

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?

Banking Union Scrutiny

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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?

Abstract

This paper defines critical banking functions and considers whether there is a need for further legal/regulatory clarification if liquidation is the default option for failing banks. We rely on EU law and soft law principles (FSB) bearing in mind that 'liquidation' is at times a loosely defined concept. Despite efforts to agree upon a set of qualitative and quantitative criteria to assess the critical nature, or lack thereof, of relevant functions we argue that simplification is needed.

Given the discretionary element in the determination of public interest and critical functions and the existence of different legal sources with different purposes, we recommend a consistent application of the resolution rules to build up credibility in the Banking Union project, considering in particular the differential treatment by the competent resolution authorities in recent Spanish and Italian liquidation and resolution cases.

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CONTENTS

LIST OF FIGURES	3
LIST OF TABLES	3
EXECUTIVE SUMMARY	4
LIST OF ABBREVIATIONS	5
1. INTRODUCTION	6
2. LIQUIDATION AND RESOLUTION	6
3. THE REGULATORY FRAMEWORK ON CRITICAL FUNCTIONS	8
4. SOURCES OF LEGAL UNCERTAINTY: IS THERE A NEED FOR SIMPLIFICATION?	10
4.1 The existence of different legal sources with different purposes	10
4.2 The confusing distinction with core business lines	11
4.3 Lack of regulatory convergence with the US framework for G-SIBs	13
5. CASE STUDIES	14
5.1 First Round of Italian Cases: 2015	14
5.2 Second Round of Italian Cases: 2017	16
5.3 Banco Popular in Spain in 2017	18
6. PUBLIC INTEREST CONSIDERATIONS	18
7. CONCLUDING OBSERVATIONS	19
8. REFERENCES	21
ANNEX I	23

LIST OF FIGURES

Figure 1: Stylised representation of a bank's internal organization related to the provision or critical functions	13
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LIST OF TABLES

Table 1: International, Regional and Domestic Main Provisions related to Critical Functions	23
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EXECUTIVE SUMMARY

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. Critical functions are most likely to be provided by core business lines and their functioning is enabled by the existence of critical shared functions within a bank. However, the little recognition of the tight interconnections among these in EU law can contribute to different assessment over the importance and impact of a possible discontinuity on critical functions and of public interest concerns.

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.

Resolution is the restructuring of a credit institution by a competent authority through the use of resolution tools in order to safeguard the public interest, the continuity of the bank critical functions, financial stability, public funds, depositors, investors and clients assets and funds.

Liquidation is a process which aims to put an end to the entity through the liquidation of its assets and the distribution of proceeds (if any) to its creditors. However, it is not necessarily the 'least costly option' for taxpayers and it is seldom used for a variety of socio-political and economic reasons. These include the cost of bank runs, the unexpected consequences of the closure of a bank and the valuable services that a bank provides, whose continuity is critical for the economic functioning of society. From this point of view, the cases of Veneto Banca and Banca Popolare di Vicenza can be seen as a sort of exception.

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, there is certainly a need for further regulatory harmonization of what constitutes public interest in the context of liquidation, apart from the continuation of critical functions.

LIST OF ABBREVIATIONS

BRRD	Bank Recovery and Resolution Directive
CJEU	Court of Justice of the European Union
DGSD	Deposit Guarantee Scheme Directive
EBA	European Banking Authority
ECB	European Central Bank
FDIC	Federal Deposit Insurance Corporation
FMU	Financial Markets Utilities
FROB	Fondo de Reestructuración Ordenada Bancaria
FSB	Financial Stability Board
G-SIB	Global Systemically Important Bank
ICSD	Investor Compensation Scheme Directive
IT	Information Technology
MPS	Monte dei Paschi di Siena
RTS	Regulatory Technical Standards
SRB	Single Resolution Board
SRMR	Single Resolution Mechanism Regulation
TFEU	Treaty on the Functioning of the European Union

1. INTRODUCTION¹

Critical functions are the activities performed by banks which are essential to the real economy, and whose cessation would cause significant disruption to the economy, financial stability, or to third parties. Therefore, it is of pivotal importance that the continuity of these functions is preserved throughout the business cycle of a bank, which may include a recovery and a resolution phase. Especially in the latter case, the ability of third parties to receive continued access to those services may ease the negative consequences of a bank crisis. It may also facilitate the smooth functioning of resolution or liquidation procedures because both may require business continuity for a limited time to allow for the transfer of activities to a third party or until the entity is liquidated.

The interrelationship between critical banking functions and the public interest at stake in the continuity of such functions is discussed in this paper. Of particular importance is the decision of how much discretion should be left to the authorities in the implementation of harmonised rules, an issue that is considered with regard to Spanish and Italian resolution and liquidation cases analysed in this paper.

The paper is divided into seven sections, following this introduction. Section 2 considers resolution and liquidation, generally. Section 3 describes the international (soft law) and EU regulatory framework that deals with critical functions. Section 4 considers the need for simplification since ambiguity may arise from the existence of different legal sources and different approaches. Section 5 analyses key case studies in Italy and Spain. Section 6 reflects upon the public or general interest considerations in the context of critical banking functions. Finally, section 7 presents some concluding observations.

2. LIQUIDATION AND RESOLUTION

Following the publication in 2011 of the Financial Stability Board (FSB) Key Attributes of Effective Resolution Regimes of Financial Institutions, the Bank Recovery and Resolution Directive (BRRD)² and the Single Resolution Mechanism Regulation (SRMR), the new resolution tools made available to the competent authorities have been incorporated in hard law many adding predictability to the resolution framework. These instruments have been refined and expanded since the global financial crisis of 2007 since a number of issues arise in the implementation of the new tools, where further legal clarity is needed.

Confronted with a failed or failing bank the competent authorities have a number of instruments at their disposal, including resolution tools, but also deposit insurance and lender of last resort, if needed. Resolution is the restructuring of a credit institution by a competent resolution authority through the use of resolution tools in order to safeguard the public interest, including the continuity of the bank's critical functions, financial stability and minimal costs to taxpayers.

Under general insolvency law, liquidation is a formal insolvency process pursuant to which an insolvency practitioner (the liquidator) is appointed to put the affairs and assets of a company in order, leading to the liquidation of the company as result of the debtor's inability to pay its debts when they become due or as result of its liabilities exceeding the value of its assets. The liquidation or winding up of a company is the process by which the assets of the company are realised, the proceeds distributed among its creditors in accordance with a set statutory order of priority, paying the surplus (if any) to

¹ One of us (Oliver-Caminal) would like to gratefully acknowledge research assistance from Marco Bodellini and Andrea Miglionico.

