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To fail or not to fail ?

Online Seminar

Florence School of Banking & Finance

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The conditions for the resolution of credit institutions under Article 32(1) BRRD and Article 19 SRMR

Criteria	Case 1	Case 2	Case 3
The credit institution is failing or likely to fail	✓	✓	✓
No reasonable prospect for effective alternative private sector measures or supervisory action	✗	✓	✓
A resolution action is necessary in the public interest	✓	✓	✗
Outcome			
	1. Recapitalisation with the use of private sector funds 2. Potential resort to support measures in the form of ‘precautionary recapitalisation’ (add-on)	1. Resolution 2. Potential use of the SRF’s available financial means 3. Potential use of the GFSTs <i>(only under the BRRD)</i>	1. Winding up under normal insolvency proceedings 2. Activation of DGS to repay covered depositors

1. Financial policy objective: ensuring the stability of the banking system instruments: the ‘bank safety net’

1. Crisis prevention

- Structural regulations
- Authorisation requirements for banks
- Micro-prudential banking regulation
- Micro-prudential banking supervision
- Macro-prudential policies (regulation and oversight)
- Specific crisis prevention measures: Resolution preparation (recovery and resolution planning, intra-group financial support agreements) - Early intervention measures

2. Crisis management

2.1 Management of liquidity crises

Lending of last resort by the central bank

2.2 Management of solvency crises

- Recapitalisation of banks by public funds (state aid)
- Resolution of banks
- Winding-up of banks
- Operation of deposit guarantee schemes (activated for the payment of compensations in the latter case only)

2. The key legal sources of the three main pillars of the European Banking Union (1/2)

	Prudential supervision and regulation of credit institutions	Resolution of non-viable credit institutions	Deposit guarantee schemes
European ‘Single Mechanisms’	<p>Single Supervisory Mechanism:</p> <ul style="list-style-type: none"> • Council Regulation (EU) No 1024/2013 (‘SSM Regulation’) • ECB Regulation (EU) No 468/2014 (‘ECB Framework Regulation’) • other ECB legal acts 	<p>Single Resolution Mechanism and Fund:</p> <ul style="list-style-type: none"> • Regulation (EU) No 806/2014 of the European Parliament and of the Council (‘SRM Regulation’), and Commission delegated and implementing acts • Intergovernmental Agreement (2014) (‘SRF’) 	<p>Proposal for a Regulation of the European Parliament and of the Council “amending Regulation EU No 806/2014 in order to establish an ‘EDIS’”</p>

2. The key legal sources of the three main pillars of the European Banking Union (2/2)

	Prudential supervision and regulation of credit institutions	Resolution of non-viable credit institutions	Deposit guarantee schemes
Harmonisation of substantive rules ('single rulebook')	<ul style="list-style-type: none"> • Regulation (EU) No 575/2013 of the European Parliament and of the Council ('CRR'), and Commission delegated and implementing acts • Directive 2013/36/EU of the European Parliament and of the Council ('CRD IV'), and Commission delegated and implementing acts 	<ul style="list-style-type: none"> • Directive 2014/59/EU of the European Parliament and of the Council ('BRRD'), and Commission delegated and implementing acts 	<ul style="list-style-type: none"> • Directive 2014/49/EU of the European Parliament and of the Council, and a Commission delegated act ('DGSD')

3. The partial Europeanisation of the ‘bank safety net’ (even) with regard to significant credit institutions (1/2)

Financial policy instruments	Scope of application	Level of action <i>(italics denotes national)</i>
Granting and withdrawal of authorisation	Euro area (+ Member States under close cooperation)	ECB within the SSM (also applicable to less significant credit institutions)
Macro-prudential oversight	EU	ESRB and ECB (specific tasks)
Micro-prudential supervision	Euro area (+ Member States under close cooperation)	ECB within the SSM (with regard to the specific tasks conferred on it for significant credit institutions)
Recovery planning and early intervention	Euro area (+ Member States under close cooperation)	ECB within the SSM for significant credit institutions
Recapitalisation by public funds	<ul style="list-style-type: none"> • EU • Euro area • Euro area 	<ul style="list-style-type: none"> • <i>National governments</i> • <i>Indirectly by the ESM</i> • Directly by the ESM (‘DRI’)

