BRIEFING

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Banking Union: Towards new arrangements to finance banks under resolution?

The recent case of Banco Popular has shown the importance of liquidity funding in the context of bank resolution. Ahead of the June Euro Summit, in a letter the President of the Euro group noted that in addition to the Single Resolution Fund (and its backstop) "work needs to continue on a possible framework for liquidity in resolution, including on the possible institutional framework". This briefing (1) describes the existing arrangements in the Banking Union, (2) compares those arrangements with the US and the UK regimes and (3) echoes ongoing reflections on possible new arrangements along the lines of the US and UK regimes, with a view to completing the Banking Union.

1. Are existing financing arrangements fit-for-purpose?

The Financial Stability Board's (FSB) guidance published in June 2018 sets out that authorities in charge of resolution planning should inter alia "*identify the temporary public sector backstop mechanisms that could be used by a firm in resolution*", and "*develop exit strategies from temporary public sector backstop funding*". In line with the FSB principles, the Single Resolution Mechanism ('SRM') Regulation has entrusted the Single Resolution Fund ('SRF') with the task of providing liquidity in resolution. While not designated as financing arrangements for resolution under the Bank Recovery and Resolution Directive ('BRRD'), other sources of liquidity exist: Emergency Liquidity Assistance ('ELA') provided by national central banks and State Aid support authorised by Commission, where appropriate. While the SRF has not been used so far, recent cases involved ELA and State Aid Support. The resolution of Banco Popular has particularly questioned whether existing financing arrangements are sufficiently robust to finance banks under resolution.

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Emergency Liquidity Assistance

The provision of ELA by Eurosystem national central banks is governed by the 2017 Agreement on emergency liquidity assistance (For a general presentation of the rationale of ELA, see EGOV briefing). Under that agreement, Eurosystem national central banks may provide central bank money to banks facing liquidity problems against collateral that is of lesser quality than the collateral eligible under the single monetary policy framework, in return charging a penalty interest rate. Any costs arising from the provision of ELA are incurred only by the NCB concerned (or by a third party acting as a guarantor). Risks are hence not shared across Eurosystem central banks. Provision of ELA amounts to a crisis prevention tool that fall within the remits of national central banks as part of their mandate to ensure financial stability. This 'crisis prevention' role is fully recognised in the SRM Regulation which explains that the "*need for emergency liquidity assistance is not a condition that sufficiently demonstrates that a [bank] is, or is likely in the near future to be, unable to pay its liabilities as they fall due*"[1]; and therefore does not need to be placed under resolution.

The 2017 Agreement puts strict limits to the provision of ELA:

- Banks have to be solvent, even though they might be in breach of minimum capital requirements: The 2017 ELA Agreement has defined under which conditions banks can be considered as solvent: (i) banks shall meet their Pillar 1 ratios (Common Equity Tier 1 of 4,5%, Tier 1 of 6% and Total Capital Ratio of 8%) or (ii) there is 'credible prospect of recapitalisation' within 24 weeks (i.e. 6 months)[2];
- ELA cannot, however, be provided to "*insolvent institutions and institutions for which insolvency proceedings have been initiated according to national laws*";
- Banks shall have 'sufficient collateral' against which ELA is provided. Definition of what 'sufficient collateral' means is determined by each national central banks absent a harmonised framework.

Yves Mersch, Member of the Executive Board of the ECB, pointed to a further development of those criteria in a speech held in January 2018: "*We will probably change these indicators in the future in order to take account of forward-looking elements, in line with the evolution of supervisory practices, so as to have a more accurate picture about the solvency of the bank and the appropriateness of continuing to provide ELA, and in view of the fact that FOLTF [Failing-or-likely-to-fail] means a handover to resolution authorities*".

In addition, ELA may be subject to State Aid under certain conditions (See section below on "Liquidity support under State aid rules").

While limited and circumscribed, the provision of ELA seems possible under the 2017 Agreement not only for pre-resolution as a crisis prevention tool, but also during a resolution under specific circumstances: i) there has to be a 'credible prospect of recapitalisation' (which is the very objective of resolution); ii) banks need to have 'sufficient' collateral; iii) insolvency proceeding shall not have been initiated according to national laws. Those conditions are restrictive and only met in specific resolution scenarios. A "credible prospect of recapitalisation" seems plausible if a bank can either count on a recapitalisation from private sources, or if its capitalisation levels can be restored via bail-

[1] See Recital 57 of the SRM Regulation. Nevertheless, resolution planning should not assume that central-bank liquidity will fill the gaps.