² Directive 2014/59/EU.

those entitled to it (i.e. shareholders) and the company is dissolved. The dissolution is the final step in the liquidation process and concludes with the cancellation of the registration of the company, i.e. its legal existence comes to an end. Liquidation is the ultimate remedy a creditor can bring against a debtor. It is important to set out from the beginning that the term 'liquidation' is at times loosely defined.³

Liquidation in banking is seldom used for a variety of socio-political and economic reasons. These include the costs of bank runs, the unexpected consequences of the closure of a bank and the valuable services that a bank provides, whose continuity is critical for the economic functioning of society, as we discuss in this paper. From this point of view, the cases of Veneto Banca and Banca Popolare di Vicenza, which are discussed below, can be seen as a sort of exception.⁴

Though liquidation may appear as a 'simple resolution procedure', in the expectation that the winding up of a credit institution could proceed in an orderly manner if insured depositors are paid off promptly, in fact liquidation is not necessarily the 'least costly option'. Least cost is a test mandated by law in the US, while it is an important consideration in the choice of resolution procedures in the EU. The 'cost' in the EU context is not the cost to the resolution authorities (like the FDIC in the US) but costs to taxpayers. In the context of the BRRD and SRMR there must be a minimum impact on public finances, financial stability and the real economy. This must be assessed against the 'value' given to the continuity of critical banking functions.

If a bank's operations are suddenly stopped, a valuable depositor base gets dissipated and vital banking services in a community may be disrupted, while confidence in the banking system may be seriously damaged, triggering a bank run and the potential for a domino effect upon other sound institutions. For this reason, the Commission's Banking Communication 2013 allows for the provision of State aid measures even in the context of a bank's liquidation in order for the liquidation to be conducted on an orderly manner or minimise potential disruptive effects. As widely acknowledged, the belief in a bank run is self-fulfilling. A financially solvent bank faced with a severe withdrawal of deposits will realize assets to raise cash to honour the convertibility guarantee or request emergency liquidity assistance from the central bank.

The danger of realizing assets is that once the bank has sold its liquid assets, it will start selling its illiquid assets at a loss value or fire sale price. A situation of illiquidity can quickly turn into one of insolvency. The difference between the going concern value and the liquidation value of the loan portfolio is a crucial consideration in the choice of resolution procedures.

³ A first attempt to deal with cross border bank insolvency was the publication by the Basel Committee of a document: "The Insolvency Liquidation of an International Bank" <https://www.bis.org/publ/bcbssc333.pdf>

⁴ These two banks were liquidated in stricto sensu despite that there was a sale of assets conducted within the liquidation procedure. The process started with the determination by the ECB on 23 June 2017 that Veneto Banca and Banca Popolare di Vicenza were failing or likely to fail. This was followed by the decision of the Single Resolution Board on the same day stating that both banks should be wound up under national procedures. On 25 June 2017, the European Commission approved the use of State aid to facilitate the liquidation of both banks under national insolvency law, which included the sale of some assets to Intesa San Paolo while the rest of the business was liquidated. See: (1) European Central Bank, ECB deemed Veneto Banca and Banca Popolare di Vicenza failing or likely to fail, Press Release, 23 June 2017, <https://www.bankingsupervision.europa.eu>; (2) Single Resolution Board, The SRB will not take resolution action in relation to Banca Popolare di Vicenza and Veneto Banca, 23 June 2017, <http://srb.europa.eu>; and, (3) European Commission, State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo, Press Release IP/17/1791, 25 June 2017, <http://www.ec.europa.eu>.

In their seminal contribution, Diamond and Dybvig⁵ contend that banks perform an explicit economic role: the transformation of illiquid assets into liquid liabilities. In this role, banks can be viewed as providing the liquidity insurance that allows agents to consume when they need to most. While this liquidity transformation enables banks to perform useful economic services, it is also a source of instability.

Banks employ the public's liquid funds to support productive illiquid investments, helping to allocate scarce savings to productive uses within the economy. Social welfare—as Diamond and Dybvig⁶ advocate—is enhanced if these loans are allowed to mature, rather than forcing a premature liquidation by recalling loans before their terms expire. A massive withdrawal of deposits in a panic scenario can also lead to a disruption of the monetary system. As noted by the FSB, “[i]f a general loss of confidence affects deposits with other banks, impact on the macroeconomic credit channel can be expected. A breakdown of depositing activity on systemic scale is likely to have an impact on credit channels, as long as there are no mitigating actions e.g., by monetary policy.”⁷

Although the structure of financial markets varies from country to country, the economic rationale of banking is more or less similar. In the banking sector, the most important critical functions are deposit taking, lending and loan servicing, and payments (clearing and settlement). However, what constitutes or not a critical function is at times a matter of judgment, which can lead to a substantial variation in the banks' characterisation of criticality.

For instance, while access to deposits and the payment system clearly are critical, and their continuity suggests that a 'public interest' is at stake, the case for the inclusion of lending requires some qualifications: “[l]ending can be critical if liquidity and funding strains for the borrowers occur before customers can find alternative sources of credit. The real economy depends on a regular flow of credit. The failure of a lender will expose borrowers to both near- and long-term liquidity constraints. The ability of borrowers to adapt to the failure of a bank will be affected by the terms on which they borrow and the ability to find alternative sources. Criticality extends to relevant loan servicing functions. In certain markets, loan servicing functions are provided by a firm separate from the loan provider. As continuation of loan servicing has an impact on the value and risk of a loan portfolio, servicing functions might also have to be considered critical.”⁸

3. THE REGULATORY FRAMEWORK ON CRITICAL FUNCTIONS

In designing the relevant framework to deal with banks in distress, regulators draw on the 2013 guidance provided by the FSB⁹. In the EU, critical functions¹⁰ are extensively covered by the BRRD¹⁰, the

⁵ Douglas W. Diamond and Philip H. Dybvig, *Bank runs, deposit insurance, and liquidity*, *Journal of Political Economy*, 91 (3): 401–419, 1983.

⁶ See Diamond and Dybvig supra 5.

⁷ See FSB, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services*, 16 July 2013, available at http://www.fsb.org/wp-content/uploads/r_130716a.pdf

⁸ See 7 supra.

⁹ FSB, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services*, 16 July 2013.

¹⁰ DIRECTIVE 2014/59/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council in OJ L 173/90 of 12.6.2014

SRMR¹¹, the Delegated Regulation 216/778¹², and several EBA Technical Standards. A complete list of the main provisions is included in Table 1 in the Annex.

Critical functions are defined by the FSB as “activities performed for third parties where failure would lead to the disruption of services that are vital for the functioning of the real economy and for financial stability due to the banking group’s size or market share, external and internal interconnectedness, complexity and cross-border activities.”¹³. This definition follows a two-pronged test as the function must: (1) be provided to a third party not affiliated to the firm; and, (2) its sudden failure may have a material impact on third parties, cause contagion, or undermine the general confidence of market participants due to its systemic relevance to the third party or to its being provided by a systemically relevant institution¹⁴. The FSB identifies five broad categories of critical functions with distinct economic objectives and characteristics: (1) deposit taking; (2) lending and loan servicing; (3) payment, clearing, custody and settlement; (4) wholesale funding markets; and, (5) capital markets and investment activities.

The BRRD expands the FSB guidance and defines critical functions as: “activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations”¹⁵ (emphasis added in roman).

