funded by the banks of participating Member States. Funds will be collected gradually. The target level of 1% of covered deposits should be reached by 1st January 2024. Initially resources will be collected in national compartments, which will be progressively mutualized.

The transfer of national funds to the Single Resolution Fund and the mutualization provisions are regulated by means of a specific intergovernmental agreement (IGA) among the participating Member States, since it was doubtful that Article 114 of the Treaty would have represented an adequate legal basis.[19] Although it is widely acknowledged, including by EU official statements, that the SRF needs some kind of public backup in case its funding revealed insufficient to meet emerging needs, e.g. following failure of a large cross-border banking group or a large number of banks at the same time, no agreement has been reached so far on the set up of such a last resort facility. The ESM has been taken into consideration, in this context, as a potential provider of financial support to the SRF, but not as a direct participant in risk sharing.

Entry into force of the new rules

The BRRD entered into force on 1st January 2015. The SRM Regulation will be applicable from January 2016; however some provisions, in particular those relating to the Single Resolution Board, also entered into force on 1st January 2015.

3. The rules for bank resolution in the BRRD

In order to ensure consistency with the Union legislation on prudential requirements and financial stability across the spectrum of institutions, the BRRD lays down rules and procedures relating to the recovery and resolution not only of credit institutions, but also of investment firms, financial holding companies established in the Union and financial institutions which are subsidiaries of the above entities.[20]

The Directive envisages three different phases: preparation and prevention, early intervention and resolution. Following this three-step approach, the rules which all Member States are bound to transpose into their legal systems aim to:

[18] BRRD, Article 34 and recital 13.

[19] Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund, 15 May 2014. On the legal basis for the different parts of the new regulatory framework, see Gian Luigi Tosato (2014), *The legal basis of the Banking Union*, in Emilio Barucci and Marcello Messori (eds.), *Towards the European Banking Union*, Astrid, Passigli Editori.

[20] BRRD, Article 1 and recital 11.

a) ensure that banks and authorities make adequate preparation for crises, by means of timely recovery and resolution planning;

b) equip the competent authorities with the tools to take a timely corrective action when problems emerge;

c) provide the competent authorities with the powers and tools for crisis management to protect depositors and taxpayers.

3.1 Preparation and prevention

a) Recovery plans

Banks are required to prepare recovery plans describing the measures that they will take to remain viable if their financial situation were to deteriorate significantly.[21] The recovery plans have to be updated at least annually or after a relevant change to the legal or organizational structure of the bank, or of its business or financial situation. These plans should be detailed and based on realistic assumptions, applicable in a range of scenarios; moreover, they should contemplate measures proportionate to the systemic importance of the institution and group and its interconnectedness, taking into account the available sources of funding, including group support. They shall contain quantitative or qualitative indicators which identify the points at which appropriate actions established in the plan will be taken.

Banks must submit their plans to the competent supervisory authorities (within the Banking Union, to the SSM). If the competent authority considers the plan inadequate to restore the institution's viability in a timely manner even in periods of severe financial stress, it may require changes and integrations and, if the bank fails to act, may direct the bank to take any measures that it considers to be necessary and proportionate.

The competent authority shall provide the recovery plan to the resolution authority, which may make recommendations to the competent authority if it deems that some of the measures contemplated can prejudice the bank's resolvability. The BRRD contains specific provisions for group recovery plans and provides that they will be assessed by the consolidating supervisor together with the competent authorities of the subsidiaries. Under the Directive's mandate, the European Banking Authority (EBA – see Box 2) has adopted a set of guidelines and draft regulatory technical standards, or RTS, related to recovery planning.

[21] BRRD, Articles 5-9.

Box 2

The role of the EBA

The EBA was established in January 2011, together with two other European supervisory authorities (the European Securities and Markets Authority, or ESMA, and the European Insurance and Occupational Pensions Authority, or EIOPA) with the aim to ensure effective coordination of supervisory activities and overcome supervisory forbearance at national level. In particular, the EBA's main tasks are to contribute to the development of a single Rulebook through proposals of standards and technical rules which will be adopted by the European Commission (by means of delegated acts or implementing acts); to foster a consistent interpretation and application of common rules and convergent supervisory practices through guidelines and recommendations; to stimulate effective supervision by national supervisory authorities and facilitate their effective cooperation in cross border matters. The EBA is competent to adopt binding decisions on the application of the single Rulebook when pursuing breaches of law or settling disputes between supervisory authorities.

The EBA Guidelines and draft RTS on the different features of the resolution framework are available on the EBA website.

b) Resolution plans

In the event of a financial institution becoming no longer viable, resolution authorities must be prepared to effectively use the powers and tools provided by the BRRD in order to pursue the resolution objectives (i.e. ensuring the continuity of the critical functions, avoiding a significant adverse effect on the financial system and protecting public funds, covered depositors, client funds and client assets). To this aim, they are required to draw up resolution plans for each institution or group, illustrating the actions that they will take were the institution or group to meet the conditions for resolution.[22] The resolution plan shall be prepared on the basis of the information provided by the institution and the competent supervisory authority and typically sets out a number of options for applying the resolution tools and powers so as to ensure in different scenarios that the vital functions for the real economy are maintained. The resolution authority shall adopt the plan only after consulting the competent supervisory authority. Like recovery plans, also resolution plans shall be reviewed, and where appropriate updated, at least annually and in case of material changes of the relevant situation.

For groups, the BRRD provides a complex coordination procedure for the adoption of resolution plans, involving the group level resolution authority and the resolution authorities of subsidiaries. In the Banking Union, the ensuing coordination challenges are partially mitigated by the institutional arrangements of the SRM.

The competent authorities should transmit the recovery plans and any changes thereto to the relevant resolution authorities, and the latter should transmit the resolution plans and any changes thereto to the former, in order to permanently ensure that each authority has a full information set.

Overall, the preparation of recovery and resolution plans is a complex, resource-intensive task and requires a close cooperation between the financial institution, the supervisory authority and the resolution authority. The information included in the plans may be highly sensitive and the protection of confidentiality raises significant challenges.

[22] BRRD, Articles 10-14. See also SRM Regulation, Articles 8-12.

c) Resolvability

For the purposes of drawing up and updating the resolution plan, the resolution authority shall assess whether there are obstacles to the resolution of the institution.[23] An institution is deemed to be resolvable if it is feasible and credible for the resolution authority to either liquidate it under normal insolvency proceedings or to resolve it by applying different resolution tools and powers while avoiding to the maximum extent possible any significant adverse effect on the financial system and ensuring the continuity of critical functions carried out by the institution. The BBRD stresses that resolvability has to be assessed without any assumption of extraordinary public financial support or central bank emergency or non standard liquidity assistance. A specific provision governs the assessment of resolvability for groups.[24]

When a resolution authority, pursuant to the assessment of resolvability and after consulting the competent authority, determines that there are substantive impediments to the resolvability of the institution, it shall notify that determination to the institution, the competent authority and the resolution authorities of the jurisdictions in which significant branches are located. The institution will have four months to propose to the resolution authority possible measures to remove the impediments. The resolution authority, again after consulting the competent authority, will assess whether these measures are adequate and, if they are not, will require the institution to take alternative measures, which may include the limitation of the institution's maximum individual and aggregate exposures, the divestiture of specific assets, the limitation or ceasing of specific activities, changes to the legal or operational structure of the institution or any group entity. The decisions ascertaining impediments to resolvability and those requiring the adoption of measures shall be reasoned and are subject to a right of appeal.

