

# Exchange of views with Mrs Elke König, Chair of the Single Resolution Board

## ECON on 4 December 2017

*This briefing presents selected issues regarding the work of the Single Resolution Board (SRB) in advance of the exchange of views with Mrs Elke König, current Chair of the SRB, and proposed by the Commission for a renewed appointment in the same position, in ECON on 4 December 2017. The briefing covers thematically events since the last hearing, an update on SRB resolution decisions, a risk outlook for the European banking system, and summaries of external expert briefing papers on the issue of “critical functions” in banking services.*

## I. Some events since the last hearing in ECON

### Composition of the board of the SRB

On 29 November 2017, the Commission [proposed](#) to extend Single Resolution Board Chair's term of office.

On 22 August 2017, the SRB [announced](#) the decision of Ms Joanne Kellermann, Board Member and Director of Resolution Planning and Decisions, to leave the SRB, though remaining in office until a successor is appointed.

### SRF contributions

On 19 July 2017, the SRB [announced](#) that it had collected EUR 6.6 billion in **annual contributions** to the Single Resolution Fund (SRF), reaching EUR 17 billion in total, which is roughly 30% of the final target size. The SRF pools the contributions raised at national level from institutions within the SRB's remit in the Banking Union and aims to reach the target level of at least 1% of covered deposits over an eight year period (2016-2023).

On 14 September 2017, the European Commission adopted its proposal for a [Delegated Regulation](#) on the final system of contributions to the **administrative expenditures** of the SRB. The SRB took up full powers on 1 January 2016 and is scaling up its infrastructure and human resources, becoming fully operational. The Delegated Regulation therefore intends to replace the provisional simplified methodology for the contributions with steady rules, inter alia allocating 5% of the administrative expenditures to those banks that are under the responsibility of national resolution authorities.

### Sixth Industry Dialogue

On 21 November 2017, the SRB organised the [sixth Industry Dialogue](#) in Brussels, that brought together representatives from banking federations, National Resolution Authorities, and EU institutions.



SRB board members highlighted in their presentations inter alia the following key issues and messages:

- > As the dermination of impediments to resolvability, the availability of data and adequate **management information systems** turned out to be a key issue (König).
- > As regards resolution plans, the SRB seeks a **complete coverage** of banks within its remit in 2018 (König).
- > As regards new guidance, the SRB seeks to finalise **new guidance** in 2018 on the public interest assessment, the four resolution tools (bail in, bridge institution, sale of business, asset separation), valuation, and funding in resolution (König).
- > As regards MREL, the SRB intends to set **binding targets** for the majority of the largest and most complex banking groups as part of the 2017 resolution planning cycle, and to set informative targets for all other banking groups (Laboureix).
- > As regards its MREL methodology, the SRB explained that in 2017 it may allow for an adjustment of bank-specific recapitalisation amounts if there are credible expectations that the amount of risk weighted assets held would change due to feasible resolution actions. The **default MREL calculation**, unchanged compared to 2016, includes the Loss Absorption Amount (Pillar 1, Pillar 2R, and combined buffers), the Recapitalisation Amount (Pillar 1 and Pillar 2R), and a **Market Confidence Charge** of 125 basis points (Laboureix).
- > The SRB estimated that its 2017 MREL policy (publication expected before end of 2017) will result in an **MREL shortfall** of EUR 117 billion in aggregate, of which EUR 47 billion are to be met with subordinated instruments (Laboureix).
- > To ensure consistency, the SRB developed a new methodology and reporting template in 2017 for the **assessment of critical functions**, including a pre-defined self-assessment step. In the development phase, however, the SRB noted some internal inconsistencies (for example that some banks, whose market share in the lending to households exceeded 10%, did not consider this function to be critical, in contrast to others with smaller market shares). The methodology will hence see further refinement, with benchmarking and peer analyses (Grande).

#### ECB opinion on the revised Union crisis management framework

The proposed amendments to the Union crisis management framework, namely to the Capital Requirements Regulation, Capital Requirements Directive, Single Resolution Mechanism Regulation, and Bank Recovery and Resolution Directive, will have a direct impact on the work of the SRB and its cooperation with other institutions. On 8 November 2017, the ECB published its [opinion](#) on those proposals.