The EU Commission Delegated Regulation 2016/778¹⁶ broadly adopts the same test used by the FSB. However, the Delegated Regulation goes beyond the contents of article 2(35) of the BRRD and specifies in further detail what a function is. Namely, ‘function’ means a structured set of activities, services or operations that are delivered by the institution or group to third parties irrespective from the internal organisation of the institution. Therefore, whereas the BRRD focus is on the effects of a disruption in their provision, the Regulation focuses on both organisational aspects (“set”, “structured”, “delivered to third parties”) and systemic aspects. Furthermore, the Delegated Regulation specifies the criteria that needs to be used to determine the systemic relevance of the function and of the provider, as well as the negative impact on third parties. These are based on the size, market share, external and internal interconnectedness, complexity, and cross-border activities of the institution or group. A further set of criteria apply to determine the impact on third parties, based on the nature and reach of the activity and number of customers and counterparties involved; the nature of customers and stakeholders affected; the relevance of the institution in the market; and the extent of the potential disruption.

The SRB¹⁷ template draws on the Delegated Regulation and the BRRD for the identification of critical functions and their assessment.

¹¹ Regulation (EU) 806/2014

¹² Commission Delegated Regulation C(2016) 424 on the criteria for the determination of the activities, services and operations with regard to critical functions, in OJ L 131/41..

¹³ See supra 9 p 7

¹⁴ *Ibid*

¹⁵ Art 2 (35) BRRD.

¹⁶ According to the Delegated Regulation a function shall be considered critical, when it meets both of the following criteria: 1) the function is provided by an institution to third parties not affiliated to the institution or group; and 2) the sudden disruption of that function would likely have a material negative impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to the systemic relevance of the function for the third parties and the systemic relevance of the institution or group in providing the function.

¹⁷ SRB, *Guidance on the Critical Functions Report*, 2016, available at https://srb.europa.eu/sites/srbsite/files/guidance_on_the_critical_functions_report.pdf

Given the importance of ensuring continuity of services, resolution authorities and banks have a role to play to avoid a possible disruption in an insolvency scenario. In preparation for resolution, authorities are empowered to take actions *ex ante* to request banks to introduce contractual mechanisms (service agreements) that assure their continuity or to review intragroup financing arrangements to cover for the provision of these functions¹⁸. In addition, resolution authorities may require changes to banks' legal and operational structures *"to ensure that critical functions may be legally and operationally separated from other functions through the application of the resolution tools"*¹⁹. In the relevant resolution plan, authorities need to demonstrate how the legal and economic separation took place in a bank²⁰. In preparation for recovery, banks—instead—must identify their critical functions²¹. Resolution authorities will draw on this information to make their own assessment. It is important to stress that BRRD refers to 'legal and operational structures', while the SRM refers to 'legal and economic separation'. This denotes a lack of consistency between both documents, which can give room to misinterpretation.

4. SOURCES OF LEGAL UNCERTAINTY: IS THERE A NEED FOR SIMPLIFICATION?

The current regulatory framework leaves no stones unturned. Critical functions are extensively defined, and a rich set of qualitative and quantitative criteria that has been developed to assess the critical nature, or lack thereof, of relevant functions. These are also compared and contrasted with core business lines and critical shared services within a bank. Nevertheless, it seems possible to argue that simplification is needed. Ambiguity may arise from: (1) the existence of different legal sources that consider the matter for different purposes; (2) the confusing distinction among business lines; and, (3) a lack of regulatory convergence with the US framework for G-SIBs.

4.1 The existence of different legal sources with different purposes

Even though the main elements of critical functions are apparently clear, confusion remains as to their actual definition and scope. This in turn may have a negative impact on banks' ability to identify them consistently as a 2015 comparative report by the EBA showed²². It may also give national resolution authorities discretion as to their importance in the home country.

Different sources of EU law provide a framework on critical functions with relation to different purposes/objectives. At primary level, the BRRD insists on the importance of critical functions: (1) to avoid disruption to financial stability; (2) to avoid disruption to the economy; and, (3) to ensure that they do not constitute an impediment to resolvability. This is a sensible approach, even though the wording may create ambiguity. For instance from the BRRD definition it appears that only the disruption to financial stability is envisaged as a consequence to the organisational complexity, the intragroup interconnections, the size, or the international footprint of the financial institution, etc. The economy instead may suffer from the sudden interruption of services that are essential to its functioning, without the need to another qualifying aspect (however the financial stability element requires a connection to size, complexity, etc.). Problems related to a possible lack of substitutability of those functions apply to both cases²³. Finally, critical functions may constitute an impediment to resolvability because they may be difficult to disentangle. In practice, this may be because of the

¹⁸ See art 17 (5) (a) BRRD

¹⁹ Art 17 (5) (g) BRRD

²⁰ See art 8 (9) (c) SRM Regulation

²¹ See BRRD Annex, Sec A, (7)

²² See EBA, *Comparative report on the approach to determining critical functions and core business lines in recovery plans*, 6 march 2015.

²³ Substitutability relates to the existence of third parties to provide the same services without disruption

degree of interconnections between the parent and the subsidiaries and among subsidiaries, but also because there may be no alignment between service providers and the legal entities of the group.

The Delegated Regulation instead focuses on the following: (1) the material negative impact that a disruption may have on third parties; (2) the possibility that a disruption may give rise to contagion; or, (3) the possibility that the disruption may undermine the confidence of markets participants. In all three cases the disruption becomes relevant because the critical function is of systemic importance to third parties *and*²⁴ because it is provided by a systemic institution. In the BRRD, the systemic importance of the function does not come into play because the BRRD focuses on its mere discontinuation that may affect financial stability and the economy²⁵. Therefore, two standards of severity seem to apply: a baseline scenario for BRRD purposes, and a systemic relevance scenario for the delegated regulation purposes. This may be because the former aims at protecting 'financial stability' and the 'economy', whereas the latter protects 'third parties'.

Finally, as mentioned above, the BRRD considers critical functions also within the context of impediments to resolvability. These need to be addressed so that those functions can continue in resolution. Section C of the BRRD Annex details the items that resolution authorities need to consider when assessing the resolvability of an institution. However, there is no mention of critical functions in the Annex whereas reference is made to critical *operations* (emphasis added). EBA Guidelines on the assessment of impediments to resolvability instead cover critical functions but are silent on critical operations. Conversely, Section B of the BRRD Annex lists information that resolution authorities may request banks to provide for the purpose of drawing up resolution plans. Critical functions are not in the list, where critical operations are mentioned instead. However, the EBA Regulatory Technical Standards (RTS) on the content of resolution plans and the assessment of resolvability requires resolution authorities to map critical functions and core business lines, but no reference is made to critical operations.

A definition of critical 'operations' seems to be missing. Whereas they fall under the definition of critical functions, the former and the latter still bear differences from a bank organizational point of view with critical operations being relevant internally and functions externally. Further clarification is needed also when it comes to legal entities and business lines as described in the following section. Reference to critical functions should be streamlined where necessary.²⁶

4.2 The confusing distinction with core business lines

The EU legislator widely distinguishes between critical functions and core business lines. The BRRD defines the latter as "*business lines and associated services which represent material sources of revenue, profit or franchise value for an institution or for a group of which an institution forms part*"²⁷. The delegated regulation further distinguishes among the two on the basis of the activities concerned. The importance of critical functions is assessed with reference to the economy and financial stability, while core business lines are important to the institution in itself because of their profitability.

²⁴ This is a difference with the FSB test which considers the two as alternatives.