The EBA has issued guidelines on the measures to remove the obstacles to resolvability and the circumstances in which they should be adopted.[25]

d) Intra group financial support

Pursuant to the BRRD,[26] the task of preparing for a deterioration of financial conditions includes the possibility for entities belonging to the same cross-border group to enter an agreement to provide each other financial support when any company in the group meets the conditions for early intervention (on this, see the next paragraph). These agreements are voluntary and the Member States are required to remove provisions which might unduly impede them. The idea is that if intra-group financial support, due to the interdependency of the entities of the same group, ensures the financial stability of the group as a whole without jeopardizing the liquidity or solvency of the group entity providing the support, it should be permitted. The BBRD provides that intra group financial support agreements must be entered into ex-ante, when the parties do not meet the conditions for early intervention. They are subject to prior authorization by the competent supervisory authorities, which will check whether the conditions aimed to ensure that the agreement is in the public interest and does not jeopardize the group entity providing the support and, more generally, financial stability,

[23] BRRD, Articles 15-18; see also SRM Regulation, Article 10.

[24] BRRD, Article 16.

[25] The Guidelines were published, together with the draft RTS on the content of resolution plans, on 19 December 2014.

[26] BRRD, Articles 19-26.

are met. When the competent authority of the entity providing support does not coincide with the consolidating supervisor or the competent authority of the entity receiving the support, in case of disagreement between the authorities the EBA can provide assistance through its mediation powers.

3.2 Early intervention

In order to preserve financial stability, the BRRD gives the competent supervisory authorities special powers to act when there are specific signals of financial distress but before the situation deteriorates irreparably so that there is no alternative than to resolve the bank (early intervention powers).[27] Early intervention measures may be adopted when an institution infringes or is likely in the near future to infringe prudential requirements due, for example, to a rapidly deteriorating financial condition, including deteriorating liquidity situation, an increasing level of leverage, non-performing loans or concentration of exposures, as assessed on the basis of a set of triggers.[28]

The BBRD requires Member States to grant the competent authorities a broad range of early intervention powers. For instance, the competent authorities may require the management of the institution to implement some of the measures set out in the recovery plan, draw up a plan for negotiating the restructuring of debt with some or all of the creditors and/or identify specific measures to overcome the situation of distress and draw up a timetable for their implementation. Moreover, the competent authorities are empowered to require changes to the business strategy and the legal and operational structure of the institution and may convene a special meeting of shareholders, setting its agenda. They can require the removal of those members of management who are found unfit to perform their duties[29] and, when the replacement of the senior management is considered insufficient to remedy the situation, may appoint a special administrator, who temporarily replaces the management body or works with it. The role and functions of the administrator must be specified in advance and may include ascertaining the financial position of the entity, managing it with a view to preserve or restore its financial position and taking measures to restore a sound and prudent management. The adoption of some specific acts can be made conditional on the prior approval by the authority. The appointment of a temporary administrator cannot normally last more than one year, but may be renewed in exceptional circumstances.

Specific provisions, entailing the coordination of the competent authorities, apply to early intervention measures in relation to groups.

Competent authorities shall set an appropriate deadline for the completion of each of the early intervention measures and monitor compliance.

The early intervention phase is the main point of contact between supervision and recovery, on one hand, and resolution, on the other. When the competent authority ascertains the conditions for early intervention in relation to an institution, it shall notify the resolution

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[27] BRRD, Articles 27-30; SRM Regulation, Article 13.

[28] See also EBA *Guidelines on triggers for use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU*, 29 July 2015 (EBA/GL/2015/03).

[29] In particular the removal of the entire senior management or individuals within senior management can be required where there is a significant deterioration in the financial situation or there are a serious infringement of law, regulation or statute of the bank or serious administrative irregularities, and other early intervention measures are not sufficient to reverse the deterioration.

authority without delay, in order to allow it to intervene at an early stage when the financial situation of a bank is deteriorating. The powers of resolution authorities, at this stage, include the power to require the bank to contact potential purchasers to prepare for resolution, subject to confidentiality provisions.

In the Banking Union, early intervention measures are adopted by the ECB or national competent authorities following the rules of the SSM. The SRM Regulation expressly provides that, when receiving information from the ECB or national competent authorities on any early intervention measure, the SRB may prepare for the resolution of the institution or group concerned and may require the national resolution authority to draft a preliminary resolution scheme.

3.3 Crisis management

a) Initiating resolution: objectives and conditions

If the situation of a bank deteriorates beyond repair, the new legislative framework provides a mechanism whereby an administrative procedure (resolution) may be initiated to manage the crisis of the institution or group with the aim to pursue specific objectives, in the public interest, which would not have been attained under normal insolvency proceedings. Whereas during the recovery and early intervention phases shareholders remain fully in charge of the institution, except when a temporary administrator is appointed as an early intervention measure, when the institution is placed under resolution shareholders no longer retain responsibility and control.

As has been recalled, resolution authorities must have a minimum set of harmonised resolution tools and powers, whose exercise is subject to common objectives, conditions and principles.

The objectives of resolution are to ensure the continuity of critical functions (e.g. the payment system); to avoid adverse effect on financial stability, preventing contagion and maintaining market discipline; to protect covered depositors, covered investors, client funds and client assets, as well as to minimize reliance on extraordinary public financial support. All these resolution objectives are considered of equal importance and the resolution authorities are allowed to balance them as they deem appropriate to the nature and circumstances of each case. On the other hand, when pursuing the above mentioned objectives, the resolution authority has to minimise the cost of resolution and avoid destruction of value unless necessary to achieve the resolution objectives.[30]

Considering the limitations on the rights of shareholders and creditors it involves, the resolution procedure may be initiated only when all the following three conditions are met:[31]

a) the institution is failing or likely to fail;

b) there is no reasonable prospect that any alternative private sector measure (including early intervention measures and the write-down or conversion of relevant capital instruments) would prevent its failure within a reasonable timeframe; and

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[30] BRRD, Article 31; SRM Regulation, Article 14.

[31] BRRD, Article 32; SRM Regulation, Article 15. See also the EBA *Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU*, 6 August 2015 (EBA/GL/2015/07).

c) a resolution action is necessary and proportionate, in the public interest, to attain one or more of the resolution objectives. The previous adoption of an early intervention measure is not a precondition for initiating the resolution procedure.

Article 32, paragraph 4, of the BRRD indicates four alternative circumstances under which an institution is deemed to be failing or likely to fail:

a) when it infringes, or is likely in the near future to infringe, the requirements for continuing authorization;
b) when the assets of the institution are, or are likely in the near future to be, less than its liabilities;
c) when the institution is, or is likely in the near future to be, unable to pay its debts as they fall due, or
d) when the institution requires extraordinary public financial support, except in the specific circumstances laid down in the Directive. In particular, extraordinary public financial support does not entail the presumption that the institution is failing or likely to fail when it takes one of the following forms: state guarantees to back liquidity facilities provided by central banks; state guarantees of newly issued liabilities; injections of a bank's own funds or purchase of capital instruments at terms and prices that do not confer an advantage upon the institution. In all these cases the addressee of financial support must be a solvent entity and the measure is conditional on the final approval under State aid rules. These measures must be of a precautionary and temporary nature, proportionate to remedy the consequences of a serious exogenous disturbance and should not be used to offset losses that the institution has incurred or is likely to incur in the near future. The third exception, concerning recapitalizations, concerns only capital shortfalls established following the stress tests, asset quality reviews or equivalent exercises.

The need for emergency liquidity assistance from a central bank is not, *per se*, sufficient to demonstrate that an institution is, or will be in the near future, unable to pay its liabilities.[32]

According to the BRRD, the assessment of whether the institution is failing or likely to fail (the first condition) is made by the supervisory authority, after consulting the resolution authority, or by the resolution authority (when it has the relevant information), after consulting the competent authority. The assessment of the second and third conditions (no effective alternative private sector measure and the public interest requirement) shall be made by the resolution authority. Within the SRM, the European Commission can object to the discretionary aspects of the assessment of the Single Resolution Board not pertaining to the existence of a public interest and can propose to the EU Council to object to the resolution scheme on the grounds that it does not fulfil the criterion of public interest.

b) Resolution principles

When applying resolution tools and powers, resolution authorities have to take into account a set of general principles listed in Article 34 of the BRRD.[33] Some of these principles, relating to

[32] BRRD, recital 41.