The ECB recommends inter alia:

- > to allow the resolution authority, after consultation with the competent supervisory authority, to adjust the MREL recapitalisation amount upwards to provide for a '**safety margin**' to cover additional unexpected losses and unforeseen costs that may arise in the period after resolution, related for example to the final outcome of a valuation or the implementation of a business reorganisation plan,
- > to eliminate, however, the proposed **market confidence charge**, arguing that it adds complexity to the framework without providing clear benefits,
- > to clarify that resolution authorities have the task of **monitoring compliance with MREL** and informing the competent supervisory authority of any breaches,
- > to introduce a procedure for the allocation of **responsibility for a moratorium tool** to either the competent supervisory or the resolution authority, depending on whether the moratorium is imposed before or after the 'failing or likely to fail' determination, and to limit the maximum period for a moratorium to five working days in total, considering the severe impact of a moratorium on creditors' rights, and to extend the proposed exemptions from the moratorium to financial market infrastructures, including CCPs,
- > and to eliminate the **legal uncertainty** as to which authority is responsible for assessing that a less significant credit institution, under the direct responsibility of the SRB, is **failing** or likely to fail.

## II Update on SRB resolution decisions

### Summary

On 7 June 2017, the SRB took a resolution decision in case of **Banco Popular**, transferring all shares and capital instruments to Banco Santander. The case is summarised in a [previous EGOV briefing](#) published on 28 August 2017.

On 23 June 2017, the SRB decided that in the cases of **Veneto Banca** and **Banca Popolare di Vicenza**, which had been declared to be failing or likely to fail by the ECB on the same day, the conditions for resolution were not met, meaning that both banks had to be wound down under normal insolvency proceedings at national level. The cases are summarised in a [previous EGOV briefing](#) published on 25 July 2017.

### Appeal proceedings

Decisions of the SRB may be challenged before the **Appeal Panel** of the SRB and before the Court of Justice of the European Union.

The Appeal Panel of the SRB consists of five members who shall act independently and in the public interest. On the SRB webpage, there are so far 34 anonymised decisions listed that are related to the resolution of Banco Popular. In all those cases the Appeal Panel **dismissed the appeals**, deciding they were not admissible. There are two more anonymised procedural orders listed in which the Appeal Panel set out that - before ruling in those cases - it needs to examine, under strict confidentiality vis-à-vis the Appellant, the full content of the Valuation Report.

There is little public information available as regards the appeals brought before the **Court of Justice**. On 30 August 2017, the news agency [Reuters reported](#) that investors filed 51 lawsuits at the European Court of Justice against European authorities for their decision to resolve Banco Popular.

### Non-confidential public version of the SRB decisions

In the meantime, the SRB published non-confidential public versions of its resolution decisions:

- > [Decision taken on 7 June 2017 in case of Banco Popular](#)
- > [Decision taken on 23 June 2017 in the case of Veneto Banca](#)
- > [Decision taken on 23 June 2017 in the case of Banca Popolare di Vicenza](#)

All decision contain a section about the public interest for resolving the bank under consideration:

In case of **Banco Popular**, the SRB assessed that the bank **provided critical functions** as regards

- > deposit taking, as the sixth largest banking group in Spain with a granular network of branches and ATMs throughout the national territory,
- > lending to SMEs, with a significant number of client SMEs and individual entrepreneurs (numbers not disclosed),
- > and payment and cash services, providing those services to a broad range of customers (numbers again not disclosed).

In case of **Veneto Banca**, the SRB assessed that the bank **did not provide critical functions** as regards

- > deposit taking, since its low and continuously decreasing market share declined from 1.24% at the end of 2014 to 0.91% at the end of 2016, and since its deposit outflows were completely absorbed by other credit institutions in Italy,
- > lending, since its low and continuously decreasing market share declined from 1.32% at the end of 2014 to 1.15% at the end of 2016, and since there is a high number of competitors with proven experience in lending in the relevant regions (the number of active credit institutions in the core markets was said to range from 25 in Marche to 37 in Veneto),
- > and payment and cash services, taking the market share developments for deposit-taking as a proxy for the declining relevance of the bank with regard to payment and cash services.

In case of **Banca Popolare di Venezia**, the SRB assessed that the bank likewise **did not provide critical functions** as regards

- > deposit taking, since its low and continuously decreasing market share declined from 1.45% at the end of 2014 to 0.9% at the end of 2016, and since its deposit outflows were completely absorbed by other credit institutions in Italy,
- > lending, since its low and continuously decreasing market share declined from 1.54% at the end of 2014 to 1.4% at the end of 2016., and since there is a high number of competitors with proven experience in lending in the relevant regions (the number of active credit institutions in the core markets was said to range from 22 in Friuli Venezia to 37 in Veneto),
- > and payment and cash services, taking the market share developments for deposit-taking as a proxy for the declining relevance of the bank with regard to payment and cash services.

For a further **discussion of critical functions**, also please see the three external expert briefings on this matter as requested by the ECON Committee, which are summarised in section IV.

