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DRAFT REPORT

with recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector
(2010/2006(INI))

Committee on Economic and Monetary Affairs

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(Initiative – Rule 42 of the Rules of Procedure)

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

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The European Parliament,

– having regard to Article 225 of the Treaty on the Functioning of the European Union,

– having regard to the Commission Communication of 20 October 2009 entitled "An EU Framework for Cross-border Crisis Management in the Banking Sector" (COM (2009)0561),

– having regard to the proposal for a regulation of the European Parliament and of the Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board (COM(2009)0499),

– having regard to the proposal for a Council regulation entrusting the European Central Bank with specific tasks concerning the functioning of the European Systemic Risk Board (COM(2009)0500),

– having regard to the proposal for a regulation of the European Parliament and of the Council establishing a European Banking Authority (COM(2009)0501),

– having regard to Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions[1],

– having regard to Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions[2],

– having regard to Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes[3],

– having regard to Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions[4],

– having regard to the Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent[5], the Third Council Directive 78/855/EEC of 9 October 1978 concerning mergers of public limited liability companies[6] and the Sixth

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[1] OJ L 177, 30.6.2006, p. 1.
[2] OJ L 177, 30.6.2006, p. 201
[3] OJ L 135, 31.5.1994, p. 5.
[4] OJ L 125, 5.5.2001, p. 15.
[5] OJ L 26, 31.1.1977 p. 1.
[6] OJ L 295, 20.10.1978, p. 36.

Council Directive 82/891/EEC of 17 December 1982, concerning the division of public limited liability companies[1],

– having regard to the Memorandum of Understanding of 1 June 2008 on cooperation between the financial supervisory authorities, central banks and finance ministries of the European Union on cross-border financial stability,

– having regard to Rules 42 and 48 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A7-0000/2010),

A. whereas there is at present insufficient EU regulation of crisis management in the banking sector,

B. whereas existing EU supervisory mechanisms for the financial sector have proven ineffective in preventing or sufficiently containing contagion,

C. whereas the cost of management of the crisis fell too heavily on taxpayers, growth and jobs,

D. whereas uncoordinated actions by national authorities increased the risk of protectionist behaviour, distortion of competition and threatened the construction of an internal market for financial services,

E. whereas a strong internal market for financial services is critical for the Union's global competitiveness,

F. whereas citizens demand that the EU institutions urgently create an adequate framework which, in the event of crisis, would preserve financial stability, would minimise the cost to taxpayers, would preserve basic banking services and would protect depositors,

G. whereas a robust response to crisis requires a coherent and comprehensive approach entailing better supervision (implementation of the new EU supervisory architecture), better regulations (ongoing initiatives such as those on Directive 2006/48/EC, Directive 2006/49/EC , Directive 94/19/EC, executive remuneration, etc.) and an effective EU crisis management framework for financial institutions,

H. whereas the polluter-pays principle must be extended to the financial sector because of the devastating impact of failure across countries, sectors and the entire economy at large,

I. whereas a strict EU code of conduct for management, as well as mechanisms to deter inappropriate behaviour, are required,

J. whereas moral hazard must be avoided to prevent excessive risk taking, and a framework that protects the system, not the "delinquent", is called for,

K. whereas the present economic, financial and social problems, as well as multiple new

[1] OJ L 378, 31.12.1982, p. 47.

regulatory demands on banks, require a gradual and sensible approach but should not be a deterrent to an ambitious and urgent agenda,

L. whereas Europe will have to build a common understanding of “who” should do “what”, “when” and “how” in the event of crisis in financial institutions,

M. whereas wide gaps between national regulatory and insolvency regimes must be bridged through reinforced dialogue among national supervisors and authorities within the Cross Border Stability Groups,

N. whereas a limited number of banks (“Systemic Banks”) represent an extremely high level of systemic risk due to their size, complexity and interconnectedness across Europe, calling for an urgent and targeted special regime,

O. whereas a special regime for Systemic Banks, in order to be effective in supporting interventions, requires a common set of rules, appropriate expertise and financial resources,

P. whereas the fast-track special framework for Systemic Banks should evolve in the medium/long term towards a universal regime covering all banks in the Union.

1. Requests the Commission to submit to Parliament by 31 December 2011, on the basis of Article 50 and Article 114 of the Treaty on the Functioning of the European Union,, one or more legislative proposals or proposals on an EU crisis management framework, a resolution unit and an EU financial stability fund, following the detailed recommendations below;

2. Confirms that the recommendations respect the principle of subsidiarity and the fundamental rights of citizens;

3. Considers that the financial implications of the requested proposal should be covered by appropriate budgetary allocations (excluding the contributions to the EU financial stability fund which are to be a responsibility of participating banks);

4. Instructs its President to forward this resolution and the accompanying detailed recommendations to the Commission, the Council, and the parliaments and governments of the Member States.