[33] See also SRM Regulation, Article 15.

how resolution affects property rights, have already been illustrated in the introduction (shareholders bear first losses; creditors bear losses after shareholders in accordance with the order of priority of their claims under normal insolvency proceedings, save expressly provided otherwise; creditors of the same class have to be treated in an equitable manner, and exceptional differences should be justified in the public interest and should not be discriminatory on the ground of nationality; no creditor shall incur greater losses than would have been incurred if the institution had been wound up under normal insolvency proceedings; covered deposits are fully protected).

In addition, the BRRD provides that the management body and senior management of the institution under resolution should in general be replaced, unless their retention is necessary for the achievement of the resolution objectives. Moreover, for entities that are part of a group[34] the resolution procedure must be carried out in a way which minimises the impact on other group entities or on the group as a whole. The principle of proportionality should always be taken into account.

c) Special management

Under the BRRD, the resolution authority can appoint a special manager to replace the management body of the institution under resolution.[35] The special manager has all the powers of the shareholders and the management body, but may only exercise these powers under the control of the resolution authority. He shall not be appointed for more than one year, although the period can be renewed on an exceptional basis. Compared to the temporary administrator who can be appointed in the early intervention phase, the special manager in the resolution phase has the statutory duty to take all the measures necessary to promote the resolution objectives and implement resolution actions according to the decision of the resolution authority. Where necessary, this duty shall override any other duties of management in accordance with the statutes of the institution or national law.

d) Valuation for the purposes of resolution

Before deciding on resolution action or the exercise of the power to write down or convert relevant capital instruments, the resolution authority has to ensure that a fair, prudent and realistic valuation of the assets and liabilities of the institution is carried out by a person who is independent from any public authority, including the resolution authority, and from the entity concerned.[36] The purposes of the valuation include providing the resolution authority with information on whether the conditions for resolution or the conditions for the write down or conversion of capital instruments are met and supporting the decision on the appropriate actions to be taken. The valuation shall contain an evaluation of the treatment that each class of shareholders and creditors would have been expected to receive if the institution or entity were wound up under normal insolvency proceedings.

When due to urgency reasons a valuation complying with the requirements set by the BRRD is not possible, a provisional valuation can be made, which will be accompanied as soon as possible by an ex-post definitive valuation.

[34] For definitions ("group", "group entity", etc.), see Article 2 of the BRRD.

[35] BRRD, Article 35.

[36] BRRD, Article 36; see also SRM Regulation, Article 20.

e) Write down and conversion powers

When the write-down or conversion of capital instruments[37] are sufficient to recapitalize the institution, they may be used without placing the bank in resolution; otherwise, the write down and conversion of capital instruments will take place within the resolution procedure, before any other resolution action is taken (see the following paragraph on bail-in).[38]

The write down and conversion powers can be exercised by resolution authorities if the conditions for resolution are met, or if in their absence an entity or group would be no longer viable, or if extraordinary financial support is required (with the exceptions provided by Article 32, paragraph 4, point d(iii) of the BRRD). The resolution framework requires resolution authorities to exercise the write down or conversion powers in accordance with the priority of claims under normal insolvency proceedings, with specific provisions on the treatment of Common Equity Tier 1 items, Additional Tier 1 instruments and Tier 2 instruments.

f) Resolution tools

The features and use of resolution tools are regulated in detail by the BRRD and SRM Regulation.[39] The following four resolution tools are available to resolution authorities:

a) the sale of the business of the institution under resolution;
b) the setting up of a bridge institution;
c) the separation of the performing assets from the impaired or under-performing assets of the failing institution;
d) the bail-in of shareholders and creditors.

The choice of tools will depend on the specific circumstances of each case and build on options laid out in the resolution plan prepared for the bank; in principle, resolution authorities should follow resolution plans unless different measures can achieve the resolution objectives more effectively. Tools can be applied either individually or in any combination; only the asset separation tool must be always applied in combination with another resolution tool, in order to avoid undue competitive advantages for the institution.

Looking at the main features of each instrument, under the sale of business tool authorities can sell an institution or parts of its business, without the consent of shareholders, to one or more purchasers that are not a bridge institution; the transfer shall be made on commercial terms, in an open, transparent and non discriminatory process while aiming to maximize the sale price. When, due to urgency reason, this is impossible, the authorities must take steps to redress detrimental effects on competition. Any net proceeds of the sale of assets and liabilities should benefit the institution left in the winding up proceedings; any net proceeds from the transfer of shares or other instruments of ownership issued by the institution should go to their owners.[40] As anticipated, the resolution authority may require the bank to contact potential buyers before opening a resolution procedure.

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[37] The write-down power may be applied to Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments; the power of conversion into shares or other instruments of ownership may be applied to Additional Tier 1 and Tier 2 instruments. Additional Tier 1 instruments are capital instruments that meet the conditions laid down in Article 52(1) of Regulation (EU) no. 575/2013; Tier 2 instruments are capital instruments or subordinated loans that meet the conditions laid down in Article 63 of the same Regulation.

[38] BRRD, Articles 59-62; SRM Regulation, Article 21.

[39] BRRD, Articles 37-58; SRM Regulation, Articles 22-27.

[40] BRRD, Articles 38-39; SRM Regulation, Article 24. See also EBA *Guidelines on factual circumstances amounting to a material threat to financial stability and on the elements related to the effectiveness of the sale of business tool under Article 39(4) of Directive 2014/59/EU*, 7 August 2014 (EBA/GL/2015/4).

The bridge institution tool consists of the transfer to a temporary structure, wholly or partially owned by public authorities and controlled by the resolution authority, of instruments of ownership, assets, rights or liabilities, with the goal to preserve essential banking functions or facilitate continuous access to deposits. The strategy and risk profile of the bridge institution are subject to the approval of the resolution authority. The operation of the bridge institution shall be in accordance with the Union State aid framework and the resolution authority may specify restrictions on its operations accordingly. The bridge institution must be operated as a viable going concern and be put back on the market when conditions are appropriate or wound up if not viable.[41]

The asset separation tool entails the transfer of assets, rights or liabilities of a bank under resolution or a bridge institution to one or more asset management vehicles, so as to separate clean and toxic assets. The asset management vehicle, which is wholly or partially owned by public authorities and is controlled by the resolution authority, is created for the specific purpose of receiving assets, rights and liabilities of a bank under resolution or a bridge institution. This vehicle manages the assets transferred to it with the view to maximizing their value through sale or orderly wind down.[42]

Finally, the bail-in tool is the mechanism to pursue the resolution objectives by writing down the institution's liabilities or converting debt to equity. It plays a crucial role in the system, since it is meant to affect the incentives of shareholders and creditors to effectively monitor the health of financial institutions, by making it credible that they will have to bear the appropriate losses in case of failure of the institution, without the possibility to shift the burden on taxpayers through bail-outs.

Resolution authorities may use the bail-in tool either when the objective is to recapitalize the institution so as to resolve it as a going concern, or to convert to equity or reduce claims or debt instruments that are transferred to a bridge institution or under the sale of business tools or the asset separation tool. The instrument should be used only when there is a reasonable prospect to restore the institution or entity to financial soundness and long term viability.[43]

As already illustrated, the write down and conversion powers outside the resolution procedure may involve only Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments. The bail-in tool within the resolution procedure potentially applies to a broader set of liabilities. The list of creditor claims that may be called extends to senior uncovered bonds and, down the line, uninsured deposits (those above € 100.000, under the Deposit Insurance Directive). Liabilities such as covered deposits, secured liabilities, short-term inter-bank lending or claims of clearing houses and payment and settlement systems that have a remaining maturity of seven days, client assets, salaries, pensions or taxes, are expressly excluded from bail-inable liabilities. On the other hand, the DGSs are liable in place of guaranteed depositors for the amount by which covered deposits would have been written down had they been included within the scope of bail-in.[44] Therefore, the bail-in tool provided by the new resolution framework goes much further than burden-sharing under State aid

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[41] BRRD, Articles 40-41; SRM Regulation, Article 25.