[2] 24 weeks after the end of the reference quarter of the data that showed that the bank does not comply with harmonised regulatory minimum standards. In duly justified, exceptional cases the Governing Council may decide to prolong the grace period of 24 weeks.

in; the latter option, however, is only available if the Single Resolution Board (SRB) finds that there is public interest in taking action. Conversely, if an undercapitalised bank has no access to private capital, and if its resolution (bail-in) is not necessary in the public interest, it would not have access to ELA either. Even banks whose resolution is in the public interest may be blocked from using ELA in the event that the resolution tool chosen (e.g. in the case of asset transfers) involves the opening of insolvency procedures.

Against this background, ELA cannot be considered as a 'generally available' source of resolution financing that the SRB may avail of or count on when resolving a bank. ELA does not seem to lend itself to resolution financing for the following reasons:

- Use of ELA is contingent on restrictive conditions being met (See above);
- Use of ELA depends on national central banks' willingness to provide liquidity, and potentially incurs costs at national level. As illustrated in the Banco Popular case (See separate EGOV briefing), haircuts imposed by national central banks to have access to central banks' liquidity may significantly impact the provision of ELA[3]. In contrast, ABLV was reported to have sufficient collateral and to have received ELA before being 'self-liquidated' (See EGOV briefing on the self-liquidation of ABLV);
- ELA in general does not provide for a mechanism to recoup potential losses from the banking industry, which is required under the FSB principles;
- To grant ELA is a decision that has to be taken by national central banks, while the monitoring of the banks' financial standing - at least for the most significant banks in the Banking Union - is allocated to the European level. A lack of information can hence lead to incorrect ELA decisions (that typically have to be taken within very short time) before resolution; and
- If a significant bank has finally to be resolved, that resolution decision is taken at European level, while the resolution funding via ELA would again fall to the national level.

Single Resolution Fund (and its ESM backstop)

The SRF has been established for the purpose of both (i) absorbing losses and compensating creditors and (ii) providing liquidity in resolution. In the latter case, the SRF may guarantee the assets or the liabilities of the institution under resolution, its subsidiaries, a bridge institution or an asset management vehicle, and make loans to the institution under resolution, its subsidiaries, a bridge institution or an asset management vehicle. The SRM regulation does not specify whether and under which conditions liquidity support needs to be backed by collateral. Collateral arrangements may have to be further worked out by the SRM[4].

[3] Before being declared 'failing or likely to fail' on 6 June 2017, Banco Popular requested EUR 2.0 bn of Emergency Liquidity Assistance on 5 June 2017, according to the financial press, and another EUR 1.6 bn of ELA according to the financial press on 6 June 2017, and then fell short of eligible collateral. It is reported in the Spanish press that the bank deposited in total about EUR 40 billion in collateral but could only withdraw EUR 3.5 billion in cash. Contradicting rumours were reported in the Spanish press on this issue, some claiming the ECB had imposed haircuts of up to 90% on the eligible collateral, others claiming that the bank had not presented all its eligible collateral.

[4] Recital 33 of the SRM Regulation notes in that respect that "Where liquidity support involves no or significantly less risk than other forms of support, in particular in the case of a short-term, one-off extension of credit to solvent institutions against adequate collateral of high quality, it is justified to give such a form of support a lower weight of only 0,5 [to determine the threshold governing decision making procedures to avoid first-mover advantages]".

The agreement reached at the Eurogroup in June 2018 on the "backstop" to the SRF keeps the amount that the ESM may use for resolution globally unchanged (See Table 1). The ESM already reserves a maximum of EUR 60bn to its Direct Recapitalisation Instrument ('DRI')[5]. Since the backstop would replace the DRI and should not be bigger than the size[6] of the SRF, the ESM envelop for resolution is kept by and large the same. Its focus has nevertheless been moved from solvency support ('recapitalisation') under the DRI to the provision of both liquidity and 'loss absorption' by the SRF.