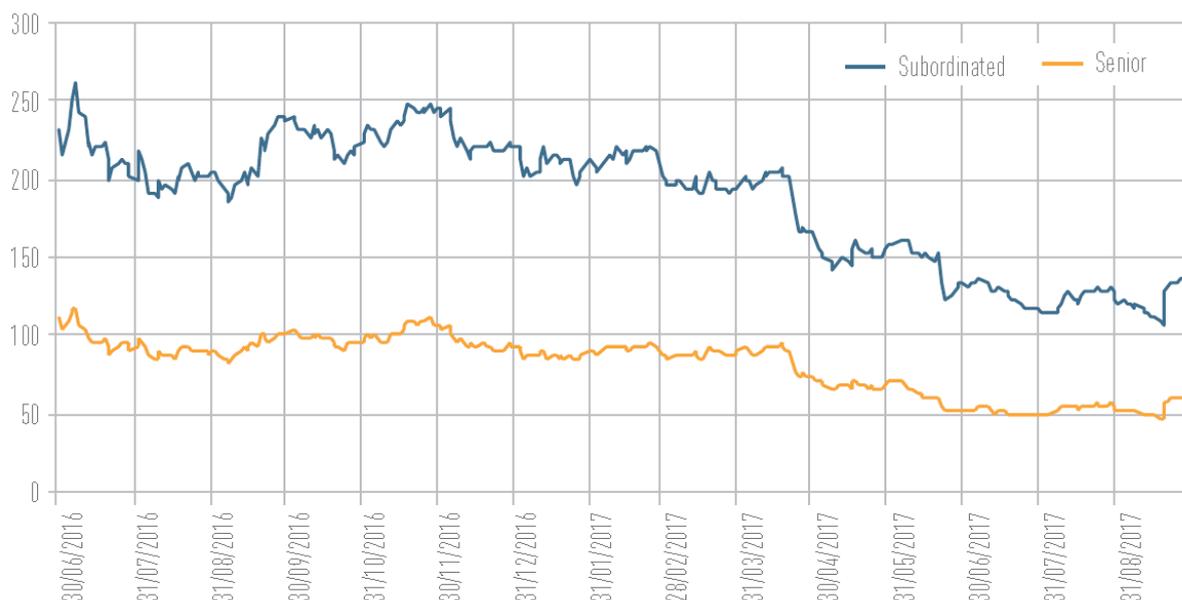
### III Risk outlook for the European banking system

On 24 November, the European Banking Authority (EBA) published its [tenth risk assessment of the European banking system](#). That report on risks and vulnerabilities in the EU banking sector is related to the remit of the SRB, though its focus goes beyond the euro area.

Looking specifically at issues that are relevant from a resolution point of view, the EBA report finds that Banks increasingly **focus their funding strategies on building loss-absorbing capacity**, but that nevertheless most banks still have to issue further MREL eligible instruments to meet BRRD requirements.

To evaluate the situation of the European banking system, EBA has inter alia used a risk assessment questionnaire that was sent to banks (38 responded) and market analysts (21 responded). According to the EBA report, respondents to the risk assessment questionnaire noted that **delays in issuing MREL-eligible instruments** were often associated with **uncertainty on both regulatory policy** (MREL eligibility criteria of instruments in different jurisdictions) **and the authorities' actions** (actual levels of required MREL amounts for each bank), while only few were concerned that there might be insufficient demand for new issuances of MREL-eligible instruments.

**Graph 1: Spreads of senior and subordinated 5 year bonds in Europe**



Source: EBA's tenth risk assessment of the European banking system, figure 33, p. 39 (based on iTraxx/Bloomberg)

The EBA report highlights benign market conditions for refinancing operations, mentioning that the spreads tightened in the first three quarters of 2017. Based on iTraxx/Bloomberg data on securities issuances, EBA finds that both senior unsecured and subordinated debt showed limited spread volatility and narrowing spreads since the beginning of 2017 (see graph 1).

However, concerns about the potential vulnerability to the banks' refinancing capacity persist in case of a sudden rise in the financial markets' volatility. The EBA report hence recommends that supervisors should monitor the ability, in particular of banks with heightened risk perceptions, to issue higher volumes of such instruments going forward at a reasonable cost.