[42] BRRD, Article 42; SRM Regulation, Article 26. See also EBA *Guidelines on the determination of when the liquidation of assets or liabilities under normal insolvency proceedings could have an adverse effect on one or more financial markets under Article 42(14) of Directive 2014/59/EU*, 7 August 2015 (EBA/GL/2015/05).

[43] BRRD, Articles 43-62; SRM Regulation, Article 27.

[44] BRRD, Article 109(1.a).

control, which as indicated by the European Commission in its Banking Communication of July 2013 can be required by the Commission only with respect to equity, hybrid capital and subordinated debt.[45]

The amount of bail-in, i.e. where relevant the amount by which eligible liabilities must be written down in order to ensure that the net asset value of the institution under resolution is equal to zero, and, where relevant, the amount by which eligible liabilities must be converted into shares or other types of capital instruments in order to restore the Common Equity Tier 1 capital ratio of either the institution under resolution or the bridge institution, must be assessed by the resolution authority on the basis of the already mentioned valuation by an independent body, that must be up to date and as comprehensive as possible.[46]

The BRRD and SRM Regulation establish the sequence of write down and conversion in application of the bail-in tool. As explained in recital 77 of the BRRD, "Losses should first be absorbed by regulatory capital instruments and should be allocated to shareholders either through the cancellation or transfer of shares or through severe dilution. Where those instruments are not sufficient, subordinated debt should be converted or written down. Senior liabilities should be converted or written down if the subordinate classes have been converted or written down entirely".

Within one month after the application of bail-in, when it is applied with the objective of enabling the institution to continue to operate as a going concern, a business reorganization plan for the bank shall be drawn up and submitted to the resolution authority.[47] The business reorganization plan shall contain a detailed diagnosis of the problems and the circumstances which caused the entity to fail or to be likely to fail, a description of the measures aimed to restore the long-term viability (e.g. the withdrawal from loss making activities and the sale of assets or business lines) and a timetable for the implementation of these measures. Where the Union State aid framework is applicable, the reorganization plan should be compatible with the restructuring plan that the institution is required to submit to the Commission under that framework.[48]

In exceptional circumstances, other liabilities can be excluded from the application of bail-in on a case-by-case basis, when it is necessary to ensure the continuity of critical functions or to prevent widespread contagion to other parts of the financial system or when they cannot be bailed-in within a reasonable time. In this context, resolution authorities are required to consider the consequences of a potential bail-in of liabilities stemming from eligible deposits held by natural persons and micro, small and medium-sized enterprises above the €100.000

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[45] The Commission indicates that "Adequate burden sharing will normally entail, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders (…). The Commission will not require contribution from senior debt holders (in particular from insured deposits, uninsured deposits, bonds and all other senior debt) as a mandatory component of burden sharing under State aid rules whether by conversion into capital or by write-down of the instruments (…). State aid must not be granted before equity, hybrid capital and subordinated debt have fully contributed to offset any losses". See the Communication from the Commission on the application from 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ("Banking Communication") (2013/C 216/01), paragraphs 42-44.

[46] BRRD, Articles 46 and 36.

[47] BRRD, Article 52.

[48] On restructuring plans under the State aid framework, see in particular the 2009 Communication by the Commission on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules ("Restructuring Communication") (2009/C 195/04).

threshold. In any case, the resolution framework expressly provides that non covered deposits held by natural persons and micro, small and medium sized enterprises should be given a higher priority ranking, in the pecking order, over the claims of ordinary unsecured, non preferred creditors, entailing – when needed – the update of national insolvency rules.[49]

When a resolution authority decides to exclude from bail-in, wholly or partially, an eligible liability or a class of liabilities, the level of write-down or conversion of other eligible liabilities may be increased to take account of such exclusions, subject to the 'no creditor worse off' clause. When the losses that would have been borne by the excluded liabilities cannot be passed completely to other creditors, a contribution of the resolution financing arrangements is allowed, under specific conditions. In particular, access to these funds is allowed only after losses totalling no less than 8% of the institution's total liabilities (including own funds) have been absorbed through bail-in; moreover, the funding provided by the financing arrangements is limited to the lower of 5% of total liabilities (including own funds) or, on the other hand, the means available to the resolution fund (including the amount that can be raised through ex-post contributions within three years).[50]

In any case, before exercising the discretion to exclude a liability, the resolution authority has to notify the Commission which, in order to protect the integrity of the internal market, may prohibit the proposed exclusion if it entails the use of resolution financing arrangements or alternative financing sources and does not meet the requirements of the BRRD and delegated acts.

g) Financing arrangements

In particular circumstances in which bail-in is not sufficient to cover the resolution requirements, the new resolution framework provides that specific financing arrangements shall support the effective working of resolution tools without involving taxpayers. To this end, the BRRD establishes common rules on financing arrangements aimed to ensure that, in case of need, all institutions operating in the Union will have access to equally effective funding instruments.[51]

These financial arrangements can be employed only for specific purposes related to the resolution and cannot be used directly to absorb the losses of the institution or to recapitalize it. The admissible purposes include: guaranteeing the assets or liabilities of, or making loans to, the institution under resolution, its subsidiaries, a bridge institution or an asset management vehicle; purchasing assets of the institution under resolution or making a contribution when the resolution authority excludes some eligible liabilities from bail-inable resources and the losses which would have been absorbed by these liabilities are not fully passed to other creditors; making a contribution to a bridge institution or an asset management vehicle; paying compensation to shareholders or creditors when, according to a

[49] BRRD, Article 108 and recital 111.

[50] BRRD, Article 44(5) and recital 73. Article 44(6) provides that in extraordinary circumstances, when the 5% ceiling has been reached and all unsecured non preferred liabilities other than eligible deposits have been written down or converted in full, the resolution authority may seek further funding from alternative financing resources, or the 5% ceiling can be exceeded by the resolution fund if there are available resources resulting from ex-ante contributions. Moreover, Article 44(8) establishes that, by way of derogation from the rule of 8% of total liabilities, resolution financing arrangements are also allowed provided that the contribution from bail-in represents not less than 20% of risk weighted assets of the institution, the assets of the institution are below € 900 billion and the resolution financing arrangement holds an amount of at least 3% of covered deposits of the credit institutions authorized in the relevant territory.

[51] BRRD, Articles 99-107.

specific valuation procedure, it turns out that they have incurred greater losses than they would have incurred in a winding up under normal insolvency proceedings.

The financing arrangements established at the national level (national resolution funds, or NRFs) should be controlled by designated public authorities, which may coincide with the resolution authorities, under the conditions laid down in the BRRD.

Contributions from the banking sector are raised ex-ante, at least annually, with the view to reach the target level of at least 1% of covered deposits by the end of 2024. The contribution of each institution is adjusted to take account of its risk profile, in order to avoid moral hazard and reflect an insurance-like model (with implications for the legal basis: financing arrangements are insurance, not taxation, instruments, and therefore the approval of EU legislative measures does not require unanimity pursuant to Article 113 TFEU).

When the resources raised through prior funding are insufficient to ensure an effective resolution, extraordinary ex-post contributions may be raised in order to cover the additional amount. For each institution extraordinary ex-post contributions shall not exceed three times the annual amount of the ex-ante contribution.

In the event that the ex-ante contributions are not sufficient and ex-post contributions are either not immediately available or insufficient, financing arrangements are enabled to contract borrowings or other forms of support from institutions, financial institutions or other third parties, or borrow from other financing arrangements within the Union. Such lending between resolution funds is acknowledged as an important component of the system, but is strictly voluntary and, due to its potential fiscal implications, may be conditional on the consent of the competent Ministry of Finance.