²⁵ Even though its practical occurrence may be very rare, a disruption that has a systemic impact on a "third party" may not necessarily have a systemic impact on "financial stability" and the "economy". The opposite may not happen however.

²⁶ In their Technical Advice on critical functions and core business lines, the EBA acknowledges the lack of definition, and considers critical operations as a synonym of critical functions on the basis of evidence from the legislative process. This notwithstanding, clarification from a primary source is still necessary. See, EBA, TECHNICAL ADVICE ON CRITICAL FUNCTIONS AND CORE BUSINESS LINES, EBA/Op/2015/05, 6 March 2015, at p 5.

²⁷ BRRD, art 2 (36).

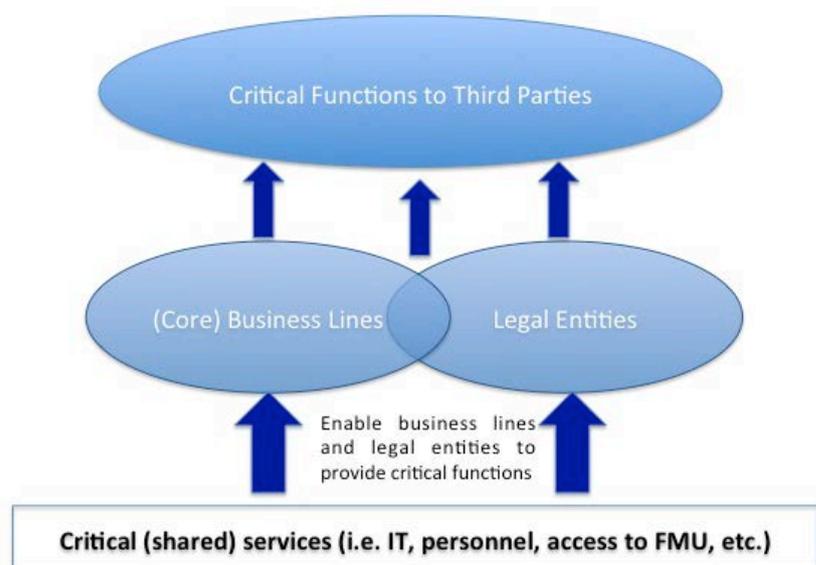
The distinction however is flimsy, as while it is possible that a core business line is not a critical function, it is hard to imagine how the latter may not generate profits for the firm and be considered a core business line. For instance, US G-SIBs include the following among their core business lines for resolution purposes: (1) markets and securities services; (2) global payments; (3) liquidity management services; (4) debt capital markets; (5) corporate portfolio management; (6) asset management; (7) asset servicing; (8) commercial banking; (9) consumer and community banking; (10) corporate and investment banking; (11) clearing servicing; and, (12) corporate trust services. These can all be examples of critical functions too. To a certain extent, the overlap is also acknowledged in the SRB Report template²⁸.

From a banking organisational point of view, critical functions are intertwined with business lines. In addition, their provision is enabled by the existence of critical shared services, which are vital to their well functioning; therefore, the three should be considered collectively. Regulators acknowledge this relationship in different places (e.g. the SRMR, the BRRD or the Delegated Regulation) and for different purposes, but tend to stress out their distinction rather than their similarities.

Business lines in turn may or may not be aligned with legal entities, as Figure 1 below shows. The possible lack of correspondence between legal entities and business lines, between critical functions and business lines and between critical shared services and legal entities may be among the main sources of disorderly resolution and this hints at how important it is that the three are not considered independently from each other. Absent available public sources, it is difficult to comment on the extent to which critical functions are or are not provided by business lines in EU banks, nor on what their international reach is.

²⁸ "Critical functions cannot overlap with critical shared services, but may overlap with core business lines". SRB, (ft 6), p 2

Figure 1: Stylised representation of a bank's internal organization related to the provision or critical functions



While there is value in adopting a broader definition, the mismatch between the economic/operational and the legal vocabulary related to the functioning of a group may cause confusion. The lack of appreciation of the connections described may give incentive to national resolution authorities to favour one or the other in the determination of public interest.

4.3 Lack of regulatory convergence with the US framework for G-SIBs

Finally, EU G-SIBs are subject to US insolvency requirements too. Whereas US law broadly conforms to the spirit of EU law (as both follow the guidance provided by the FSB), there are two main discrepancies. The first relates to the definition of core business lines and the second to that of critical functions.

As in Europe, the US also adopts revenue, profit and franchise value as the distinguishing elements of core business lines. However, they are considered more appropriately in the context of an insolvency scenario as *“those business lines of an institution, including associating operations, services, functions and support, that ... upon failure would result in a material loss of revenue, profit or franchise value”*²⁹. In other words, the EU focuses on the going concern value of these lines, while the US consider them from the gone concern perspective.

There is no mention of critical functions as such in the relevant US legislation. Instead, reference is made to critical operations as those *“operations of the covered company, including associated services, functions and support, the failure or discontinuance of which, in the view of the covered company or as jointly directed by the Board and the Corporation, would pose a threat to the financial stability of the United States”*³⁰.

Irrespective of differences in definitions of critical functions and business lines, US authorities would tend to favour a winding up over resolution.

²⁹ Regulation QQ, Sec 243.2 (b)

³⁰ *Ibid* Sec 243.2 (g)

5. CASE STUDIES

This section analyses a series of cases that are relevant in the context of the paper as the issues of critical banking functions and the potential of a liquidation scenario were considered. The cases included are those cases that took place after the implementation of the Single Supervisory Mechanism and the establishment of the Single Resolution Board. These cases are mainly Italian and happened in two rounds, the first one in 2015 and the second one in 2017—with the exception of Banco Popular de España S.A. (Banco Popular) in Spain. The inclusion of the first round of Italian cases is important to contrast different outcomes within the same country and under the same regime, only two years apart.

In the first round, Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara and Cassa di Risparmio di Chieti were resolved under the BRRD without the use of bail-in because the bail-in rules entered into force on 1 January 2016, i.e. after these entities were resolved. The Bank of Italy submitted these banks to resolution since they were not significant.

In 2017, three Italian banks were seeking precautionary recapitalization: Banca Monte dei Paschi di Siena (MPS), Banca Popolare di Vicenza and Veneto Banca. Between February and April 2017, Banca Popolare di Vicenza and Veneto Banca were issuing bonds guaranteed by the State³¹ in line with article 32.4(d)(ii) of the BRRD (which requires that the entities are solvent). A few months later, MPS was recapitalized on a precautionary basis but Banca Popolare di Vicenza and Veneto Banca were liquidated. The implications of these cases, with emphasis on the decision concerning the two liquidated entities are analysed below.