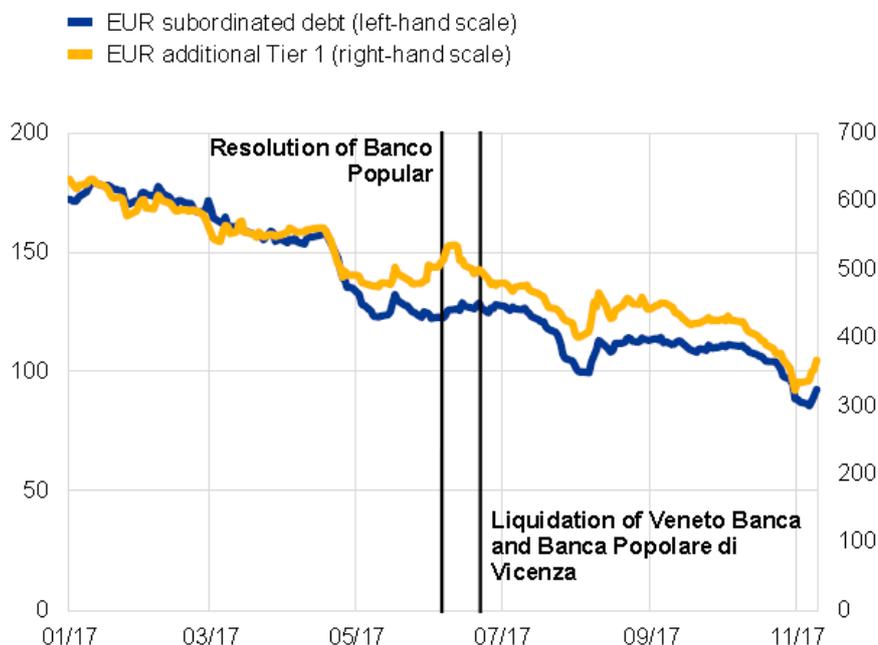
With regard to the average NPL ratio of EU banks, the EBA report shows a positive trend, as NPLs decreased from 5.4 % to 4.5 % between June 2016 and June 2017 reflecting progress made by EU banks to clean up their balance sheets. However, EBA also points out that coverage ratios - i.e. specific allowances for loans to total non-performing loans - still differ considerably across EU countries with values ranging between 26 % and 68 %.

The [Financial Stability Review](#) of the ECB, published on 29 November 2017, which assesses systemic stress indicators for the euro area, likewise points to the fact that market conditions for bank debt instruments have remained favourable, and that spreads on senior unsecured debt and covered bonds have remained at tight levels since mid-2017. Amid strong investor demand, spreads on subordinated debt and additional Tier 1 instruments have tightened further in recent months and, overall, recent bank resolution and liquidation events had a very limited impact on these markets (see graphs 2), although the instruments issued by some specific banks perceived by markets to be vulnerable did register a fall in price, which was only partly reversed afterwards.

**Graph 2: Spreads on additional Tier 1 instruments have tightened in recent months, following the episodes of high volatility in 2016**

**Spreads on euro-denominated subordinated debt and additional Tier 1 instruments**

(Jan. 2017 – Nov. 2017, asset swap spreads in basis points)



Source: ECB's [Financial Stability Review](#), published on 29 November 2017, p. 80

## IV Summary of external briefing papers

On request of ECON coordinators, EGOV commissioned external briefing papers from academic experts on the topic “**The Provision of Critical Functions** at Global, National and Regional Level – is there a need for further legal/regulatory clarification if liquidation is the default option for failing banks?”.

[Silvia Merler](#) points out that under the current EU frameworks for dealing with banking problems, resolution is seen as an exception to be granted only if liquidation under national insolvency proceedings would not be warranted. This is most notably the case when the bank provides critical functions to the economy, or when its liquidation may have sizeable effects on financial stability.

The two options, resolution and liquidation, differ substantially when it comes to the scope of legislation that is applicable to the use of public funds. Resolution is covered by the EU BRRD, liquidation is regulated by national insolvency laws; the use of public funds in resolution would be subject to both BRRD scope and State Aid scope, whereas the use of public funds in liquidation is only subject to the State aid scope, requiring a “light” burden sharing of equity and junior debt.

The liquidation of Veneto Banca S.p.a. and Banca Popolare di Vicenza S.p.a. highlights how this two-tier framework raises some important questions in the context of Banking Union. The first question is whether the definition of critical functions and of “public interest” – key elements in the context of liquidation – should be clarified. A second question is whether the current legal and regulatory situation within the Banking Union ensures that similar banks can expect a predictable equal treatment in case of failure, or whether there may be a need for legal or regulatory clarification or harmonization.

She argues that more clarity would be warranted as to the role that the concepts of critical functions and public interest play in Member States’ decision to grant liquidation aid, as the current situation may give lead to outcomes in which the view of national authorities seems to contradict the SRB’s assessment. The current diversity in national insolvency frameworks is a source of uncertainty about the outcome of a liquidation procedure, for all actors involved.