For the resolution of groups, the NRF of each institution which is part of the group should contribute, through a 'mutualization' of financial arrangements, provided that an agreement is found between the national authorities on the resolution of the group.

Finally, the new resolution legislative package provides a financial contribution of deposit guarantee schemes to resolution procedures.[52] As anticipated, deposits covered by deposit guarantee schemes should never bear any losses in the resolution process. In this context, where resolution authorities take resolution action and provided that such action ensures that depositors continue to have access to their deposits, deposit guarantee schemes to which the institution under resolution is affiliated are called to make a contribution to the resolution, for an amount not greater than the amount of losses they would have had to bear if the institution had been wound up under normal insolvency proceedings.

h) Minimum requirements for own funds and other eligible liabilities

Since the pecking order for bail-in is known, institutions may have the incentive to structure their liabilities in a way which reduces the risk of bail-in, impairing the effectiveness of the bail-in tool. To avoid this scenario, the regulatory framework establishes that institutions and groups should meet at all times a minimum requirement for own funds and eligible liabilities (MREL), which will be determined by the resolution authority after consulting the competent authority, on the basis of a set of criteria established by the BRRD and further specified by technical regulatory standards drafted by the EBA.[53]

[52] BRRD, Article 109.

[53] BRRD, Article 45.

i) Due process

Since the measures adopted by resolution authorities may significantly affect the rights of the parties concerned, in particular shareholders and creditors, the legislative framework contains a set of provisions on confidentiality, due process and right of appeal.[54]

In this last respect, the BRRD stresses that the complex nature of the economic assessments made by national resolution authorities should not prevent the competent courts from examining whether the evidence relied on by the resolution authority is factually accurate, reliable and consistent, contains all relevant information and is capable of substantiating the conclusions drawn therefrom. On the other hand, since resolution measures aim to cover situations of extreme urgency and the suspension of any decision might impede the continuity of critical functions, the lodging of an appeal not only does not automatically suspend the effects of the decision, but the decision of the resolution authority is immediately enforceable and gives rise to a presumption that a suspension of its enforcement would be against the public interest. The presumption, however, is rebuttable and therefore may be challenged before the court. Moreover, for the sake of legal certainty, in order to protect the rights of third parties which have acquired in good faith assets, rights and liabilities of the institution under resolution, the annulment of a decision by the resolution authority shall not affect any subsequent administrative act or transaction concluded on the basis of the annulled decision. In the same perspective, remedies for a wrongful decision will be limited to the award of compensation for the damages suffered by the affected persons.

j) Resolution of cross border groups

In the event of failure of a cross border group, the harmonization of resolution tools and powers must be accompanied by cross border coordination of the relevant authorities. The BRRD contains a set of provisions to this aim,[55] whereas within the Banking Union a more structured coordination framework is provided by the SRM. The BRRD requires the establishment of resolution colleges, built around the core of the existing supervisory colleges through the inclusion of resolution authorities, and the involvement of competent ministries, central banks, EBA and where appropriate authorities responsible for the deposit guarantee schemes. The resolution college is not a decision-making body, but a platform for the exchange of information and the coordination of resolution actions by national authorities. The group level resolution authority shall propose a group resolution scheme and submit it to the resolution college. National resolution authorities which disagree or decide to take independent resolution action have to explain the reasons for their choice, taking into account the impact on financial stability in other Member States and the potential effect on the other parts of the group.

k) Delegated and implementing acts and the role of EBA

The BRRD provides that the Commission is empowered to adopt delegated acts in order to specify some aspects of the new framework for the resolution of banks, such as the criteria for defining critical functions or the conditions for the exclusion of liabilities from the write down or conversion requirements.[56] The Commission is required to carry out appropriate consultations during its preparatory work. The European Parliament and the Council have three months from the date of notification to object to a delegated act.

[54] BRRD, Article 85.

[55] BRRD, Articles 87-92.

[56] BRRD, Article 115.

As anticipated, in the EU financial regulatory framework the EBA is entrusted with the development of draft regulatory and implementing technical standards which do not involve policy choices, for submission to the Commission. Moreover, in areas not covered by regulatory or implementing technical standards EBA may issue guidelines and recommendations on the application of Union law under its own initiative. The internal organization of EBA has been integrated with a new permanent Resolution Committee for the purpose of preparing EBA acts (including draft standards) concerning the resolution framework.[57] The internal committee is composed of the resolution authorities and is structurally separated from the other functions attributed to EBA. The resolution committee will promote the development and coordination of resolution plans and develop methods for the resolution of failing financial institutions.

4. Resolution in the Banking Union: the main features of the SRM and of the SRF

The BRRD establishes minimum harmonised rules and provides common resolution tools and powers to the national authorities of each Member State but leaves them discretion in the application of the tools and in the use of national financing arrangements in support of resolution procedures. Although EBA is given the task to ensure a uniform and harmonious application by means of its regulatory and mediation powers, the decentralized enforcement of the Directive does not completely eliminate the risk of inconsistent decisions and of different approaches by Member States to the use of financing arrangements. Moreover, when the resolution involves banks or groups with cross-border activities, the cooperation mechanisms established by the BRRD are complicated and may reduce the efficiency of cross border resolution processes.

In order to overcome these potential weaknesses, the SRM Regulation establishes for the Banking Union a more centralized architecture for decision-making in the field of resolution. As already anticipated, for the Member States participating to the SSM the common rules established by the BRRD are applied by a resolution network composed by a Union agency, the Single Resolution Board, which acts as a resolution authority for the banks directly supervised by the ECB and cross border groups, and by national resolution authorities for the other banks within the SSM. Moreover, the European Commission and the Council are given specific tasks for the operation of the system.

In order to ensure a level playing field in the internal market, the SRM Regulation is modelled on the BRRD, although the rules and principles of the Directive are adapted to the specificities of the SRM and specific provisions ensure that appropriate funding is available to the latter. Moreover, when the Board, the Commission and the Council exercise the powers conferred on them by the Regulation, they are subject to the delegated acts, regulatory and implementing technical standards, guidelines and recommendations adopted by EBA. In particular, EBA is required to ensure equality of treatment between the Board, the Council, the Commission and the national authorities performing similar tasks.

In order to understand the operation of the new framework, it is necessary to consider in greater detail the composition of the SRB and the allocation of competences between the SRB and the NRAs, the roles of the different institutions in the procedure and the provisions relating to the SRF.

[57] BRRD, Article 127.

a) Composition of the SRB and allocation of competences between the Board and NRAs

In order to ensure a rapid and effective decision-making in resolution issues, the Board is conceived as a Union agency with a dedicated structure.[58] The composition of the Board, however, is quite complex because of the need to ensure that all relevant interests at stake in resolution procedures are duly taken into account. The Single Resolution Board is composed of five permanent members (a Chair and four full-time members), chosen among experts and appointed by the European Parliament on the proposal of the Commission, and by one member for each participating Member State, representing their national resolution authorities. Each member has one vote. One representative designated by the Commission and one designated by the ECB are entitled to participate as permanent observers at the meetings of the Board, with no voting rights.

The Regulation expressly states that when performing the tasks conferred on them, the Board and the national resolution authorities shall act independently and in the general interest. In particular, the Chair and the four permanent members of the Board are required neither to seek nor to take instructions from the Union's institutions and bodies, from any government of a Member State or from any other public or private body.

The Board shall act in compliance with Union law, in particular with the Council and the Commission decisions pursuant to the Regulation. It is accountable to the European Parliament, the Council and the Commission for the implementation of the Regulation.

The tasks of the Board, which will be carried out in close cooperation with the NRAs, include drawing up the resolution plans and adopting all the decisions relating to the resolution of significant entities or groups, entities or groups subject to the supervision of the ECB, and, in addition, of cross-border groups. For these institutions, the NRAs continue to carry out activities relating to the implementation of the resolution schemes.