ANNEX TO THE MOTION FOR A RESOLUTION: DETAILED RECOMMENDATIONS AS TO THE CONTENT OF THE PROPOSAL REQUESTED

Recommendation 1 - on a common EU crisis management framework

The European Parliament considers that the legislative act to be adopted should aim to regulate as follows:

1. Create a European crisis management framework with a common minimum set of rules and ultimately a common resolution and insolvency law, applicable to all banking institutions operating in the Union and with the following objectives:
   - promote stability of the financial system;
   - limit/prevent financial contagion;
   - limit public cost of interventions;
   - optimize position of depositors and guarantee their equal treatment across countries;
   - preserve provision of core banking services;
   - avoid moral hazard and charge costs to industry and shareholders;
   - ensure equal treatment of each class of creditors in the Union;
   - strengthen the EU financial services internal market and its competitiveness.

2. Progressively harmonize existing national resolution and insolvency laws and supervisory powers and, within a reasonable calendar, build an effective single EU regime.

3. Attribute to the relevant supervisor the responsibility for crisis management and the approval of each bank's contingency plan, as follows:
   - for Systemic Banks: the European Banking Authority (EBA) in close cooperation with the college of national supervisors and the Cross Border Stability Groups (as defined in the above-mentioned Memorandum of Understanding of June 2008);
   - for all other cross border non-systemic banks: the consolidated supervisor within the college, under the coordination of the EBA and in consultation with the Cross Border Stability Groups;
   - for local banks: the local supervisor.

4. Design an EU supervisors' common set of rules for crisis management including common methodologies, definitions and terminology.

5. **Resolution plans to become a mandatory regulatory requirement**.

6. Design, before December 2011, an European supervisory rating for banks based on a common set of quantitative and qualitative indicators ("Risk Dashboard") comprising at least:
   - capital;
   - leverage;
   - liquidity;
   - maturity, interest rate and currency mismatch;

- liquidity of assets;
- large exposures and risk concentrations;
- expected losses;
- sensitivity to market prices, interest and exchange rates;
- access to funding;
- outcomes of stress tests;
- effectiveness of internal controls;
- quality of management;
- complexity and opacity;
- risk outlook;
- compliance with law or regulatory requirements.

7. Empower supervisors to intervene on the basis of thresholds of the supervisory rating, in full accordance with the principle of proportionality.

8. Expand the crisis management minimum intervention toolbox available to supervisors, beyond the Article 136 of Directive 2006/48/EC, to include at least the power to:
   - require adjustments of capital, liquidity, business mix and internal process;
   - recommend changes of management;
   - limit the terms of banking licenses;
   - impose a total or partial sale;
   - create a Bridge Bank or Good Bank/Bad Bank;
   - require swaps of debt into equity with appropriate haircuts;
   - take temporary public control;
   - winding-up.

   For banks contributing in the EU Financial Stability Fund, the supervisory powers shall include:
   - provision of direct loans;
   - injection of capital.

9. All the above-mentioned tools shall be applied in full compliance with the EU competition rules and equal treatment of creditors and depositors across Member States.

Recommendation 2 on <u>Systemic Banks</u>

The European Parliament considers that the legislative act to be adopted should aim to regulate:

1. Systemic Banks, due to their special risk profile, require to be urgently addressed by a new special regime to be known as the European Bank Company Law to be designed until the end of 2011.

2. Systemic Banks shall adhere to the new special regime which shall overcome legal impediments to effective action across borders while ensuring clear and predictable treatment of shareholders, depositors, creditors and other stakeholders.

3. The Commission shall adopt a measure setting up, before April 2011, criteria for definition of Systemic Banks based on a draft elaborated by the European Systemic Risk Board (ESRB).

4. The ESRB shall draw, until December 2011, a list of Systemic Banks and update it on a regular basis.

5. For each of the Systemic Banks, the EBA shall lead the college of supervisors, act under normal circumstances through national supervisors and retain the ultimate decision power and a binding mediating role.

6. An EU Financial Stability Fund and a Resolution Unit shall support interventions led by the EBA (resolution or insolvency) as regards Systemic Banks.