With respect to the **size of this backstop**, the Chair of the SRB took the view in an interview delivered to the German press in June 2018 that "*she can live*" with a backstop of 60bn that will double the size of the SRF. At the same time, reflecting on the Banco Popular case, the SRB questioned whether the SRF could provide enough financing means to address liquidity shortfalls. It was stressed that Santander provided more liquidity than the SRF could have done[7], highlighting the need to find a solution when a buyer cannot immediately be found. While acknowledging that the "SRF can play a role [in resolution financing], in particular if a back stop is in place, Elke König noted in a conference in April 2018 that "this will always be too little for any systemic bank". Liquidity financing was not seen as "*the wisest use*" of the Single Resolution Fund in that respect.

Table 1: "Landing zone on the common backstop to the SRF" (Annex to the Eurogroup letter)

General characteristics	• The ESM will provide the common backstop, in the form of a revolving credit line • The size of the credit line will be aligned with the target level of the SRF • The Direct Recapitalisation Instrument be should be replaced by the common backstop • No country should be excluded from accessing the backstop
Modalities	• Fiscal neutrality • Maturities: 3 years+ possible 2 years extension • Equivalent treatment would be ensured with non-euro area Member States participating in the Banking Union, via parallel credit lines to the SRF
Decision making arrangements	• ESM BoD could take decisions on the use of the common backstop, arrangements with procedures in place for swift and efficient decision making whilst respecting national constitutional requirements • Option to be developed further in second half of 2018
Early introduction	• Common Backstop would enter into force ahead of 2024 if sufficient progress is achieved in risk reduction measures • Technical work, including on a possible revision of the IGA, to continue in the second half of 2018

The potential liquidity outflows from a mid-sized bank (let alone a European G-SIB) is likely to easily outstrip the SRF's ultimate size of 120bn. By way of example, liquidity support needed to restructure

[5] DRI has been introduced in December 2014 further to an agreement on its main features reached in June 2013, ahead of the Council general approach on the Bank Recovery and Resolution Directive (BRRD) which laid down conditions for its use. DRI may be used in very specific circumstances as a last resort instrument when all other instruments, including bail-in, have been applied and after the SRF has been used. The total amount of ESM resources available for the new instrument is limited to EUR60 billion.

[6] The size of the SRF amounts to 1% of the covered deposits which has been initially estimated at 55bn and recently re-assessed at 60bn according to the SRB

[7] The financial means of the SRF are capped to the sum of the ex-ante contributions and ex-post contributions that the SRF may raise (ex post contributions shall not exceed per year three times the annual amount of ex ante contributions). When those financial means are not available, the SRB may resort to "alternative funding means" (e.g borrowing from financial institutions).

the banking group Hypo Real Estate amounted to EUR 145 billion (restructuring plan approved by Commission for HRE). In that respect, in a paper commissioned by the ECON Committee, A. Lehmann argued that *"potentially larger backstop would reassure markets and make the ultimate use of a guarantee less likely, and could thereby secure the success of the resolution and the institution that emerges"*.

Liquidity support under State aid rules

The 2013 Banking Communication clarifies under which conditions liquidity aid is considered State aid, which has to be authorized and comes with consequences, and under which conditions ELA is not considered State aid.

In 2017, for example, two Italian banks - Banca Popolare di Vicenza and Veneto Banca - received State aid for the financing of their liquidation mass. Those cases were assessed based on the 2013 Banking Communication and approved on grounds that those banks were to be subject to orderly wind down, and that shareholders and subordinated debt holders had fully contributed to the associated costs of the liquidation procedure (for more details please see a previous EGOV briefing and the Commission's press release).

Liquidity support does not fall under State aid rules if it is raised on the market (unless with a State guarantee) or from other **private sources**.

If liquidity support is provided by **central banks** as part of their ordinary activities - namely in form of ELA - that will not fall within the scope of the State aid rules if all conditions of the Banking communication are met (see box 1).

The exemption of ELA from State aid rules is based in particular on the assumption that a bank is only temporarily illiquid but otherwise **solvent at the moment of the liquidity provision**. It seems up for debate how to square that understanding of solvency ('point-in-time' assessment) with that of the ECB ('forward looking' assessment), as the 2017 Agreement considers undercapitalised banks with a 'credible prospect of recapitalisation' to be solvent as well.

Box 1: State aid rules regarding Emergency Liquidity Aid

The **ordinary activities of central banks** related to monetary policy, such as open market operations and standing facilities, **do not fall within the scope of the State aid rules**.

