

BRIEFING

Hearing with Mrs Elke König, Chair of the Single Resolution Board

ECON, 28 January 2016

The Single Resolution Board (SRB) was established on 1 January 2015 and on 1 January 2016 it became fully responsible for the resolution of those banks which are directly supervised by the ECB and of other cross-border groups. This briefing presents the state of play regarding the work of the SRB as well as a short insight into the vulnerability of those banks which are directly supervised by the Single Supervisory Board (SSB). It is published in advance of the Hearing with Mrs Elke König, Chair of the SRB, in the ECON Committee on 28 January in accordance with Article 45.4 of Regulation (EU) 806/2014.

Single Resolution Board: setting up the European agency

Establishment of the SRB (for the main features of the SRB see also [PE 528.749](#))

The SRB was established as an independent EU agency on 1 January 2015, and held its first plenary meeting on 25 March 2015, setting the [priorities](#) for the first year: cooperating closely with all stakeholders, notably on resolution planning and resolving obstacles to resolution, setting standards for resolution regimes and resolution plans, and recruiting 120 highly qualified staff by the end of 2015 (about 300 staff will support the SRB by the end of 2017). The SRB took over full responsibility for the direct monitoring of significant banks and cross-border groups on 1 January 2016. On 8 January the SRB published the list of banks under its remit, including the 129 significant [institutions directly supervised by the ECB](#) and 15 other [cross-border groups](#) with subsidiaries established in more than one participating Member State.

As to the organisational issues, many competitions were organized in 2015 to recruit temporary agents. The [organisational chart](#) was also published in early October (See Annex 2). In the latest version of the 2016 budget to date, published on 25 November 2015, the SRB foresees the recruitment of about 100 headcount in 2016 (from 122 to 230), for a total operating budget of EUR 57 million in 2016 (EUR 22 million in 2015). In 2016 the banks will contribute for the first time to the Single Resolution Fund (SRF), with total ex-ante contributions reaching EUR 11.8 billion.

First amendment to the 2016 budget				
	Part I: administration		Part II: SRF	
	<u>Budget</u>	<u>Appropriations</u>	<u>Budget</u>	<u>Appropriations</u>
Contributions	€ 57.0 mn		€ 11 779.9 mn	
Staff		€ 25.2 mn		
Buildings, equipment and others operating expenditures		€ 12.8 mn		
Operating expenses		€ 19.0 mn		
Investments				€ 11 779.9 mn

Building-up the SRF

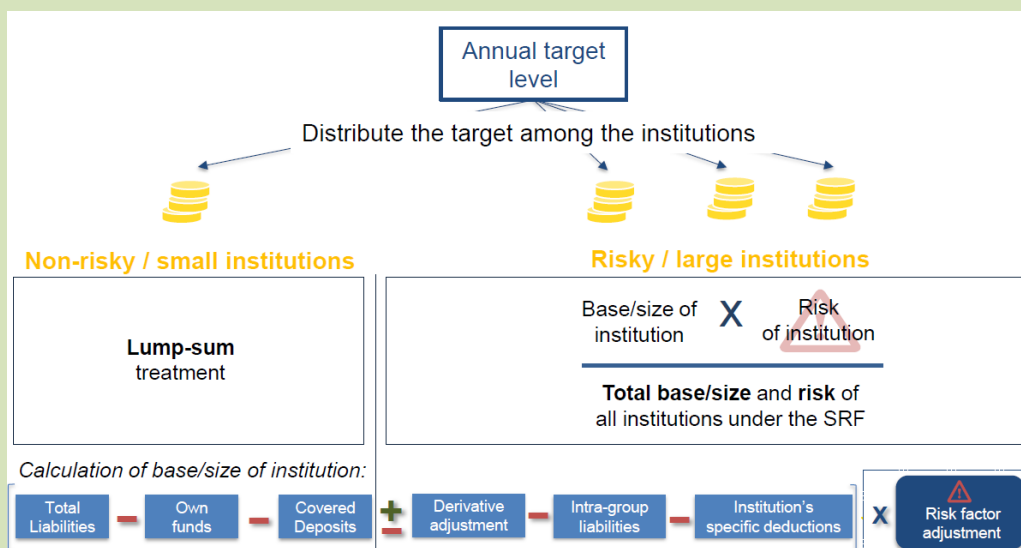
The SRF is aimed at ensuring the effective application of the resolution tools within a resolution scheme approved by the SRB: it can be used for instance to guarantee assets or liabilities of the bank under resolution or to purchase assets from that entity (sale of assets), to contribute to a bridge institution or to an asset management vehicle (separation of assets), to contribute to the entity under resolution if certain creditors are excluded from the bail-in (bail-in), to make loans to the entity under resolution, a bridge institution or an asset management vehicle ([article 76.1 of the SRMR](#)).

In 2016, those contributions which were raised by each Member State in 2015 under the BRRD will be transferred to the SRF, in principle by end of January. In addition, banks will, for the first time, contribute directly to the SRF. The SRB is responsible for the calculation of ex-ante contributions, while those contributions are collected through National Resolution Authorities (NRA). The total budget for ex-ante contributions to be raised from banks or transferred from Member States is EUR 11.8 billion in 2016. The remaining funds will be raised gradually so that the SRF reaches its target size (approximately EUR 55 billion) at the end of 2023.