The fact that insolvency law remains national makes it possible for Member States to amend it compared to the normal insolvency proceedings that constitutes the reference for the SRB’s assessment of the no-creditor-worse-off condition. In particular, to the extent that different governments may have a different propensity to provide liquidation aid to the banking sector, the final outcome is not clear. Absent an EU insolvency law – or at least further harmonisation – this can lead to paradoxical results such as in the Italian case, where senior creditors were eventually better off under insolvency than they would have been under resolution, while taxpayers were worse off. For Banking Union to function effectively, Merler recommends that the framework should be changed so as to provide the same level of certainty in liquidation as there is expected to be in resolution.

[Rosa Lastra, Rodrigo Olivares-Caminal, and Costanza Russo](#) point out that the continuity of critical functions when a bank is facing financial distress is of paramount importance to avoid disruptions to the real economy, to financial stability and to third parties.

A failing bank should be liquidated, however, under certain circumstances it can be resolved. The two procedures are in fact different and may have different consequences on taxpayers, creditors and other stakeholders with liquidation as the default option. However, if a possible liquidation would jeopardise financial stability, interrupt the provision of critical functions and have a negative impact on depositors, then reasons of public interest may dictate the application of resolution tools instead.

Regulatory authorities retain some discretion in the consideration of public interest and critical functions. Even if the latter are defined by EU Law, a lack of consistency in their definition may unnecessarily increase regulatory discretion in the assessment of public interest and level of criticality of some functions.

Specifically, ambiguity may arise from: (1) different legal sources that consider the matter for different purposes; (2) the confusing distinction among business lines; and, (3) a lack of international regulatory convergence.

For instance, in the case of Banca Popolare di Vicenza and Veneto Banca the SRB decided that the failure of these banks was not considered likely to result in significant adverse effects on financial stability considering, particularly, their limited financial and operational interconnection with other financial institutions. The decision was based on the consideration that the functions performed by the two banks were not critical since they were provided to a limited number of third parties and could be replaced in an acceptable manner and within a reasonable timeframe. However, Italian authorities decided that the liquidation procedure would have caused a disruption of the regional economy and have a negative impact on depositors, creditors and other stakeholders and therefore provided public funds to facilitate the liquidation process.

There is also a discretionary element in the determination of public interest as is the case of the definition of critical functions. For instance, concerns have been voiced about the predictability of treatment of failed or failing credit institutions depending upon the Member State whose resolution authority is involved in the choice of resolution tools. The need for equal treatment is of paramount importance in the context of a Banking Union. In this regard, Lastra, Olivares-Caminal, and Russo therefore conclude that there is a need for further regulatory harmonization of what constitutes public interest in the context of liquidation, apart from the continuation of critical functions.

[Willem Pieter De Groen](#) agrees in his assessment of the regulation and its implementation that there is room to sharpen the definition of critical functions and equal application across banks. From his point of view it is, however, questionable whether regulatory intervention is necessary, given the on-going work of authorities at different levels.

De Groen observes that the SRB's four step assessment process, and specifically the current template used for the assessment of the critical functions offers quite some room for flexibility. The first two steps (identifying the functions and collecting data inputs) are quite factual. Nevertheless, these steps also provide some flexibility: Banks are allowed to use best estimates, different accounting standards (IFRS and national GAAP) and not all functions are tightly defined based on supervisory or financial reporting. That might potentially lead to different conclusions about the critical functions across similar entities. Yet, the main potential source of variation in the results is likely to originate from the third and fourth step to assess the impact and supply-side effect as well as a conclusion on the criticality of the function. Those steps are largely based on expert judgement, which leaves potentially ample room for interpretation of the experts filling out the template for the bank that completes the initial assessment and the Internal Resolution Teams that review the assessments.

De Groen acknowledges that the SRB initiated several measures to mitigate the potential flexibility that these expert judgements might cause, checking the internal consistency in the templates and performing a benchmarking exercise across all entities for which the template has been completed. However, according to interviews that De Groen held with experts of the SRB and NRAs, there are currently still substantial differences regarding perceived critical functions, due to differences in the risk perceptions at national level and human resources.

De Groen finally argues that the cases of Banca Popolare di Vicenza and Veneto Banca showed an important inconsistency between the resolution mechanism and the state aid regime. Although the SRB concluded that resolution was not in the public interest, the two Venetian banks eventually received public support from the Italian government for the liquidation to mitigate the effects of the exit from the market. De Groen therefore concludes that legislative intervention would be required to align the objectives of the resolution framework and state aid.

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