Dedicated support to a specific credit institution (commonly referred to as 'emergency liquidity assistance') **may constitute State Aid unless** the following cumulative conditions are met:

a) the credit institution is **temporarily illiquid but solvent** at the moment of the liquidity provision which occurs in exceptional circumstances and is not part of a larger aid package;
b) the facility is **fully secured by collateral** to which appropriate haircuts are applied, in function of its quality and market value;
c) the central bank charges a **penal interest rate** to the beneficiary;
d) the measure is taken at the **central bank's own initiative**, and in particular is not backed by any counter-guarantee of the State.

(Note: authors' own emphasis added)

Source: 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')

If, however, liquidity support is provided from **public sources** by a Member State, the usual State aid procedures apply, meaning the aid has to be approved based on a restructuring plan that sets out how the bank will restore its viability, whether the bank and its capital holders contribute to the restructuring as much as possible with their own resources etc.

Such support is not specifically referred to in the BRRD[8]. Under the BRRD and the SRM Regulation, liquidity support under State aid is governed by the legislation as a tool to prevent 'resolution' in case of a systemic crisis[9]. Liquidity support should be predicated on the need to remedy a serious disturbance in the economy of a Member State and preserve financial stability. Provision of State Aid is not ruled out under the SRM which provides for a specific decision making process when resolution actions involve State Aid (See Article 19 of the SRM Regulation).

In terms of magnitude of possible liquidity needs in resolution, it must be noted that liquidity support in form of guarantees - as opposed to solvency support - has been the form of State aid with the highest financial volume during the financial crisis. According to Commission, EU countries provided EUR 671 billion in capital and repayable loans, as opposed to EUR 1.288 billion in guarantees from 2007 to 2015.

Liquidity support from public funds - qualifying as State Aid - is of course at odds with the very objective of the Banking Union, namely disconnecting sovereign support and banking risks. For that reason, Elke König, Chair of the SRB ruled out in a conference in April 2017 Member States' guarantees as a way to provide liquidity to a bank short of collateral. Assets guaranteed by Member States, once sold to other banks, are indeed eligible as collateral to the ECB according to Yves Mersch speaking at the same conference.

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8 Article 56 of BRRD allows Member States to provide financial support through additional financial stabilisation tool in accordance with the Union's State aid framework, but those tools are limited to public equity support and temporary public ownership. Nevertheless, Article 56(4)(d) specifies that government stabilisation toll may be used where "extraordinary liquidity assistance from the central and has previously been given to the institution" and "the competent ministry or government and the resolution authority determine that the application of the resolution tools would not suffice to protect the public interest". Those government financial stabilisation tools have not been included in the SRM Regulation for Banking Union Member States.

9 In accordance with Article 32(4)(d) of BRRD, an institution shall be deemed failing or likely to fail where extraordinary public financial support is required except when it takes the form of a "State guarantee to back liquidity facilities provided by central banks according to the central banks' conditions" or a 'State guarantee of newly issued liabilities".

2. How do Banking Union arrangements work compared to the UK and the US regimes?

In keeping with the FSB principles for effective resolution (See box 2, in particular point 6.3), the US and UK have equipped their resolution toolkit with a special facility intended to provide funding to banks under resolution where short-term liquidity from the private sector is not immediately available. At the April ECON hearing, Vitor Constâncio called for a similar regime to be introduced in the Eurozone.

The UK Regime

Bank of England's objective is to provide liquidity "in the necessary scale" and "for a sufficient period of time" to allow the firm to make the transition to market-based funding. The government has sole responsibility for authorising liquidity support via the resolution liquidity framework. Losses incurred by the Bank of England or the Treasury in connection with the Resolution Liquidity Framework has to be recovered from industry in line with FSB principles (See box 2) and requirements in the Bank Recovery and Resolution Directive (BRRD).

The UK resolution regime provides a continuum of financing arrangements to banks under resolution:

- First, a bank in resolution has access to the Bank of England published standing facilities, as set out in the Sterling Monetary Framework, subject to meeting the necessary eligibility criteria;
- Second, the Resolution Liquidity Framework ('RLF') - described by the Bank of England as a "flexible" tool supplementing the Sterling Monetary Framework. The RLF may be secured against a wide range of collateral, building on the collateral eligible in Sterling Monetary Framework operations. The terms, costs and conditions of liquidity support are designed according to the Bank of England "*in a way to support the effectiveness of the resolution regime, incentivise the transition of the firm back to market-based funding, and protect public money*".

