

# Public hearing with Elke König, Chair of the Single Resolution Board

ECON on 05 May 2020

*This note is prepared in view of an extraordinary public hearing with the Chair of the Single Resolution Board (SRB), Elke König, which will take place on 5 April 2020. The aim of the meeting is to discuss the impact of the corona crisis.*

*The briefing addresses (1) the status-quo of ex-ante contributions to the Single Resolution Fund, (2) operation relief measures in view of the COVID-19 outbreak, (3) the proposal for a centralised administrative liquidation tool, (4) ring-fencing risks, and (5) the recent “no compensation” decision in case of Banco Popular.*



## 1. Single Resolution Fund - Status quo

The Single Resolution Fund (SRF), established in 2014 ([Regulation \(EU\) No 806/2014](#)), shall reach its target level of at least 1% of the covered deposits by the end of 2023 (approximately €60 billion).

The SRF currently totals just under €33 billion, which marks the status quo after the [last cycle](#) of national contributions in 2019.

### Exhibit 1: Ex-ante contributions cycle for the SRF



Source: [SRB](#).



The next transfer of ex-ante contributions is expected in June 2020 (contributions are annually raised via the national resolution authorities (NRAs); banks need to provide the required data input until the end of January and are informed about their contributions in May, see exhibit 1).

There is currently no information on the [related SRB website](#) that the ex-ante contribution cycle to SRF for 2020 would have been postponed.

A ballpark estimate about the size of the 2020 ex-ante contributions can be found in the SRB's [Work Programme 2020](#) (p. 23): "A key priority in 2020 will be the collection of the amounts from the 2020 ex-ante contributions cycle, which are estimated to amount to approximately EUR 8 billion after deductions."

In July 2020, the SRF should hence reach approximately €41 billion, or 2/3 of its target size.

In the context of the corona crisis, the pending contributions to the SRF might still become subject to controversy:

The [press statement](#) of the German banking federation, for example, recently welcomed the Commission's corona-related Banking Package to facilitate bank lending ("CRR quick fix"), at the same time expressing disappointment about the fact that there was no indication about a postponement of the 2020 ex-ante SRF contributions, arguing such postponement would not cause any damage, as contribution gaps could later on be made up for.

The recent flow of credit rating agencies' downgrades, on the another hand, signals growing vulnerabilities in the markets, indicating a rising probability that the SRF may have to be used, in which case it does not seem wise to leave it short of funds.

The credit rating agency Moody's published on 20 April 2020 its [outlook for banking systems](#), stating that the effects of the coronavirus-related disruption of economic activity and operating conditions prompted a wide reassessment. From 17 March through 17 April, Moody's updated in total 54 banking system outlooks, of which 13 concern national banking systems within the Banking Union. Ten of those outlooks changed to negative, one was maintained at negative (DE), and two outlooks were maintained at stable (AT, IE). Overall, though, Moody's found that banks' capital and funding remain adequate across most systems.

In the past, there have been concerns that the SRF may not be large enough, even if fully stocked, its target size has been criticised as being at the lower end of estimated potential needs (see for example [De Groen and Gros 2015](#)). The Eurogroup discussed and agreed in December 2018 to have the European Stability Mechanism acting as a Euro Area wide backstop to the SRF. Nevertheless, the credit line underpinning such safety net is still being discussed on the basis of a draft [Guideline](#) approved in December 2019<sup>1</sup>.

Against that backdrop, Timo Löyttyniemi, at that time Vice Chair of the SRB in charge of the SRF, pointed to the relevance of a [backstop](#): "Market confidence in a time of crisis is key. For credibility, the existence of a Backstop to the SRF is crucial, in particular for situations where the SRF might not be able to provide sufficient funds or those financial means are not readily available". However, the Common backstop that Member States in principle agreed on in 2018 – to be provided by the ESM, available only as a last resort and to be repaid by the Banking Sector in case of use – will only become operational at the end of the transitional period, i.e. the end 2023, replacing the current system of non-mutualised arrangements by which each Member State provides a national individual credit line to the SRB to back its national compartment following resolution cases. Pablo Hernández de

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<sup>1</sup> For additional information on the European Stability Mechanism as a backstop to the SRF see [specific EGOV briefing](#).

Cos, Governor of the Bank of Spain, hence recently [recommended](#): “Member States should summon up the political resolve to bring forward the full mutualisation of the SRF, duly reinforced by the ESM as the common backstop. This is an essential step that would ensure that the SRM/SRF is fully operational.”

The SRB may in any case legally use the SRF only in case of a bank resolution to cover losses or to recapitalise the entity, provided the bank’s shareholders and creditors have contributed to the loss absorption or recapitalisation equal to at least 8% of total liabilities of the bank, including own funds. The contribution from the SRF is moreover limited to a maximum of 5% of the total liabilities, including own funds.

## 2. Operational relief measures

On 25 March 2020, reacting to the worsening situation after the COVID-19 outbreak, the Single Resolution Board (SRB) sent [letters](#) to banks under their remit indicating potential operational relief measures. Conceding that banks in the current situation need to focus on core operations and critical functions, the SRB announced that would postpone less urgent information or data requests, indicating that its priority was to receive the essential reports (the reports on liability data and MREL).