5.1 First Round of Italian Cases: 2015

On 21 November 2015 (few days after the transposition of the BRRD into the Italian legislation³², but before the bail-in rules entered into force³³) the Bank of Italy submitted to resolution four small and medium-sized banks: Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara and Cassa di Risparmio di Chieti. These four banks jointly represented a market share of approximately 1% of system-wide deposits. These cases are analysed below³⁴:

- **Banca delle Marche:** was active in the Marche region and in other areas of Central Italy, such as Umbria, Emilia Romagna, Lazio, Abruzzo and Molise through 308 branches. The business model was mainly focused on lending to small and medium enterprises and retail clients. According to the figures published at the end of 2012, the bank had total assets of EUR 22.7 billion, net customer loans of EUR 17.3 billion and deposits of EUR 7.2 billion. The bank was placed under special administration according to the Italian banking law on 15 October 2013³⁵.
- **Banca Popolare dell'Etruria e del Lazio:** was listed on the Italian stock exchange (Borsa Italiana) and operated mainly in Tuscany and other Central Italy's areas. It had 175 branches and its business was mainly focused on lending to small and medium enterprises as well as retail clients. According to figures published in September 2014, the group had total assets of EUR 12.3 billion, net customer loans of EUR 6.1 billion and deposits of EUR 6.4 billion. The bank

³¹ Banca Popolare di Vicenza, Press Release dated 20 Feb 2017, Successful Completion of the offering of Euro 1.25billion bond guaranteed by the Italian Government.

³² The Legislative Decree 180/2015 has transposed the BRRD into the Italian legal system on 16 November 2015.

³³ In Italy, the bail-in rules entered into force on 1 January 2016.

³⁴ The banks are listed in order of priority based on their total assets.

³⁵ See European Commission, State aid: Commission approves resolution plans for four small Italian banks Banca Marche, Banca Etruria, Carife and Carichieti, Press Release, Brussels 22 November 2015, available at www.ec.europa.eu.

was placed under special administration according to the Italian banking law on 10 February 2015³⁶.

- **Cassa di Risparmio di Ferrara:** was a regional bank whose business was mainly focused on lending to small and medium enterprises and private clients. It operated with 106 branches in the geographical areas around the city of Ferrara in Emilia Romagna. According to figures published at the end of 2012, the group had total assets of EUR 6.9 billion, net customer loans of EUR 4.6 billion and deposits of EUR 3.4 billion. The bank was placed under special administration according to the Italian banking law on 27 May 2013³⁷.
- **Cassa di Risparmio della Provincia di Chieti:** was a small regional bank mainly active in the Italian region of Abruzzo. Its business was mainly focused on lending to small and medium enterprises and retail clients. According to figures published at the end of 2013, the bank had total assets of EUR 4.7 billion, EUR 2.1 billion of net customer loans and deposits of EUR 2.5 billion. The bank was placed under special administration according to the Italian banking law on 5 September 2014³⁸.

All these banks were already under special administration, according to the Italian banking law, when the Bank of Italy, in its capacity as the new Italian resolution authority under the BRRD, intervened by submitting them to the resolution procedure.

The submission to resolution, instead of liquidation, has allowed the continuation of their activities, protecting in this way the interests of the local economies where they were mainly based and active. Such solution has also enabled to fully protect savings (such as deposits, current accounts and ordinary bonds) of both households and firms without recurring to public money³⁹. This outcome was reached with the write down of both, shares and subordinated bonds allowing to partially absorb the incurred losses⁴⁰. Their resolution was performed on the basis of a number of measures adopted following the new BRRD provisions and in compliance with the State aid framework.

The European Commission approved the resolution plans under EU state aid rules since the intervention by the Italian resolution fund was said to allow the orderly resolution of the banks while preserving financial stability in line with EU state aid rules⁴¹. The Commission found that such measures were in line with the overarching objective of preserving financial stability and with the burden-sharing principle since existing shareholders and subordinated debt holders contributed to the costs, reducing the need for the intervention by the resolution fund⁴².

In January 2017, Atlante Fund II bought EUR 2.2 billion of non-performing loans from Banca delle Marche, Banca Popolare dell'Etruria e del Lazio and Cassa di Risparmio della Provincia di Chieti. In March 2017 Cassa di Risparmio di Ferrara has been bought by Banca Popolare dell'Emilia Romagna for EUR 1

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ See Banca d'Italia, Information on resolution of Banca Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Chieti and Cassa di Risparmio di Ferrara crises, Rome 22 November 2015, available at www.bancaditalia.it.

⁴⁰ See M. Bodellini, Greek and Italian Lessons on Bank Restructuring: Is Precautionary Recapitalisation the Way Forward?, 19 Cambridge Yearbook of European Legal Studies, p. 8.

⁴¹ See European Commission, State aid: Commission approves resolution plans for four small Italian banks Banca Marche, Banca Etruria, Carife and Carichieti, Press Release, Brussels 22 November 2015, available at www.ec.europa.eu.

⁴² *Id.*

and then merged absorbing it, while in May 2017 UBI Banca has bought Banca delle Marche, Banca Popolare dell'Etruria e del Lazio and Cassa di Risparmio della Provincia di Chieti for EUR 1 each.

5.2 Second Round of Italian Cases: 2017

Both Banca Popolare di Vicenza and Veneto Banca had an excessive amount of non-performing loans (i.e. 37% compared to the Italian average of 18%) and very high operating costs. In addition, they were incurring losses for a number of years⁴³.

The 2014 European Central Bank (ECB) comprehensive assessment identified relevant capital shortfalls⁴⁴. Being significant banks, both were under the supervision of the ECB within the SSM.

The most salient features of these two banks are summarized below:

- **Banca Popolare di Vicenza:** was an Italian commercial bank headquartered in the Veneto Region that mainly operated in the northeastern regions of the country. As of 31 December 2016, the bank had around 500 branches and a market share of around 1% in terms of deposits and around 1.5% in terms of loans. The bank also had total assets of slightly below EUR 35 billion⁴⁵.
- **Veneto Banca:** was an Italian commercial bank headquartered in the Veneto Region that mainly operated in the North of the country. As of 31 December 2016, the bank had around 400 branches and a market share of around 1% in terms of deposits and loans. The bank also had EUR 28 billion of total assets⁴⁶.

Between 2016 and 2017, the Atlante Fund invested approximately EUR 3.5 billion in both Banca Popolare di Vicenza and Veneto Banca. The Atlante fund was set up to recapitalize weak Italian lenders and purchase portfolios of non-performing loans after the two capital raising exercises of Banca Popolare di Vicenza and Veneto Banca failed. The fund injected EUR 2.5 billion of capital in the two banks in 2016 and a further EUR 0.9 billion in January 2017 in advance of the future capital increase⁴⁷.

Banca Popolare di Vicenza and Veneto Banca confirmed that the capital shortfall estimated by the European Central Bank in the adverse scenario of the 2016 stress test amounted to EUR 3.3 billion and EUR 3.1 billion respectively. In March 2017, they applied for a precautionary recapitalisation to be performed by the Italian State, claiming that the January 2017 capital increases would have adequately addressed the shortfall in the baseline scenario. However, the Commission requested that EUR 1.2 billion be raised from private investors, as part of the combined capital increase⁴⁸.

On 23 June 2017, surprisingly in the eyes of some⁴⁹, the ECB determined that both banks were failing

⁴³ See European Commission *supra* 4.

⁴⁴ *Id.*

⁴⁵ See European Commission, State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo, Press Release IP/17/1791, 25 June 2017, <http://www.ec.europa.eu>.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ See European Parliament, Precautionary recapitalisations under the Bank Recovery and Resolution Directive: conditionality and case practice, Brussels, 16 June 2017, available at www.europarl.europa.eu.