3. The partial Europeanisation of the ‘bank safety net’ (even) with regard to significant credit institutions (2/2)

Financial policy instruments	Scope of application	Level of action <i>(italics denotes national)</i>
Drawing up of resolution plans, assessment of resolvability and resolution	Euro area (+ Member States under close cooperation)	Single Resolution Board (SRB) within the SRM for significant credit institutions
Winding up	EU	<i>National administrative or judicial authorities (under national law)</i>
Deposit guarantee	EU	<i>National deposit guarantee schemes</i> European Deposit Insurance Scheme (EDIS) (<i>proposal</i>)
Last resort lending (‘ELA’)	Euro area	<i>National central banks-members of the Eurosystem – under the conditions of Article 14.4 of the Statute of the ESCB and the ECB</i>

4. The conditions for the resolution of credit institutions under Article 32(1) BRRD *and* Article 19 SRMR

Criteria	Case 1	Case 2	Case 3
The credit institution is failing or likely to fail	✓	✓	✓
No reasonable prospect for effective alternative private sector measures or supervisory action	✗	✓	✓
A resolution action is necessary in the public interest	✓	✓	✗
Outcome			
	1. Recapitalisation with the use of private sector funds 2. Potential resort to support measures in the form of ‘precautionary recapitalisation’ (add-on)	1. Resolution 2. Potential use of the SRF’s available financial means 3. Potential use of the GFSTs <i>(only under the BRRD)</i>	1. Winding up under normal insolvency proceedings 2. Activation of DGS to repay covered depositors

5. The ‘failing or likely to fail’ criterion (1/2)

The first condition for resolution consists in that the competent authority (i.e., as the case may be the ECB for significant credit institutions or the national competent authority for less significant ones) determines, after consulting the resolution authority, that the credit institution is ‘failing or likely to fail’.

(1) A credit institution is deemed to be in such a situation upon assessment of *one or several* of the **objective elements** relating to the following areas:

Capital position

(a) It infringes, or there are objective elements to support a determination that it will, in the near future, infringe **own fund requirements** relating to the continuing of its authorisation, in a way that would justify its withdrawal by the competent authority. *This includes, but is not limited to, the fact that the institution has incurred or is likely to incur losses that might deplete the entirety or a significant amount of its own funds*

(b) Its assets are, or there are objective elements to support a determination that they will, in the near future, be less than its liabilities

Liquidity position

It infringes, or there are objective elements to support a determination that it will, in the near future, infringe **regulatory liquidity requirements** for continuing authorisation in a way that would justify its withdrawal by the competent authority

5. The ‘failing or likely to fail’ criterion (2/2)

Other requirements for continuing authorisation

It infringes, or there are objective elements to support a determination that it will, in the near future, infringe **other requirements** of its authorisation, in a way that would justify its withdrawal by the competent authority. For that purpose, the competent and/or the resolution authority should consider:

- governance arrangements, and
- the reliability and operational capacity to provide regulated activities