In the UK, both ELA and Resolution Liquidity Framework are authorised by the Treasury. ELA is available to firms that are at risk but are judged to be solvent while liquidity support via the Resolution Liquidity Framework (RLF) is provided to a firm placed under resolution by the Bank of England. Coordination is addressed in a MoU between the Bank of England and the Treasury on resolution planning and financial crisis management.

Box 2: FSB Key Attributes for Effective Resolution regarding the funding of firms in resolution

6.1. Jurisdictions should have statutory or other policies in place so that authorities are not constrained to rely on public ownership or bail-out funds as a means of resolving firms.

6.2. Where temporary sources of funding to maintain essential functions are needed to accomplish orderly resolution, the resolution authority or authority extending the temporary funding should make provision to recover any losses incurred (i) from shareholders and unsecured creditors subject to the "no creditor worse off than in liquidation" safeguard ; or (ii) if necessary, from the financial system more widely.

6.3. Jurisdictions should have in place privately-financed deposit insurance or resolution funds, **or a funding mechanism with ex post recovery from the industry of the costs of providing temporary financing to facilitate the resolution of the firm**.

6.4. Any provision by the authorities of temporary funding should be subject to strict conditions that minimise the risk of moral hazard, and should include the following: a determination that the provision of temporary funding is necessary to foster financial stability and will permit implementation of a resolution option that is best able to achieve the objectives of an orderly resolution, and that private sources of funding have been exhausted or cannot achieve these objectives; and the allocation of losses to equity holders and residual costs, as appropriate, to unsecured and uninsured creditors and the industry through ex-post assessments, insurance premium or other mechanisms.

6.5 As a last resort and for the overarching purpose of maintaining financial stability, some countries may decide to have a power to place the firm under temporary public ownership and control in order to continue critical operations, while seeking to arrange a permanent solution such as a sale or merger with a commercial private sector purchaser. Where countries do equip themselves with such powers, they should make provision to recover any losses incurred by the state from unsecured creditors or, if necessary, the financial system more widely.

The US Regime

The Dodd-Frank Act established an Orderly Liquidation Fund (OLF) at the US Treasury. OLF is a liquidity facility that the FDIC may draw upon - subject to terms set by Treasury that needs to approve each advance of funds to the FDIC - to lend to the financial company that is being resolved ('in receivership').

In practical terms, the facility takes the form of obligations issued by the FDIC[10] and may be provided when the following conditions are met:

- Private-sector liquidity is unavailable;
- The FDIC must submit an orderly liquidation plan and a mandatory repayment plan, which must be approved by the Treasury;

This facility is limited and should be strictly commensurate to the size of the bank and its value in order for the Treasury to secure repayment of the funds[11].

[10] The US Treasury describes the facility as follows: "*the FDIC issues obligations to Treasury, the proceeds of which are deposited into the OLF, and the FDIC can use the proceeds to make OLF loans to the bridge company. In addition, the FDIC may issue loan guarantees to facilitate private sector lending to the bridge company*".

[11] The OLF cannot provide any amount greater than 10 percent of the assets of the bank until the Secretary and FDIC have agreed on a plan and schedule for repayment. Once the FDIC has completed a fair value estimate of the total consolidated assets of the bank, advances under the OLF are limited to 90 percent of the amount of such value.

OLF is currently being reviewed in the US to further limit the use of the liquidity facility and better protect taxpayer money. In a report dated February 2018, the US Treasury suggests to better frame the use of OLF to eliminate any risk of unrecovered OLF loans as follows:

- Loan guarantees of private funding should be preferred over direct lending.
- The FDIC should only lend funds or provide loan guarantees if it charges an interest rate or guarantee fee set at a significant premium;
- Lending - where loan guarantees are not possible - should be secured by "high level quality asset" and limited in time;

Table 2 - Funding of failing banks

	USA	UK	Eurozone		
Who?	FDIC	Bank of England	National Central Bank	SRF	Member State
What?	OLF	ELA Resolution Liquidity Framework	ELA	Liquidity support	Guarantees/ Loans
When?	In resolution	In resolution	Before and in resolution (the latter only in very specific situations)	In resolution	Systemic crisis and/or when agreed upon by Commission under State aid rules
How much?	Limitations commensurate with banks' balance sheet	No limitation, but need for collateral	No limitation, but need for collateral	60 bn (SRF) for both capital and liquidity support	not specified
State aid rules	n.a.	Subject to EU State aid rules	Subject to EU State aid rules	Subject to EU State aid rules	Subject to EU State aid rules
Backstop	Federal budget	National budget	National budget	60bn ESM	National budget