On their part, NRAs directly exercise resolution powers in relation to the other institutions directly supervised by national competent authorities within the SSM. When adopting decisions under the Regulation, the Board and the NRAs apply the same material rules.[59] NRAs must inform the Board of the measures that they are willing to take and coordinate with the Board when they take such measures; they also have to submit the resolution plans to the Board for an assessment. Besides these general rules, in specific circumstances the Board has a strengthened role with regard to entities for which the resolution powers are usually held by national resolution authorities. First, in all cases in which the resolution action requires the use of the Single Resolution Fund, the resolution scheme has to be adopted by the Board. Second, if the Board considers that a draft decision by a NRA does not comply with the Regulation or the general instructions issued by the Board, it may issue a warning to the authority. At any time, in particular if its warning is not appropriately addressed, the Board can decide on its own initiative, after consulting the relevant NRA, or requested by that authority, to exercise directly all of the relevant powers under the Regulation.

The Board operates in executive and plenary sessions. The executive session[60] prepares all decisions concerning the resolution procedure and directly takes the decisions relating to individual entities or banking groups when the use of the Single Resolution Fund remains below € 5 billion. In its executive session the Board is composed of the five permanent

[58] SRM Regulation, Articles 42-56.

[59] SRM Regulation, Article 7.

[60] SRM Regulation, Articles 53-55.

members, the observers from the Commission and the ECB, and the representatives of the national resolution authorities of the Member States where the institution or group under resolution operates. When deliberating on the resolution of an individual entity or group and a consensus is not reached within the deadline set by the Chair, the decision is taken by the Chair and the four permanent members, under a simple majority rule. The Board may also invite, as observers, representatives of EBA, the ESM and of the NRAs of non participating Member States.

The plenary session[61] of the Board takes all decisions of a general nature and the decisions relating to individual entities falling outside the competence of the executive session. In particular, the plenary session decides on the use of the Fund if the support considered in an individual resolution action exceeds € 5 billion and provides guidance to the executive session in the use of resolution tools when in the previous twelve months the net accumulated use of the Fund has reached the same threshold. Moreover, the plenary session decides on the necessity to raise extraordinary ex-post contributions, on the voluntary borrowing between financing arrangements, on alternative financing arrangements and on the mutualization of national financing arrangements in the case of group resolutions. Special majority rules are provided for the most sensitive issues.

b) Roles of the different institutions in the procedure

The procedure for the recovery and resolution of banks in the Banking Union follows the phases set out in the BRRD: preparation and prevention through recovery and resolution planning; early intervention; resolution. Regulation no. 806/2014 addresses only the steps directly or indirectly involving the SRM, starting with resolution planning.

Resolution plans are drawn up by the SRB for the entities and groups for which it is the resolution authority, after consulting the ECB or the relevant national competent authorities and the NRAs. Moreover the SRB, where applicable, requests national resolution authorities to adopt the measures necessary to remove obstacles to resolvability and determines the minimum requirement for own funds and eligible liabilities (MREL).[62]

Early intervention measures are taken by the ECB or national competent authorities within the SSM; the SRB is informed of such measures and notifies the Commission thereof. In line with the BRRD, when the SRB receives information on early intervention measures, it prepares for the possible resolution of the institution or group concerned; it may also require the institution to search for potential purchasers and the national resolution authority to draft a preliminary resolution scheme.[63]

As for the opening of a resolution procedure, in the Banking Union the assessment of whether a bank or a group is failing or likely to fail is normally made by the ECB, as the single supervisor within the SSM, after consulting the Board, and it is communicated to the Commission and the Board.[64] The Board can assess that a bank is failing or likely to fail only after informing the ECB of its intention and only if the ECB does not make this assessment within three days of receipt of the information.

[61] SRM Regulation, Articles 49-52.

[62] SRM Regulation, Articles 8-12.

[63] SRM Regulation, Article 13.

[64] SRM Regulation, Article 18.

The assessment of the second condition for opening a resolution procedure, i.e. whether there is no reasonable prospect that any alternative private sector or supervisory action would prevent the failure of the bank within a reasonable timeframe, is made by the Board in executive session, in close cooperation with the ECB, or, when applicable, by NRAs, in close cooperation with the ECB. The executive session of the Board also ascertains whether the third condition (resolution action is necessary in the public interest) is met. When the SRB considers that all the three conditions for resolution are met, it adopts a resolution scheme, which places the entity under resolution and determines the application of the resolution tools and the eventual use of the SRF to support the resolution actions.

The Board immediately transmits the resolution scheme to the Commission. Within twelve hours, the Commission can propose to the Council (which acts on simple majority rule) to object to the resolution scheme on the ground that it doesn't fulfil the criterion of public interest, and to "approve or object" on the amount of the Fund contribution provided for in the scheme. Moreover, within twenty four hours from the transmission of the scheme by the Board, the Commission can either endorse the resolution scheme or object to it with regard to the discretionary aspects of the scheme not pertaining to the above mentioned aspects.

If the Council and the Commission do not raise any objection, the resolution scheme will enter into force within twenty-four hours after its transmission by the Board. The resolution scheme will be implemented by NRAs under close monitoring by the SRB.

If, within twenty-four hours from the transmission of the resolution scheme by the Board, the Council accepts that the Fund's contribution must be modified, or the Commission raises objection for the matters falling in its competence, the Board has eight hours to amend the resolution scheme. On the other hand, if the Council objects on the ground that the public interest requirement is not met, the entity will be wound up in an orderly manner in accordance with the applicable national law.

This resolution procedure deserves some comments. Although the time-schedules set by the Regulation are strict, the involvement of several different institutions makes it particularly difficult to ensure an efficient and effective decision-making. For this reason some US commentators define the SRM as a baroque system.[65] Particular concerns emerge with respect to the ability of the system to ensure compliance with crucial confidentiality requirements.

However, the more efficient alternative of conferring the whole decision-making power to an independent Union Agency would have probably raised objections of legality under the Treaty. The case law of the Court of Justice strictly circumscribes the competences which can be assigned to a Union Agency under EU rules. Reference to the *Meroni* doctrine of the Court of Justice,[66] which strictly limits the possibility for the Commission to delegate its powers, is not fully appropriate in this situation, since the *Meroni* judgment referred to specific circumstances and cannot be applied as such to the establishment of a new EU agency by means of a legislative act. *Vice versa*, the principles set out by the Court of Justice in the recent *ESMA* judgment[67] are directly relevant for the issues at stake. In the *ESMA* case the UK

[65] Cato Institute, *The EU's New Banking "Single Resolution Board"*, 28 December 2013, available at http://catosdomain.com/?p=19965.

[66] Court of Justice, 13 June 1958, Case C-9/56, *Meroni v. High Authority of the European Coal and Steel Community*. On the Meroni doctrine, see Mario P. Chiti, *The Transition from banking supervision to banking resolution. Players, competences, guarantees*, ASTRID, (2014) *Towards the European Banking Union*.

[67] Court of Justice 22 January 2014, case C-270/12, *United Kingdom v. European Parliament and Council of the European Union*.

government had challenged before the Court of Justice the powers conferred on the ESMA by Article 28 of regulation (EU) no. 236/2012 with respect to short selling, although those powers are much less intrusive than the powers contemplated for the resolution of banks. The Court dismissed the action of annulment of Article 28 of the ESMA Regulation, but at the same time listed a number of requirements that must be met in order to ensure that the powers delegated by a legislative act to a Union agency are compatible with the Treaty. In particular, the Court requires that these powers are precisely delineated, remain within the bounds of the regulatory framework established by a EU legislative act, are circumscribed by conditions and criteria which limit the Agency's discretion (including the power of the European Commission to adopt delegated acts) and are amenable to judicial review.