## 3. Centralised administrative liquidation tool

In a recent [article](#) Elke König reiterated her policy stance that resolution was a “*tool for the few, not the many*”, clearly saying that for smaller less significant banks facing troubles, insolvency would be a procedure of choice if and when they fail. However, based on the SRB experience so far, the main difficulty currently is to find a solution for medium-sized banks that are too “small” to meet the public interest assessment, but too “large” to be liquidated under insolvency procedures.

While the SRB has strongly advocated for harmonisation of insolvency regimes for banks, as a necessary end-goal achievement, Elke König acknowledged that such solution is unlikely to be reached in the near future.

Nevertheless, as a short-to-medium term fix, Elke König proposed in the same article to create a centralised administrative liquidation tool, which would address many of the issues identified for medium-sized banks, with insolvency tools remaining available for smaller banks.

*“A centralized liquidation regime in the EU would address the current gap in the framework for medium-sized banks and improve the overall system: a further step towards the completion of the Banking Union that policymakers ought to explore further ... Such a liquidation tool could be created by amending the BRRD, SRMR and DGSD, and could provide for the powers to transfer (some) assets and liabilities in an orderly liquidation, much in line with current resolution tools. In the Banking Union, this could be entrusted to a central authority. As a first step, the SRB’s toolbox could be enriched with a “pre-liquidation tool”, allowing the application of resolution tools to save the good part of a bank without entering into liquidation, or without requiring a specific liquidation regime at European level.”*

As additional argument for a centralised administrative liquidation tool, Elke König referred to the US Federal Deposit Insurance Corporation’s experience, which used the purchase and assumption tool for the majority of US bank failures in the last decade. Establishment of a similar centralised authority in the EU could enhance coordination across Deposit Guarantee Schemes (DGS) and enable a more effective management of bank failures, reduce the impact on the DGS system, and, finally, help reduce moral hazard by removing the need to provide liquidation aid, she argues. More details on how to proceed along those lines would be interesting, particularly at the current juncture.

## 4. Ring fencing risks

In a second [article](#) in the EUROFI Magazine Elke König elaborates on the fact that the current legislative framework permits to choose one of the two following resolution strategies for banking groups with subsidiaries in several countries: single point of entry (SPE) or multiple point of entry (MPE). SPE resolution strategies are said to be more suitable for banking groups with highly centralised and integrated structures, allowing for the efficient allocation of resources within a group in going concern. The SPE approach relies on the concept that the parent, as the resolvable entity, will be the subject of any resolution action. Key issues while using a SPE strategy in gone concern are the upstreaming of losses, down streaming of resources from subsidiaries and maintaining critical functions that must be secured.

The MPE resolution strategy, on the other hand, seems preferable if a bank's structure is based on reasonably independent - in particular "self-funded" - entities or sub-groups. This would result in multiple, operationally independent resolution entities within a group that may be resolved without affecting the other entities or sub-groups.

Elke König then reflects on the effects of the revised rules that were adopted in 2019 as "Banking Package" and that include a "safe harbour" clause which enables host authorities to request a higher internal MREL, part of which is not be subject to EBA mediation between home and host authorities:

*„The Banking Package strengthen[ed] the feasibility and credibility of implementing SPE, by requiring resolution authorities to set internal MREL and TLAC requirements, which should facilitate loss absorption within a group. However, the new provisions also provide for a high level of pre-positioning of internal MREL, potentially leading to locked-in capital. It is too early to judge the consequences, but the SRB is concerned that this de facto ring-fencing within the EU might reduce substantially the needed financial flexibility at parent level.“*

In view of that challenge, she encourages policymakers to take forward concrete work on a legally enforceable group insolvency support mechanism for banking groups.

In the meantime, the SRB has made "bail-in playbooks" a priority of its work since 2018 and is focussing on credible and executable plans to upstream losses and downstream capital within a group, if need be. Elke König concludes with the statement that trust among authorities remains a main driver to overcome ring-fencing attempts.

## 5. No compensation in case of Banco Popular

In the context of so called "[right to be heard](#)" process ([opened](#) on 6 August 2018), the SRB announced on 18 March 2020 its [decision](#) that no compensation would be due to the shareholders and creditors of Banco Popular Español. The decision was based on the post-resolution valuation by an independent assessor, which concluded that insolvency would have been more costly.

The final decision was taken after having reviewed 2856 submissions from affected shareholders and creditors.

As Elke König had highlighted in the press release announcing the decision, *"This decision now closes the process of analysing whether insolvency would have meant a better outcome for affected shareholders and creditors of [Banco Popular]. It is clear that this is not the case. I understand this will be disappointing for those who have lost out, however it proves that the resolution framework is effective and shielded the taxpayer from losses and financial instability."*

Banco Popular was [resolved](#) on 7 June 2017 and sold to Banco Santander, following the ECB [assessment](#) that the bank was failing or likely to fail. There are currently a number of cases pending before the European Court of Justice, including on Banco Popular resolution (a list can be found in a recent external paper commissioned by ECON and available [here](#)).

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