⁴⁹ The ECB's decision was surprising also in light of the fact that both banks were already issuing bonds with Italian State guarantees under article 32.4(d)(ii) of the BRRD on the grounds of being considered as solvent; see Bodellini *supra* 40, p. 17.

or likely to fail as they repeatedly breached supervisory capital requirements⁵⁰. Consequently, precautionary recapitalisation could no longer take place being reserved for solvent institutions⁵¹ and subsequently the two banks were submitted to winding up under the Italian law on the grounds of the lack of public interest for resolution as determined by the SRB⁵². The SRB's decision was based on the consideration that the functions performed by the two banks (i.e. deposit-taking, lending activities and payment services), 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. Therefore, 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. In addition, normal Italian insolvency proceedings would have achieved the resolution objectives to the same extent as resolution, since such proceedings would also have ensured a comparable degree of protection for depositors, investors, other customers, clients' funds and assets⁵³. Immediately afterwards, even more surprisingly, the Commission approved State aid measures in order to facilitate the liquidation of the two institutions⁵⁴, apparently implying that there was a public interest to maintain financial stability (at least in their geographical areas) which needed to be protected with the use of public money⁵⁵.

The measures proposed by the Italian Government to the Commission included the sale of parts of the two banks' activities to Intesa San Paolo with the liquidation of the remaining mass through financing provided by Intesa San Paolo itself. Italy selected Intesa Sanpaolo as the buyer in an open sales procedure⁵⁶. In particular, the Italian State committed to grant the following aid measures: (1) cash injections of about EUR 4.785 billion; and, (2) State guarantees of a maximum of about EUR 12 billion, notably on Intesa's financing of the liquidation mass. The State guarantees are meant to be called upon if the liquidation mass is insufficient to pay back Intesa San Paolo for its financing⁵⁷.

Both guarantees and cash injections are backed up by the Italian State's senior claims on the assets in the liquidation mass. Correspondingly, the net costs to the Italian State are planned to be much lower than the nominal amounts of the measures authorised by the Commission⁵⁸.

The Commission found these measures to be in line with the EU State aid rules since existing shareholders and subordinated debt holders have fully contributed to the losses, reducing the cost of the intervention for the Italian State.

Both aid recipients (i.e. Banca Popolare di Vicenza and Veneto Banca) have been wound up, while the transferred activities are meant to be restructured and significantly downsized by Intesa San Paolo, which in combination will limit distortions of competition arising from the aid⁵⁹. The subsequent deep

⁵⁰ See European Central Bank, *supra* 4.

⁵¹ For a description of the requisites needed to allow a precautionary recapitalization see Rodrigo Olivares-Caminal and Costanza Russo, *Precautionary Recapitalization: Time for a Review*, European parliament, IPOL IDA(2017)602092.

⁵² See Bodellini *supra* 40, p. 18.

⁵³ See Single Resolution Board, *supra* 4.

⁵⁴ See European Commission, *State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo*, Press Release IP/17/1791, 25 June 2017, <http://www.ec.europa.eu>.

⁵⁵ See Bodellini *supra* 40, p. 18.

⁵⁶ See European Commission, *State aid: Commission approves aid for market exit of Banca Popolare di Vicenza and Veneto Banca under Italian insolvency law, involving sale of some parts to Intesa Sanpaolo*, Press Release IP/17/1791, 25 June 2017, <http://www.ec.europa.eu>.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

integration by Intesa San Paolo will return the acquired parts to viability. The Commission also confirmed that the measures do not constitute aid to Intesa San Paolo, because it was selected after an open, fair and transparent sales process, fully managed by the Italian authorities, ensuring that the activities were sold to the best available offer⁶⁰.

5.3 Banco Popular in Spain in 2017

Following a bank run on Banco Popular, the sixth largest Spanish bank, the ECB—after having approved the granting of Emergency Liquidity Assistance by the Banco de España on 4 and 5 June 2017—decided that Banco Popular was “*failing or likely to fail*” and notified the SRB accordingly on June 6, 2017. A sale of business—considered in this case as the most appropriate resolution tool according to the BRRD—was arranged.⁶¹ On 7 June 2017, the SRB transferred all shares and capital instruments of Banco Popular to Banco Santander S.A (Santander).⁶²

The SRB and the Spanish National Resolution Authority (FROB or Fondo de Reestructuración Ordenada Bancaria) decided that the sale was in the public interest as it protected all depositors of Banco Popular and ensured financial stability in Spain and Portugal (where Banco Popular owned a subsidiary).⁶³ Santander bought Popular for the nominal sum of EUR1, promising to clean up the lender and offload its real-estate assets. Though Spanish taxpayers and Banco Popular’s depositors were spared from footing a bill, shareholders and junior bondholders lost EUR4 billion approx. The sale was hailed as a resounding success, since in less than 24 hours a bank was put into resolution and sold, at no cost to the taxpayer, and not producing ‘domino effect’ on other entities.⁶⁴

However, following the sale to Santander, aggrieved investors and shareholders filed lawsuits with the EU General Court against the SRB, and in some cases also against the Commission. Amongst the issues at stake are property rights, due process, right of audience and other guarantees available under traditional administrative law procedures.

In early August 2017, Santander sold 51% of the mortgage portfolio of Banco Popular to Blackstone. Questions have since arisen from the differential – and in the eyes of many also unfair – treatment of Popular compared with the approach taken to other ailing banks, notably in the case of Italy’s MPS.

6. PUBLIC INTEREST CONSIDERATIONS

Under EU law, the public interest (or general interest) serves as a ground for justifying limitations on either the fundamental freedoms of the EU internal market or the fundamental rights protected at EU level. This is recognized in primary law (e.g., Article 106 TFEU), secondary law (a large number of Directives and Regulations) and the jurisprudence of the Court of Justice of the European Union (CJEU).

The CJEU has developed an open-ended list of public interest justifications for national measures restricting or impeding free movement of goods, persons, services and capital. The measures must

⁶⁰ *Id.*

⁶¹ <https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/-/interactive-single-rulebook/article-id/2774>

⁶² <http://www.frob.es/es/Lists/Contenidos/Attachments/519/FROBImplementingActJune72017.pdf>

⁶³ <https://srb.europa.eu/en/node/315>

⁶⁴ See “Banco Popular caught in death spiral”, FT 9 June 2017.

comply with the principle of proportionality; they must be suitable, necessary and reasonable for the attainment of the particular public interest objective pursued.⁶⁵

Public interest 'exceptions' from the free movement provisions of the Treaty include the integrity of the financial sector. There are important public interest considerations at stake in some regulatory and resolution actions. According to the BRRD, a resolution action must be taken only where it is deemed necessary in the public interest and only when winding up of the bank under normal insolvency proceedings would not meet to the same extent the resolution objectives as defined in the BRRD. This has been precisely the criterion used by the SRB in deciding that both Veneto Banca and Banca Popolare di Vicenza had to be liquidated instead of resolved. Therefore, resolution tools are to be used to intervene in a failing bank to ensure the continuity of the bank's critical financial and economic functions, while minimizing the impact of the bank's failure on the economy and the financial system. The resolution regime ensures that a failing bank's shareholders and creditors will bear the losses, rather than taxpayers.⁶⁶

There is also a discretionary element in the determination of public interest as is the case of the definition of critical functions. As discussed previously, 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, there is certainly a need for further regulatory harmonization of what constitutes public interest in the context of liquidation, apart from the continuation of critical functions.