Looking at the SRM in the light of *ESMA* judgment facilitates the understanding of the veto powers given to the Commission and the Council. Recital 24 of the Regulation stresses that "since only institutions of the Union may establish the resolution policy of the Union and since a margin of discretion remains in the adoption of each specific resolution scheme, it is necessary to provide for the adequate involvement of the Council and the Commission as institutions which may exercise implementing powers (…)". Therefore, the Commission is given the competence to assess the discretionary aspects of the resolution decisions taken by the SRB and may adopt delegated acts to specify the criteria and conditions to be taken into account by the Board in the exercise of its functions. The Council, on the other hand, due to the potential impact of resolution decisions on the financial stability of the Member States and of the Union and on fiscal sovereignty, has the competence, acting on the proposal from the Commission, to control the alleged existence of a public interest underpinning a resolution proposal, as well as any material use of the SRF.

In any case, the Regulation clearly states that the decisions adopted by the Board, the Council and the Commission are subject to judicial review before the Court of Justice.

c) The Single Resolution Fund

For the Banking Union, the SRM Regulation establishes an integrated system of financial arrangements aimed to support resolution, centred on the SRF. As argued in recital 19 of the SRM Regulation, if the funding were to remain national, in the longer term the link between sovereign debt and the banking sector would not be fully broken and investors would continue to establish borrowing conditions according to the place of establishment of the banks rather than to their creditworthiness.

The SRF is financed by all banks in the participating Member States by means of contributions raised at the national level on an annual basis, starting in 2016, with the target of reaching 1% of the amount of covered deposits (approximately € 55 billion) by 2024.[68]

During the transitional period, the Single Fund will comprise national compartments which will be gradually mutualised by 2024, starting with a mutualization of 40% of the resources collected in the first year. The pooling of bank contributions, based on the IGA of May 2014, will increase financial stability by limiting the link between the perceived fiscal position of individual Member States and the funding costs of banks operating in those Member States. In order to further break the link with the fiscal position of Member States, decisions taken within the SRM (notably, decisions involving the use of the SRF or of a deposit guarantee scheme) will not be considered to impinge on the fiscal responsibilities of the Member States.

[68] See also the Council Implementing Regulation (EU) 2015/81 of 19 December 2014 specifying uniform conditions of application of Regulation (EU) n. 806/2014, with regard to ex-ante contributions to the Single Resolution Fund.

The Regulation specifies that the SRB will be the owner of the Fund and will administer it and that the Board will use the Fund only to ensure the efficient application of the resolution tools and resolution powers. The modalities for the use of the Fund are established by the provisions on financing arrangements of the BRRD, integrated by the SRM Regulation.[69] According to this framework, the SRB should ensure that any losses, costs or other expenses incurred in connection with the use of the resolution tools are first borne by the shareholders and the creditors of the institution under resolution. Only where, according the provisions of the BRRD, the resources from shareholders and creditors are exhausted, the losses, costs and expenses incurred with the resolution tools can be borne by the SRF.

Whenever the Fund is involved in the resolution of a bank, the SRB has to notify the Commission of the proposed use of the Fund. The resolution scheme cannot take place until the Commission has adopted a positive or conditional decision on the compatibility of the use of the Fund with the rules on State aid.[70]

5. Public backstops and State aid control

When the new EU financial framework will become fully operational, the risk of further emergency recapitalizations will be significantly reduced. The European Commission argues that "no bank which faced problems since 2008 in the European Union – apart from a handful of exceptions – would have needed extra recapitalization from public funding if it had held Capital Requirement Directive IV levels of capital and been subject to bail-in as set out in BRRD".[71]

On the other hand, it is clear that the scenario where a public backstop may be necessary cannot be completely ruled out. Therefore, the BRRD and SRM regulation contain some provisions aimed to regulate public backstops and to coordinate the resolution rules with the control of State aid.

a) Public backstops as an instrument of last resort

Since one of the main aims of the new EU financial framework is to avoid the massive bailouts of banks experienced during the crisis and to make the private sector bear losses to the largest possible extent, the BRRD and the SRM provide that the resolution tools should be applied before any public sector injection of capital or equivalent extraordinary public financial support to an institution. Extraordinary public financial support is defined as "State aid within the meaning of Article 107(1) TFEU or any other public financial support at supra-national level which, if provided for at national level, would constitute State aid, that is provided in order to preserve or restore the viability, liquidity or solvency" of an institution, entity or group.[72] The reference to support which "would constitute State aid if provided for at national level" means that all measures are considered, even if financial support may not come from a Member State, when they entail a transfer of public resources ascribable to a public authority, an economic advantage that the beneficiary would not have obtained by a private investor and selectivity.

[69] SRM Regulation, Articles 67-78.

[70] SRM Regulation, Article 19.

[71] European Commission, MEMO/14/244, 28 March 2014.

[72] BRRD, Article 2, no 28.

As already illustrated, the need for extraordinary public financial support is one of the conditions in which a bank is considered failing or likely to fail in the context of the assessment of whether a resolution action should be initiated.[73]

b) Government financial stabilization tools

The BRRD provides that "in the very extraordinary situation of a systemic crisis" the resolution authority may seek funding from alternative financing sources through the use of government stabilisation tools provided by the Directive, once shareholders and other holders of eligible liabilities have contributed to loss absorption and recapitalization for an amount not less than 8% of total liabilities and the measure has been approved under the Union State aid framework.[74]

The possibility for Member States to contribute through government financial stabilization tools with a view to meeting the objectives of resolution in relation to the Member State or the Union as a whole is regulated by Articles 56 to 58 of the BRRD. In particular, governments are allowed to use public equity support tools (Article 57) or temporary public ownership tools (Article 58). The action shall be carried out under the leadership of a ministry or the government in close cooperation with the resolution authority. This kind of support must be used as a last resort after having assessed and exploited the other resolution tools to the maximum extent practicable whilst maintaining financial stability. When the Commission undertakes State aid assessment of government stabilization tools referred to in the Directive, it should separately assess whether the notified stabilization tools do not infringe any provisions of Union law, including those related to the minimum loss absorption requirement of 8% and whether there is a "very extraordinary situation of a systemic crisis" justifying resorting to those tools under this directive, while ensuring the level playing field in the internal market. Not only the assessment under State aid rules, but also this separate assessment have to be made before the government stabilisation tool may be used.

c) Control of State aid and Fund aid

Any measure entailing public financial support has to comply with the relevant State aid rules. Article 19 of the SRM Regulation provides that whenever the SRF is involved in the resolution of a bank, the SRB has to notify the Commission of the proposed use of the Fund and the Commission has to assess its compatibility with the Treaty on the basis of the rules on State aid. Thus, where the resolution action involves the granting of State aid pursuant to Article 107(1) TFEU or of Fund aid, the adoption of the resolution scheme shall not take place until the Commission has adopted a positive or conditional decision concerning the compatibility of such aid with the internal market. The Regulation recalls the principle of the BRRD (Article 3.3) whereby public institutions involved should ensure the operational independence between their function in the resolution framework and their other functions. For the Commission, this entails that the performance of the institutional tasks related to public aid control will have to be clearly separated, also from an organizational perspective, from the Commission tasks in the resolution procedure.

State aid must be notified to the Commission by the relevant Member State, and the Board should invite Member States to respect this obligation. Whenever the resolution action proposed by the Board involves the use of the Fund, the Board shall notify the Commission of the proposed use, including all the information necessary for an assessment under the rules

[73] BRRD, Article 32(4).

[74] BRRD, Article 37(10).

on State aid. The resolution decision can be adopted only after the Commission has adopted a positive or conditional decision on the compatibility of Fund aid. Recital 30 stresses that the Commission may impose conditions, commitments or undertakings with respect of the beneficiary and mentions, as examples, burden sharing requirements, restrictions on the payment of dividends, prohibitions against aggressive commercial practices, behavioural requirements and requirements for restructuring plans, relating to sales of the beneficiary, or of its assets, rights and liabilities and to its liquidation.