Recommendation 3 on <u>EU Financial Stability Fund</u>

The European Parliament considers that the legislative act to be adopted should aim to regulate:

1. An EU Financial Stability Fund shall be created, under the responsibility of the EBA, to finance interventions (rehabilitation or orderly winding-up) aimed at preserving the system's stability and limit contagion from failing banks. The Commission shall present to the Parliament, by April 2011, a proposal with details of the Fund's charter, structure, governance, size, operating model as well as a precise calendar for implementation (in accordance with points 2 and 3 below).

2. The Fund shall be:
   - pan-European;
   - funded ex-ante by the Systemic Banks on the basis of risk-based, countercyclical criteria;
   - separate from Deposit Guarantee Schemes and substitute national similar funds;
   - adequately sized to support temporary interventions (loans, asset purchases, capital injections) and cover costs of resolution or insolvency procedures;
   - gradually built, recognising the present economic environment.

3. The Commission shall also address:
   - investment guidelines for the Fund's assets (risk, liquidity, alignment with EU targets);
   - selection criteria for Fund's asset manager (internal or via a private or public third party such as the European Investment Bank);
   - possibility of contributions qualifying for calculation of regulatory capital ratios;
   - conditions for eventual expansion of the scope of the Fund to include institutions beyond Systemic Banks.

Recommendation 4 on <u>Resolution Unit</u>

The European Parliament considers that the legislative act to be adopted should aim to regulate:

1. A resolution unit shall be established within the EBA to lead the resolution and insolvency procedures for Systemic Banks. This unit shall:
   - operate within the strict boundaries defined by the legal framework and the EBA's competencies;
   - be a pool of legal and financial expertise specially skilled in bank restructurings, turnarounds and liquidation;
   - cooperate closely with national authorities on implementation, technical assistance and sharing of staff;
   - propose the disbursements from the Stability Fund.

EXPLANATORY STATEMENT

1. The recent and severe financial crisis created a broad consensus across stakeholders and the political spectrum that action is urgently required to ensure the sustainability and stability of the financial system.
   Preventing the collapse and containing contagion of the financial system involved costs of an unprecedented magnitude. Negative side effects ranged from the almost freezing of financial markets leading to shrinking of the credit markets, paralysis of businesses, a sharp increase of unemployment and reduction of tax revenues. This massive allocation of resources was diverted key areas of development (from education, to innovation, research, alternative energies, etc.).
   Whatever the final total bill is at the end, it is clear that it weighted too much on taxpayers, European growth and jobs, and represented a huge setback in the pace at which Europe is building its future.

2. Intervention tools used by governments, central banks and regulators across Europe varied widely ranging from less intrusive regulatory actions (temporary relaxation of capital or liquidity requirements) to capital injections, liquidity provision, guaranteeing toxic assets, loans, negotiating sale to other institutions or taking public ownership. Very often the interventions targeted cross border institutions or banks with material international transactions (therefore with an impact on banks or other clients in other jurisdictions). These tools were used by the local authorities with little international alignment raising numerous issues, such as:
   - distortion of competition (i.e. the migration of deposits from England to Ireland when the Irish government guaranteed all deposits);
   - challenges by shareholders (i.e. Northern Rock, Lloyds, RBS, Fortis, etc.);
   - severe delays (caused by challenges from shareholders) of some key transactions like the acquisition of Fortis Belgium and Luxembourg by BNPParibas;
   - confusion about legal frameworks and rights of stakeholders;
   - protectionist measures.

   In sum, the variety of approaches, methods and tools used across Europe and the US, in a vaguely coordinated (at the last minute) manner, raised serious concerns as to the:
   - effectiveness of the overall exercise;
   - legal uncertainty;
   - level playing field and distortion of competition.

3. Risk travels fast across sectors due to close links between banking, insurance, asset management, etc. warranting an enlarged crisis management framework beyond the banking sector. However realism forces us to start by focusing on banks, without precluding a future extension of the scope.

4. While today's global markets require global solutions, therefore calling on international alignment of regulations and procedures, the EU should not shy away from showing leadership and have an active participation in tailoring the financial system of the future.

The proposals being put forward build upon multiple contributions from European academic, private and public stakeholders, international institutions such as the G20, Financial Stability Board and the IMF and the practical lessons learned from the crisis. Solutions such as the Federal Deposit Insurance Corporation in the US were also particularly inspiring.

5. Presently there is patchwork of national frameworks, not always compatible between themselves. It is difficult to deal swiftly and efficiently with cross-border groups involving several jurisdictions. A robust and sound European single financial market requires coherence and cohesiveness of regulations across the 27 members. With that Europe can be the place of excellence for international finance.