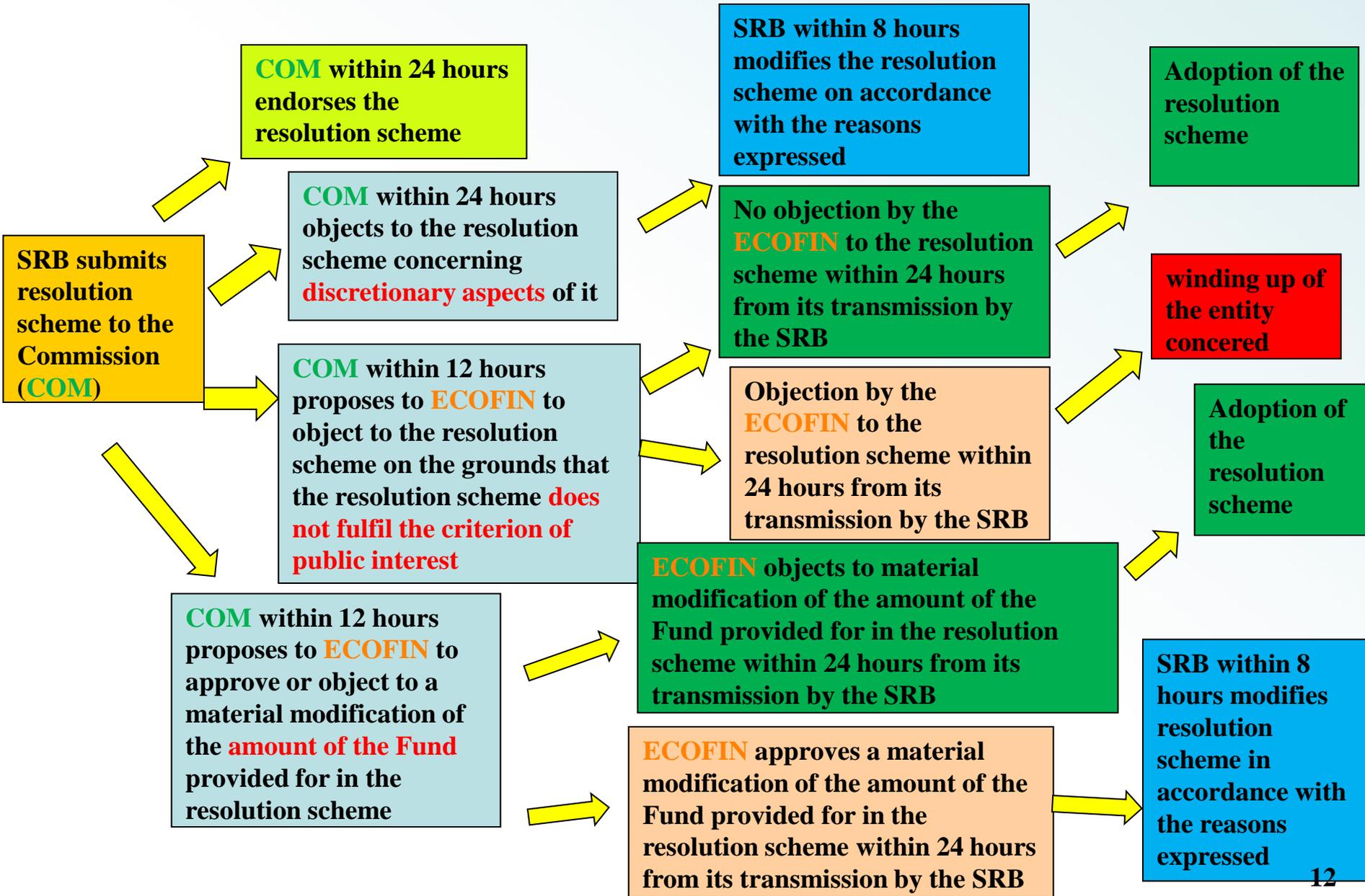
The assessment of the objective elements is usually carried out by the competent authority in the course of the ‘Supervisory Review and Evaluation Process’ (**SREP**), which is performed in accordance with the **“EBA SREP Guidelines (2014)”**

(2) ‘Extraordinary public financial support’ is required, unless that support takes any of the three (3) permissible forms

6. Alternative forms of (permissible) recapitalisation of credit institutions by public funds (bail-out) in the EU

Form	Legal basis	Financial condition
‘Precautionary recapitalisation’	BRRD , Article 32(4)(d)(iii)	Solvent credit institutions
Direct Recapitalisation Instrument (DRI)	DRI Guideline (ESM)	Systemically relevant credit institutions or credit institutions posing a serious threat to financial stability unable to meet regulatory capital requirements
Government financial stabilisation tools (GFSTs)	BRRD , Articles 37(10) and 56-58	Credit institutions ‘failing or likely to fail’ <i>within resolution</i>

7. The process



7. Final considerations

(1) The creation of a European Banking Union (EBU) is an ambitious political initiative, which was tabled at the Euro Area Summit of 29 June 2012, amidst the current fiscal crisis in the euro area, which became manifest in 2010.

(2) The main rationale behind this initiative is summarised in the following sentence of the Summit's Statement: "*We affirm that it is imperative to break the vicious circle between banks and sovereigns.*"

(3) The design of the EBU is **mainly** about correcting 'market failures' in the banking system by 'europeanising' parts of the bank safety net. Apart from its completion, due attention also has to be paid to avoiding:

- 'regulatory failures',
- 'supervisory failures', and
- 'macroeconomic failures' (monetary and fiscal)

(4) *One specific aspect:* is the EU resolution framework appropriate for '**generalised systemic crises**' affecting the entire banking system, or is it designed for 'idiosyncratic' banking failures ?