Source: EGOV

The Eurozone framework

The Banking Union framework has been qualified by Elke König as "*being geared towards addressing solvency issues more than liquidity*" (see April 2018 conference). The following example was taken: should a bank that is short of sufficient collateral be resolved on a Friday, bail-in would not provide on Monday additional collateral that would allow the bank to have access to central bank money. That is why Elke König sees a need for central banks to step in and to provide liquidity in resolution. In the same vein, at the ECON April hearing, Vitor Constâncio explained that the ECB needs a way to finance failing banks while they are being resolved, quoting the British and U.S. models as possible examples: "*The UK and U.S. have [...] a solid, whole process of resolution that includes those liquidity problems during that period of time, and I hope that Europe will get to some solution to this problem*".

Unlike the UK and U.S. regimes, financing in resolution in the Banking Union is provided by different bodies, which may raise coordination challenges, as different sources of liquidity (ELA, SRF and State support) may be available depending on the circumstances of each case and the availability of the SRF fund (and its backstop).

While the funding provided by the SRF is capped by the size of the SRF, its backstop and the amount of ex post contributions that the SRF may raise, liquidity in resolution in the UK is designed to be provided "in the necessary scale".

3. Towards new arrangements in the Banking Union?

Further to the resolution of Banco Popular (See EGOV Briefing), a debate has emerged as to whether an additional liquidity facility provided by the ECB should be available to finance banks in resolution. This debate is closely linked to the centralisation of ELA provision at the ECB.

A new Euro-system Resolution Liquidity Facility?

According to the financial press, the ECB is discussing internally a new instrument for granting Eurosystem Resolution Liquidity ('ERL'): That instrument is construed as a monetary policy tool since the ECB is prevented by law from financing actions that should be undertaken by public authorities. In that context, Yves Mersch, recently pointed to the limits of central bank financing in a speech[12] and in particular reiterated that providing liquidity to a bank that is in the process of being resolved is a task for the Single Resolution Fund, not for central banks.

Rules governing the provision of Eurosystem Resolution Liquidity that are being discussed include the following:

- The bank has been declared "failing or likely to fail" and the resolution scheme has been adopted by the SRB. Benoit Coeuré, Member of the ECB executive board further explained that the bank should be "*financially sound so if we know that the outcome of the resolution will be liquidation then of course we shouldn't provide central bank liquidity*";
- The bank is formally still eligible as counterparty for Eurosystem[13] monetary policy operations;
- The Eurosystem should benefit from a public-sector guarantee at European level covering the amount of liquidity provided to the bank via ERL;
- The Eurosystem should receive a remuneration set equal to the rate of the marginal lending facility as a minimum and could demand a mark-up.

According to the financial press, "*funding under ERL would require public backing because the requirements for the collateral that banks provide would be weaker than for the ECB's regular operations.*

[12] See speech held by Yves Mersch at the Goethe Universität Frankfurt on 30 January 2018 on "The limits of central bank financing in resolution".

[13] As explained in Yves Meersch's speech, "counterparties to Eurosystem credit operations must fulfil certain eligibility criteria. In essence, an entity must not only be a licensed credit institution or a branch but also needs to be financially sound".

The collateral demand could even be dropped entirely and replaced by the euro-area guarantee in "exceptional circumstances".

Consideration is being given as to whether the public-sector guarantee backing a Liquidity Resolution Framework should be provided by the ESM. It its letter to the President of the Euro Summit, the President of the Euro group noted that "*work needs to continue on a possible framework for liquidity in resolution, including on the possible institutional framework*". Likewise, the French German Meseberg declaration of 19 June 2018 includes under the heading 'ESM' "*further work on an appropriate framework for liquidity support on resolution*". Working papers discussed at the Eurogroup have not been made public.