6. A robust, comprehensive approach is needed to create an effective preventive framework and safety net, safeguarding and reinforcing the internal market. The approach must have a multilayered nature combining in a coherent way:
   - an effective EU supervisory architecture with an European Systemic Risk Board and three sector authorities: Banking, Insurance and Occupational Pensions and Securities and Markets;
   - improved international regulations amongst other by revising capital requirements, redefining tier 1 and tier 2 capital, covering additional risks, introducing liquidity ratios, countercyclical buffers, leverage ratios, reforming accounting standards and rules on executive compensation, etc.;
   - an EU crisis management framework that can overcome the present limitations resulting from nationally based and often conflicting resolution and insolvency regimes.

7. Effective as a crisis management framework may be, risk and failure will remain important features of a well functioning financial market. Therefore the present proposals aim at preserving the “public good” dimension of financial services rather than rescuing individual financial institutions. “Rehabilitation” or “euthanasia” must remain as alternative outcomes of intervention. This uncertainty is essential to prevent moral hazard.

8. Interventions must be designed to redirect cost away from taxpayers and depositors to the industry, along the polluter pay principle.

9. The bulk of the pain must be felt by the shareholders and partially by unsecured creditors through appropriate haircuts. Rescue aid must always be repaid.

10. The need for a European level playing field in the financial sector cannot ignore the existence of serious imbalances among Member States, evident in the difficulty of accepting common regulatory and supervisory tools, settling home/host issues, deciding on burden sharing and fears of institutional capture. Insufficient mutual trust has been amplified by the crisis.

11. Progress in building up a common approach will only be achieved through an inclusive, bottom up process of constructive dialogue between colleges of supervisors and representatives of the governments of the Member States.

12. The persistent economic, financial and fiscal effects of the crisis resulting in huge Member States public deficit and debt burden, the unfinished state of the EU supervision architecture and common regulatory rulebook and the aggregated impact on banks of increased requirements on capital, liquidity, DGS, etc., all call for a gradual and balanced roadmap to reach the desirable EU common framework for cross border crisis management.

13. However, it is evident that the time has arrived for Europe to make choices between further steps towards a common future or a nationalistic path. The latter is definitely not a solution. But the implementation of the former requires a lengthy process of convergence and mutual trust building, while immediate solutions are needed to tackle the risks posed by Systemic Banks.

14. In fact, less than 50 banks (out of 12,000 in the EU) represent 70% of banking assets. The high risk they embody results from their size, complexity and interconnectedness with the rest of the system. Their problems send shock waves across sectors and countries.

15. While starting with the Systemic Banks may sound excessively ambitious, prioritizing them addresses the core of the issue and may serve as an embryonic platform to develop in the medium/long run a universal regime covering the whole banking system and eventually non-banking financial institutions.

16. This proposal leverages on the ongoing regulatory developments, in particular those on the EU supervisory architecture by positioning the EBA as a central piece for the building up of a common culture of supervision and playing a leading role in what Systemic Banks are concerned.

17. Contingency/resolution mandatory plans, developed for each institution within the colleges of supervisors with input from the cross border stability groups, seem to be the ideal vehicle to developing consensus on diagnosis and solutions for cross border banks (systemic or not).

18. The choice for future crisis management of a Stability Fund (privately funded and publicly managed) instead of a bank levy is based on the belief that:
    - immediate availability of funds is a precondition for efficiency in intervention;
    - it is important to link in a transparent way industry contributions and the cost of cleaning its own pollution;
    - its pan European nature is the only way to overcome nationalistic behaviour when crisis hit.

    Although the size of the fund requires further research, contributions must be risk based. The liquidity of the Fund must be managed conservatively while still being put to good use given the EU's strategic agenda.

19. The proposed separation of the Stability Fund from the Deposit Guarantee Schemes emanates from the recognition of their different purposes and the fear that the comingling of funds could, in the worst case, jeopardize the payment to depositors.

20. The expertise required and scope of resolution procedures involved in dealing with Systemic Banks would potentially warrant the creation of a specific agency (as is the case of FDIC in the US). However, bureaucracy and costs containment, strongly recommends starting with a lighter infrastructure working as a special unit within the EBA.

21. Existing laws and court practices on insolvency and bankruptcy are materially different across countries and tend to focus on protection of creditors and shareholders rather than on preserving the stability of the financial system. Thus, the delivery of a universal European resolution regime will require an extremely complex harmonisation process. A European Bank Corporate Law (inspired on the existing European Company Law Directive), to be adopted by all Systemic Banks, seems to be then necessary to achieve progress in the near future.

22. The moment calls for an ambitious although balanced and realistic approach. This historical window of opportunity needs to be seized. The European Parliament will act according to its mandate and meet the expectations and trust of the European citizens.