In an interview, the EBA Chairman noted that the distinction between public interest and common interest—being applied "*one at the EU level and another one by national authorities*"—could undermine a consistent application of the new EU banking framework across the EU. This can of course damage its credibility.⁶⁷

7. CONCLUDING OBSERVATIONS

This paper has considered the question of the provision of critical banking functions and whether there is a need for further legal/regulatory clarification if liquidation is the default option for failing banks. We have relied mostly on EU law and soft law principles (FSB) bearing in mind that 'liquidation' is at times loosely defined. Despite efforts to agree upon a set of qualitative and quantitative criteria to assess the critical nature, or lack thereof, of relevant functions we argue that simplification is needed. Ambiguity may arise from: (1) the existence of 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.

⁶⁵ See e.g. Case C-55/94, Gebhard [1995] ECR I-4165 (establishment); Case C-288/89, Gouda [1991] ECR I-4007 (services); Case C-367/98, Commission v Portugal ("Golden Shares") [2002] ECR I-4731 (capital).

See generally <http://publicinterest.info/?q=eu-law/public-interest-and-fundamental-freedoms-eu-internal-market> "The extent of the review of proportionality by the Court of Justice seems to vary significantly, depending on the subject-matter at hand ("sliding scale of judicial review"); ranging from a more rigid proportionality test (...) to a less intensive and very lax or deferential proportionality test. (...) A second limit set to the defence of restrictions on free movement relying on either express derogations or judge-made public interest grounds is the prohibition of arbitrary discrimination. (...). A third limit is the exclusion of purely economic / budgetary considerations (e.g. Case C-109/04, *Kranemann* [2005] ECR I-2421)."

⁶⁶ <http://pubdocs.worldbank.org/en/609571482207234996/FinSAC-BRRD-Guidebook.pdf>

⁶⁷ <https://www.politico.eu/article/europes-top-bank-watchdog-makes-case-for-optimism/> and <http://www.euractiv.com/section/banking-union/news/liquidation-of-italian-banks-shows-limits-of-banking-resolution-rules/>

We have analysed recent Italian and Spanish resolution and liquidation cases. As reported by Moody's⁶⁸, when contrasting the rescue procedures used in Italy and Spain it is interesting to observe that the use of public funds to rescue failing banks was restricted in the case of Banco Popular (the first resolution case led by the SRB), while MPS received a precautionary recapitalisation, the cost of which was to be shared between the Italian government and the bank's shareholders and junior creditors.⁶⁹ While the case of Banco Popular has been hailed as a successful application of EU banking resolution rules, MPS shows that there is a degree of discretion for Member States to approach banks in financial distress.

The current source of uncertainty in the regime derives from the discretionary element in the determination of public interest and critical functions and the existence of different legal sources with different purposes. This is rendered more difficult by the multitude of authorities involved in the process, each one probably having a different policy objective. Consistent application of the resolution rules is needed to build up credibility in the Banking Union project.

⁶⁸ Moody's, Banks—Europe; FAQ: Europe's differing treatment of ailing banks, available at www.moodys.com.

⁶⁹ Monte dei Paschi was the poorest performer in the 2016 stress EBA tests. See <https://www.eba.europa.eu/-/eba-publishes-2016-eu-wide-stress-test-results> and <https://www.ft.com/content/da6ccdde-4b9b-11e7-a3f4-c742b9791d43>

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ANNEX I

Table 1: International, Regional and Domestic Main Provisions related to Critical Functions

EU LEVEL	PROVISION	SOURCE
Bank Recovery and Resolution Directive (BRRD)	'critical functions' means activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations;	Art 2 (35)
	Without prejudice to Article 4, the resolution plan shall set out options for applying the resolution tools and resolution powers referred to in Title IV to the institution. It shall include, quantified whenever appropriate and possible: (c) a demonstration of how critical functions and core business lines could be legally and economically separated, to the extent necessary, from other functions so as to ensure continuity upon the failure of the institution;	Art 10 (7) (c)
	An institution shall be deemed to be resolvable if it is feasible and credible for the resolution authority to either liquidate it under normal insolvency proceedings or to resolve it by applying the different resolution tools and powers to the institution while avoiding to the maximum extent possible any significant adverse effect on the financial system, including in circumstances of broader financial instability or system-wide events, of the Member State in which the institution is established, or other Member States or the Union and with a view to ensuring the continuity of critical functions carried out by the institution. The resolution authorities shall notify EBA in a timely manner whenever an institution is deemed not to be resolvable.	Art 15 (1)
	When applying the resolution tools and exercising the resolution powers, resolution authorities shall have regard to the resolution objectives, and choose the tools and powers that best achieve the objectives that are relevant in the circumstances of the case. 2. The resolution objectives referred to in paragraph 1 are: (a) to ensure the continuity of critical functions;	Art 31 (1) and (2)(a)
	The recovery plan shall include the following information: (7) identification of critical functions;	Annex A (7)
Commission Delegated Regulation 2016/778 on the criteria for the determination of the activities, services and operations with regard to critical functions	'function' means a structured set of activities, services or operations that are delivered by the institution or group to third parties irrespective from the internal organisation of the institution;	Art 2 (2)
	Criteria relating to the determination of critical functions A function shall be considered critical, where it fulfils both of the following:	Art 6