Although in principle the Commission can consider all these aspects when taking decisions in application of Article 107 TFEU, recital 30 clearly reflects the approach followed in the Commission communications on State aid for banks that were adopted when the new regulatory financial framework had still to be finalised. Once the new system becomes fully operational, the application of the rules on bail-in should be sufficient to ensure an appropriate burden sharing, with no need for a duplication of the assessment by the Commission under State aid rules.[75]

Interestingly, the SRM Regulation provides that the Commission may amend its initial decision, following a recommendation by the SRB or on its own initiative, if the implementation of resolution tools and actions departs from the criteria on the basis of which it has taken its original decision.[76] This opens the way to the exercise of some flexibility in the case of unforeseen developments related to financial stability.

If the Commission adopts a negative decision on the compatibility of Fund aid with the internal market, the Board has to prepare a revised resolution scheme. If aid is illegally granted, it will be recovered according to the usual rules of State aid control. The Regulation contains a provision modelled on Article 108(2) of the Treaty whereby by way of derogation to the normal rules, in exceptional circumstances the Council may, on application by a Member State and acting unanimously, decide that the use of the Fund shall be considered compatible with the internal market. The Council has to adopt this decision within seven days from the said application, whereas under Article 108 the deadline is three months.

d) *Role of the ESM*

A European backstop from public resources may come from the ESM. In 2012 the Eurogroup stated that the establishment of an effective SSM could be accompanied by the possibility for the ESM, under well defined conditions, to recapitalize banks directly, with a cap on such exposure set at € 60 billion.[77] The conditions for this backstop have been established by a decision of the Eurogroup of 20 June 2013. In particular, banks which have requested or received direct public financial assistance from the ESM fall under the direct supervision of the ECB (a provision made largely redundant by the subsequent establishment of the SSM). Moreover, the ESM can intervene to recapitalize the bank only following a bail-in of at least 8% of bank liabilities and, if needed, a recapitalization by the interested Member State to raise Common Equity Tier 1 to 4,5% of liabilities. Several commentators argue that these pre-conditions are too tight and should be relaxed; moreover, they consider that the € 60 billion

[75] See Stefano Micossi, Ginevra Bruzzone and Miriam Cassella, *Bail-in Provisions in State Aid and Resolution Procedures: Are they consistent with systemic stability?*, in Franklin Allen, Elena Carletti and Joanna Gray*, Bearing the Losses from Bank and Sovereign Default in the Eurozone*, FIC Press, 2014.

[76] SRM Regulation, Article 19(9).

[77] ESM, Establishment of the instrument for the direct recapitalization of institutions, 8 December 2014.

ceiling on the ESM direct recapitalization capacity should be raised in order to ensure a credible and adequate common backstop capable of severing the bank-sovereign link.[78]

6. Looking ahead: critical aspects and remaining challenges

The new system for the resolution of failing banks is on the whole well designed and, more important, it is consistent with the SSM, on one hand, and the rules on State aid on the other. While it is obviously too early to assess its operation in practice, some of its features deserve continuing consideration and review.

The first one is the decision-making procedure for placing a bank under resolution, which seems exceedingly complex and open to politicization, notably owing to the possible involvement of the Council. The involvement of many different institutions in the decision – including the ECB, the European Commission and the NRAs of the failing bank or banking group – may make reaching a consensus rather cumbersome, especially when the decision concerns a large cross-border bank. Under these circumstances, respecting the twin requirements of rapidity and confidentiality may then become especially difficult.

The coexistence within the Union of Member States which participate and Member States which do not participate in the Banking Union arrangements may compound the problem when the failing bank has substantial assets in jurisdictions in and out of the SSM. A related issue, as time passes, may arise in connection with the continuing role of EBA in the system, entailing several possible functional overlaps with the SSM.[79]

A second area of potential difficulty concerns the strict requirement of bail-in of private capital for any measure of support of failing banks. This was of course one of the main pre-conditions for the Banking Union and the transfer to the ECB of the responsibility of supervising eurozone banks. This is a key provision for the eradication of moral hazard from the financial system. And yet, as the transition back to stable financial conditions is still under way and banking systems in the European Union remain plagued by massive amounts of non-performing loans, these provisions may be unduly limiting the room for manoeuvre of national authorities in accelerating the clean-up of banks' balance sheets – an important factor in perpetuating financial market fragmentation.

As for the relation between financial regulation and the control of State aid, during the crisis and also in the transition to the new system the Commission has used competition rules to preserve financial stability and a level playing field. Once the new regulatory system is fully operational, the control of State aid may recede to its normal tasks, becoming complementary to the resolution system and focussing on competition issues. It is important to recall that for Banking Union the Commission's decisions on public aid will always be based on the resolution scheme prepared by the Board (which includes information on the exercise of bail-in powers). The Commission will only have to assess whether the proposal made by the SRB under resolution rules satisfies the requirement of sufficient burden sharing under State aid rules. While this may entail some room for discussion between the competition and resolution authorities, there seems to be no inherent contradiction. However, a double check of burden

[78] See International Monetary Fund (IMF), Staff report for the 2015 Article IV consultations with member countries, July 2015, and Stefano Micossi, *Tough love for sinners in the eurozone banking union*, 1 July 2013, Centre for European Policy Studies (CEPS).

[79] See European Court of Auditors, *European banking supervision taking shape - EBA and its changing context*, Special Report no 5/2014.

sharing requirements based on different criteria might unduly increase the perceived riskiness of bank liabilities. In the new system, the task of preventing moral hazard through a credible expectation of burden sharing should probably be left to financial regulation.

A third and related area deserving continuing review is the adequacy of the SRF in providing a credible backstop to the SRM. The point is often overstated by those who tend to see the SRF as the backup of the banking system in general, thus overlooking its limited scope in assisting resolution, which does not extend to covering bank losses. However, the lack of centralized deposit insurance in the Banking Union may entail a higher probability of systemic crises following the crisis of a large cross-border bank, for which adequate financial and fiscal backup do not exist. Clearly, resolution procedures may be able to handle the crisis of individual banks, but perhaps not the fallouts of renewed systemic crises. The main reinforcement of the system which seem desirable, however, lies in completing the system with supra-national deposit insurance, and designing some kind of last resort fiscal backup behind it in case of systemic crisis.

A last point to be raised concerns the international coordination of the new rules for managing bank crises. The Banking Union offers powerful tools for the prevention of distress by means of stricter prudential requirements, enhanced supervision and robust incentives against moral hazard. However, the Union is not a closed system, and its banks operate in a broader environment where the FSB may establish new requirements and other regulators develop and apply their rules. For instance, the FSB has recently proposed a Total Loss Absorbing Capacity (TLAC) requirement as a new standard for global systemically important banks in resolution, whose consistency with the EU new regulatory framework has still to be fully explored. As for non-EU jurisdictions, US regulators have been typically more restrictive in their application of the new Basel capital rules as well as of the provisions on the preparation of resolution ('living wills'). As a result, European banks operating in those jurisdictions have found themselves obliged to meet different, and tighter, requirements in order to be able to operate in US markets. De facto, any bank undertaking the clearing of dollar transactions in New York has found itself subject to the rules and oversight of US regulators. On the other hand, banks in Europe already complain that capital requirements should not be set so high as to unduly limit their capability to provide credit to the real economy.

To an extent, the different attitude of regulators vis-à-vis the banks reflects their different weight in the total financing flows of the economy – close to 80 per cent in the EU, below 40 per cent in the US. This difference may become an important factor in shaping the discussions in the two jurisdictions on the desirability of structural separation of commercial and investment banking and, more broadly, in feeding a divergent application of the new regulations enacted after the great financial crisis.