European Parliament

# Precautionary recapitalisations: time for a review

**The Bank Recovery and Resolution Directive ("BRRD") provides that banks which benefit from public support may not necessarily be deemed failing or likely to fail, subject to a number of conditions (article 32 BRRD)**. This makes possible the recapitalisation, through State resources, of solvent banks which temporarily lose access to capital markets due to severe market disturbances. For more details on the framework for precautionary recapitalisations, in particular the conditionality and case practice, see EGOV briefing PE 602.084.

**Under article 32 of the BRRD, the Commission was supposed to review, by 31 December 2015, whether the framework for precautionary recapitalisations was still needed**, as well as the conditions attached to such support. Indeed the use of this clause has sometimes been questioned on the ground that the foreseen conditionality may not be fully complied with.

## Prof Olivares Caminal and Prof Russo (*Queen Mary University in London*)

**In their paper the authors argue that there is a "continuing need" for allowing precautionary recapitalisations in the "*present economic juncture*"**, in order to facilitate the restoration of solvent banks' capital positions. They also defend the flexibility granted by article 32.4 BRRD, since it gives room for manoeuvre while the system of political checks and balances at EU level prevents opportunistic behaviours. In particular, the authors explain that the application of two sets of norms (the BRRD and State aid rules) could lead to a too restrictive approach, due to specific State aid requirements regarding burden sharing. However, in their view the framework remains overall flexible enough (in the absence of a clear definition of "*serious disturbance*" and "*financial stability*") to cater for financial stability concerns. While precautionary recapitalisation may be not sufficient or alternatively not necessary under various scenarios, there is no efficient alternative ex ante measure which would make it redundant. In addition, the authors defend that a few clarifications are needed in the legal text, in particular as regards diverging wording in different language versions (a point which was also pointed out by other experts) or the location of clause on precautionary recapitalisation, which should be moved out of article 32 BRRD in their view.

## Prof Martin Hellwig (*Max Planck Institute for Research on Collective Goods*)

**Prof Martin Hellwig also stresses the diverging objectives of State aid rules on the one hand and the BRRD on the other hand**. He argues that precautionary recapitalisations can be useful, in particular for those systemic institutions that have a footprint in multiple jurisdictions, because of the potentially negative impact of resolution procedures on some of their integrated operations. Other concerns

ECONOMIC GOVERNANCE SUPPORT UNIT
Authors: B. Mesnard, A. Margerit, M. Magnus
Directorate-General for Internal Policies
PE 602.100 - August 2017

(maintenance of payment systems and lending, contagion to banks' creditors) can be dealt with under resolution, while the impact of bail-in on banks' funding costs is not valid in the author's view. However, the author identifies a number of weaknesses in the current framework. He first points to the length of State aid procedures, and then reviews the conditionality enshrined in article 32 (4) BRRD. A key issue remains the focus on solvency and its subjective assessment by authorities, resulting in delays and magnified losses for taxpayers. The author also notes some contradictions in the wording of the article, and fears that limits put on the amount of recapitalisation may lead to failed rescues, a point which is also made by Willem-Pieter de Groen in his paper (see below). Then the author deems unrealistic the condition that the recapitalisation should not offset losses that have occurred or are likely to occur in the near future. Finally, he suggests reviewing the conditionality, clarifying the relation between the BRRD and State aid rules, and moving the entire procedure at European level with sufficient resources and appropriate incentives.

# Mr Nicolas Véron (*Bruegel*)

**Nicolas Véron also sees the precautionary recapitalisation as a "*legitimate instrument for bank crisis management*", noting that so far it had not benefited insolvent banks**. The two underlying motivations, ensuring a smooth transition to the new resolution regime and preserving financial stability in exceptional circumstances, remain valid according to him. The author deems the current conditionality appropriate and dismisses any major need to reform the framework, beyond a few clarifications. The analysis of the Greek and Italian cases does not unveil any major flaw in the way the BRRD was implemented, albeit the author notes differences, in particular in the treatment of creditors. Nicolas Véron concludes that "*whenever the case for such transitional flexibility ceases to exist, the desirable policy response should be a tightening of state aid control to remove the applicability of article 107 (3) (b) TFUE*". However, he also suggests further work on the EU audit framework, and recommends the empowerment of the ESM so that it can participate in future precautionary recapitalisations.

# Mr Willem Pieter de Groen (*Centre for European Policy Studies*)

**Mr Willem Pieter de Groen argues that precautionary recapitalisations should target those banks which are undercapitalized but remain solvent, provided the solvency be assessed both on the regulatory and the economic value of the bank**. In his opinion, the current conditionality is too flexible and banks which are de facto insolvent can benefit from precautionary recapitalisations. He thus suggests a stricter selection of eligible banks: an asset quality review would assess the economic value of the balance sheet, while a stress test would assess its long term solvency and whether the capital position is sufficient to finance the optimal level of loan. On the other hand, the eligible banks could receive higher amounts of capital as currently authorized under State aid rules: the author recommends that the amount of capital injected in the bank should be at least equal to the capital shortfall as determined by the supervisor, in order to avoid further rounds of recapitalisation. Finally, the author elaborates on the need to mobilize funds at EU level to finance precautionary recapitalisation, since the fiscal situation at national level may not allow for such measures in times of crisis.

## Disclaimer and Copyright

The content of this document is the sole responsibility of the author and any opinions expressed therein do not necessarily represent the official position of the European Parliament. It is addressed to the Members and staff of the EP for their parliamentary work. Reproduction and translation for non-commercial purposes are authorised, provided the source is acknowledged and the European Parliament is given prior notice and sent a copy.
© European Union, 2017

Contact: egov@europarl.europa.eu

This document is available on the Internet at: www.europarl.europa.eu/supporting-analyses