	<p>(a) the function is provided by an institution to third parties not affiliated to the institution or group; and</p> <p>(b) the sudden disruption of that function would likely have a material negative impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to the systemic relevance of the function for the third parties and the systemic relevance of the institution or group in providing the function.</p> <p>(2) When assessing the material negative impact on third parties, the systemic relevance of the function for third parties and the systemic relevance of the institution or group providing the function, the institution and the resolution authority shall take into account the size, market share, external and internal interconnectedness, complexity, and cross-border activities of the institution or group.</p> <p>The assessment criteria for the impact on third parties shall include at least the following elements:</p> <p>(a) the nature and reach of the activity, the global, national or regional reach, volume and number of transactions; the number of customers and counterparties; the number of customers for which the institution is the only or principal banking partner.</p> <p>(b) the relevance of the institution, on a local, regional, national or European level, as appropriate for the market concerned. The relevance of the institution may be assessed on the basis of the market share, the interconnectedness, the complexity and cross border activities.</p> <p>(c) the nature of the customers and stakeholders affected by the function, such as but not limited to retail customers, corporate customers, interbank customers, central clearing houses and public entities.</p> <p>(d) the potential disruption of the function on markets, infrastructures, customers and public services. In particular, the assessment may include the effect on the liquidity of markets concerned, the impact and extent of disruption to customer business, and short-term liquidity needs; the perceptibility to counterparties, customers and the public; the capacity and speed of customer reaction; the relevance to the functioning of other markets; the effect on the liquidity, operations, structure of another market; the effect on other counterparties related to the main customers and the interrelation of the function with other services.</p> <p>(3) A function that is essential to the real economy and financial markets shall be considered substitutable where it can be replaced in an acceptable manner and within a reasonable timeframe thereby avoiding systemic problems for the real economy and the financial markets.</p> <p>When assessing the substitutability of a function the following criteria shall be taken into account:</p> <p>(a) the structure of the market for that function and the availability of substitute providers;</p>	
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	<p>(b) the ability of other providers in terms of capacity, the requirements for performing the function, and potential barriers to entry or expansion;</p> <p>(c) the incentive of other providers to take on these activities;</p> <p>(d) the time required by users of the service to move to the new service provider and costs of that move, the time required for other competitors to take over the functions and whether that time is sufficient to prevent significant disruption depending on the type of service.</p> <p>(4) A service is considered critical where its disruption can present a serious impediment to, or prevent the performance of, one or more critical functions. A service is not considered critical where it can be provided by another provider within a reasonable timeframe to a comparable extent as regards its object, quality and cost.</p> <p>(5) The disruption of functions or services shall consist in functions and services that are no longer provided to a comparable extent, under comparable conditions and of comparable quality, unless the change in providing the function or service concerned takes place in an orderly manner.</p>	
<p>Single Resolution Mechanism Regulation</p>	<p>9.The resolution plan for each entity shall include, quantified where appropriate and possible: (c) a demonstration of how critical functions and core business lines could be legally and economically separated, to the extent necessary, from other functions so as to ensure continuity upon the failure of the institution;</p>	<p>Art 8 (9) (c)</p>
	<p>3.When drafting a resolution plan, the Board shall assess the extent to which such an entity is resolvable in accordance with this Regulation. An entity shall be deemed to be resolvable if it is feasible and credible for the Board to either liquidate it under normal insolvency proceedings or to resolve it by applying to it resolution tools and exercising resolution powers while avoiding, to the maximum extent possible, any significant adverse consequences for financial systems, including circumstances of broader financial instability or system wide events, of the Member State in which the entity is situated, or other Member States, or the Union and with a view to ensuring the continuity of critical functions carried out by the entity. The Board shall notify EBA in a timely manner where an institution is deemed not to be resolvable.</p> <p>4. A group shall be deemed to be resolvable if it is feasible and credible for the Board to either liquidate group entities under normal insolvency proceedings or to resolve them by applying resolution tools and exercising resolution powers in relation to group entities while avoiding, to the maximum extent possible, any significant adverse consequences for financial systems, including circumstances of broader financial instability or system</p>	<p>Art 10 (3) and (4)</p>

	<p>wide events, of the Member States in which group entities are established, or other Member States or the Union and with a view to ensuring the continuity of critical functions carried out by those group entities, where they can be easily separated in a timely manner or by other means. The Board shall notify EBA in a timely manner where a group is deemed not to be resolvable.</p> <p>30.7.2014 L 225/31 Official Journal of the European Union EN</p>	
	<p>1. When acting under the resolution procedure referred to in Article 18, the Board, the Council, the Commission, and, where relevant, the national resolution authorities, in respect of their respective responsibilities, shall take into account the resolution objectives, and choose the resolution tools and resolution powers which, in their view, best achieve the resolution objectives that are relevant in the circumstances of the case.</p> <p>2. The resolution objectives referred to in paragraph 1 are the following: (a) to ensure the continuity of critical functions</p>	Art 14 (2) (a)
<p>EBA/ RTS ON THE CONTENT OF RESOLUTION PLANS AND THE ASSESSMENT OF RESOLVABILITY</p> <p>(EBA/RTS/2014/15)</p>	<p>A resolution plan shall contain at least the elements laid down in letters (a) to (h) of this Article, including all information required under Articles 10 and 12 of Directive 2014/59/EU and any additional information necessary to enable the delivery of the resolution strategy:</p> <p>c) A description of the information, and the arrangements for the provision of this information, necessary in order to effectively implement the resolution strategy, including at least:</p> <p>ii. A mapping of critical functions and core business lines to legal entities which identifies in particular a) the critical functions and core business lines carried out by entities subject to resolution actions and b) the critical functions or core business lines spread across legal entities which would be separated by implementation of the resolution strategy;</p>	Art 3 (c) (ii)
<p>EBA FINAL REPORT ON BUSINESS REORGANISATION PLANS</p> <p>(EBA/RTS/2015/12)</p> <p>(EBA/GL/2015/21)</p>	<p>The business reorganisation plan shall provide information to support the resolution authority and the competent authority in their analysis of the reorganisation's impact on the critical functions of institution or entity referred to in points (b), (c) and (d) of Article 1(1) of Directive 2014/59/EU and on financial stability.</p>	Art 4 (2)
<p>EBA GUIDELINES ON MEASURES TO REDUCE OR REMOVE IMPEDIMENTS TO RESOLVABILITY</p> <p>(EBA/GL/2014/11)</p>	<p>Consideration of critical functions is made under:</p> <p>Title II – Specifications applying to all measures</p> <p>Title III- Details and circumstances with respect to specific measures</p>	<p>Par 4 (a)</p> <p>Par 6</p> <p>Par 7</p> <p>Par 9 (d)</p> <p>Par 10 (d)</p> <p>Par 11 (b)</p> <p>Par 13</p>

The Provision of Critical Functions at Global, National and Regional Level

		<p>Par 13 (a), (b), (d), (e), (f),(g), (h), (i), (j), (k)</p> <p>Par 14 (b), (c)</p> <p>Par 15 (b)</p>
<p>Technical advice on the delegated acts on critical functions and core business lines</p> <p>(EBA/Op/2015/05)</p>	<p>The aim of this advice is to develop a common understanding of which of the functions performed by an institution are critical to the real economy and financial markets and which are core to its own performance.</p> <p>To this end, in this advice the EBA proposes shared definitions and harmonised evaluation criteria to be used, as guidance, by financial institutions, competent authorities and resolution authorities to identify “critical functions” and “core business lines”.</p> <p>3. The EBA has structured its advice in two main sections: (i) Section 1 is entitled ‘Critical functions’. It proposes further details to be added to the definition of ‘critical functions’ envisaged in the BRRD and offers criteria for the identification of ‘critical functions’; (ii) Section 2 is entitled ‘Core business lines’. It proposes a clarification for the definition envisaged in the BRRD and presents potential criteria for the identification of ‘core business lines’.</p>	
US LEVEL	PROVISION	SOURCE
<p>Regulation QQ</p> <p>(12 CFR 243)</p>	<p>(g) <i>Critical operations</i> means those operations of the covered company, including associated services, functions and support, the failure or discontinuance of which, in the view of the covered company or as jointly directed by the Board and the Corporation, would pose a threat to the financial stability of the United States.</p>	<p>243.2 (g)</p>
INTERNATIONAL LEVEL	PROVISION	SOURCE
<p>FSB Guidance on Identification of Critical Functions and Critical Shared Services</p>	<p>Critical functions are activities performed for third parties where failure would lead to the disruption of services that are vital for the functioning of the real economy and for financial stability due to the banking group’s size or market share, external and internal interconnectedness, complexity and cross-border activities. Examples include payments, custody, certain lending and deposit-taking activities in the commercial or retail sector, clearing and settling, limited segments of wholesale markets, market making in certain securities and highly concentrated specialist lending sectors.</p>	<p>p. 7</p>

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