The backstop cannot be provided by the ECB since this would violate key principles underpinning the ECB institutional and monetary framework, as explained by Yves Mersch at a conference in April 2018. These principles are the following: (i) independence of central banks; (ii) monetary financing (financing resolution comes down to financing a public deficit); (iii) the ECB can only operate according to a functioning market economy. It was noted that the Bank of England is not subject to the same level of constraints in terms of independence and benefit from a standing guarantee from the UK Treasury when providing its Resolution Liquidity.

A new facility would raise critical questions as to how institutional arrangements need to be changed to best articulate both the provision of ELA - which is provided at national level - and the SRF with a new liquidity facility. Those questions would include the following:

- Should the SRF be limited to its 'loss absorption' function as opposed to liquidity financing, if a new 'Eurosystem Resolution Liquidity' is established? During a conference organised in April 2018, Elke König was wondering whether financing in resolution was the best use of the SRF;
- Should the provision of ELA be centralised so that the ECB may best articulate ELA and ERL (See below)?
- Which risk sharing, if any, between Member States (that currently provide the back stop to national central bank providing ELA) may be suitable, and should there be a 'European' backstop?
- Would the funds provided (potential losses stemming from) by a new Resolution Liquidity facility be recouped from the industry? The FSB Key principles make it clear that the authority extending the temporary funding should make provision to recover any losses incurred from the financial system more widely.
- What would be the treatment under State aid rules of this new facility? It must be noted that under BRRD Article 2(1)(28), support at supra-national level is treated equally to national support.

To best coordinate the different sources of liquidity, some have proposed both the centralisation of ELA at the ECB and the provision of liquidity for resolution by the ECB. In a recent private sector paper (BBVA research), it is suggested that the SRF would provide guarantees to be considered as appropriate collateral either to the bank directly or to the ECB. The ESM will act as a public backstop to the SRF when the latter runs out of funds.

A centralisation of ELA?

At present the responsibility for the provision of ELA primarily lies with the national central banks. Some have argued that the ECB should have more competencies for the provisioning of ELA at least with regard to those banks that are directly supervised by the ECB and that such step would be necessary to complete the Banking Union[14], not least because banking groups with significant operations outside their home country may find it difficult to get access to ELA[15], if required.

Should a Eurosystem Resolution Liquidity be established, a centralisation of ELA may help to best coordinate the provision of liquidity. There have been two recent cases of significant banks in the euro area that were put in resolution because they ran out of liquidity, even though both banks – ABLV Bank in Latvia and Banco Popular in Spain – reportedly received some amounts of ELA before the ECB finally decided that the banks were "failing or likely to fail"[16] due to the significant deterioration of their liquidity position. Since ELA shall actually prevent that a bank has to be resolved due to only a temporary liquidity shortage in the first place, the ECB might in future still have to play a more prominent role than now.

Asked about the ABLV case in the ECON monetary dialogue hearing of 26 February 2018, Mario Draghi, the President ECB, clearly called for a change of the existing ELA rules in the Eurosystem, saying that "*I personally have argued several times toward a centralization of ELA. This is a remnant of a past time*", conceding that a change would require the agreement of all the members of the ECB's Governing Council.

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14 See C. Gortsos: "Last resort lending to solvent credit institutions in the Euro area before and after the establishment of the Single Supervisory Mechanism (SSM)", published in the document "ECB Legal Conference 2015: From Monetary Union to Banking Union, on the way to Capital Markets Union: New opportunities for European integration, December 2015", p. 67

15 Ioannis Glinavos reports in his blog "Challenging Emergency Liquidity Assistance - Decisions in International Tribunals", published on 1 July 2016, about an appeal at the International Centre for Settlement of Investment Disputes by the Cyprus Popular Bank Group, which operated under the name Laiki Bank. Laiki Bank had significant banking activities in Greece, and argues in its appeal against Greece that in 2012 it was not given equal treatment by the Central Bank of Greece, which refused the group access to ELA for its Greek banking operations. Lainki Bank than had to turn to the Central Bank of Cyprus, and was later on wound down.

16 See the ECB's press release on ABLV Bank of 24 February 2018, and the ECB's press release on Banco Popular of 7 June 2017. However, though the financial press reports that ABLV Bank and Banco Popular received ELA (for many see the Reuters article of 12 June 2017 and the Reuters article of 23 February 2018), that information is neither disclosed in the press releases of the ECB nor those by the national authorities in charge, the Latvian Financial and Capital Market Commission and the Spanish Central Bank.