Calculation of ex ante contributions

At the first industry dialogue organized by the SRB on 29 October 2015, the SRB presented the methodology used for the [calculation of ex ante contributions](#). This methodology was defined in the [Commission Delegated Regulation \(EU\) 2015/63](#):

Figure 1: Calculation of ex-ante contributions



Source: [SRB](#)

Small institutions are those institutions with total assets less than EUR 1 billion and a base/size less than EUR 300 million ("base/size" is roughly equal to "uncovered liabilities excluding own funds", as calculated in figure 1 above). Considered as less risky, they will pay contributions ranging from 1000 euros to 50 000 euros depending on their base/size, unless they demonstrate that the full risk adjustment methodology would imply an even lower contribution.

For other institutions, the calculation is risk-adjusted, meaning the calculation takes into account a number of parameters related to their risk exposure, structure of funding, systemic importance and business model.

Since that calculation differs from the calculation foreseen under the BRRD framework, to be raised by NRAs, the [Council Implementing Regulation \(EU\) 2015/81](#) provides for a transitory regime from 2016 to 2023, with ex-ante contribution calculated as the average of BRRD contributions (with a weight decreasing from 60% in 2016 to 7% in 2022) and SRM contributions (with a weight increasing from 40% in 2016 to 93% in 2022 and 100% in 2023).

Those contributions will initially be allocated to national compartments within the SRF. The transfer of contributions and their gradual mutualisation are governed by the [intergovernmental agreement](#) signed on 14 May 2014. As of [12 January 2016](#), all 19 members of the banking union had ratified the IGA, albeit one had not yet deposited its instrument of ratification. The gradual mutualisation of national compartments is explained in annex 2.

Since the SRF is gradually built up, during the start-up period actual contributions may not yet be sufficient to cover the costs incurred by a resolution case; in such a scenario, the SRB would need to seek alternative funding means, in the form of borrowings or other form of support from financial institutions or other third parties. To that end, Member States participating in the Banking Union agreed on [8 December 2015](#) to ensure that a system of bridge financing arrangements would be available to the SRF in the transitional period. Each participating Member State will thereby provide a national credit line to the SRB in the form of a Loan Facility Agreement, totalling a maximum aggregate amount of EUR 55 billion.

An [expert paper](#) commissioned by the ECON committee (authors: D. Gros and W-P. de Groen, CEPS) assessed the hypothetical cost of resolutions and needs for further bridge financing, and concluded that a bridge facility may be needed in the transitional period to cover the assumed maximum shortfall of up to EUR 45 billion on SRF funds. The overall size of the bridge financing arrangements is in line with the authors' conclusions (See main findings of the study in the EGOV [At a glance](#) note).

Procedural agreements with the ECB and the European Parliament

On 16 December 2015, the SRB and the European Parliament signed an [agreement](#) on practical modalities of the exercise of democratic accountability and oversight. The agreement clarifies the content of the annual report to be submitted every year to the European Parliament on the execution of tasks under the SRM Regulation. In addition, the agreement provides in particular that:

- the Chair of the Board shall participate in ordinary public hearings twice a year;
- the Chair of the SRB may be invited to additional ad hoc exchanges of views or special confidential meetings involving the exchange of confidential information, with strict rules regarding the attendance and confidentiality of such meetings;
- the SRB shall reply in writing to written questions put to it by Parliament, with questions and answers to be published on both websites;
- the SRB shall provide ECON with records of proceedings of the executive or plenary sessions of the SRB within six weeks from the date of such meetings, as well as non-confidential information relating to resolution cases.

The agreement also covers the investigation powers of the Parliament and the selection procedures for the SRB members, as well as the right of the Parliament to be informed about the content of the draft Code of Conduct of the SRB before it is adopted by the plenary session of the SRB, and about the procedures set up within the SRB regarding the adoption of decisions guidelines or instructions.

On 22 December 2015, the SRB and the ECB signed a [Memorandum of Understanding](#) in respect of cooperation and information exchange. The purpose of this agreement is to ensure efficient cooperation between both organisations, since such close cooperation is instrumental for the completion of supervisory tasks and resolution tasks, including recovery planning, resolution planning, as well as both early intervention and resolution phases.

The agreement provides for the representation of the SRB as an observer at the Supervisory Board of the ECB or other substructures, when relevant, as well as for the participation of the ECB as an observer in relevant committees and working groups, if invited by the SRB. The agreement governs the rules regarding direct communication channels at technical level, and establishes arrangements regarding the cooperation of both organisation in resolution procedures and early intervention phases. It also covers the exchange of information and related confidentiality issues.

2016 working priorities

On 8 December 2015, the SRB published its [2016 Work programme](#), which describes both the objectives defined by the SRB and the means and resources employed to that end. The work programme identifies four main operational areas with a number of objectives which can be summarized as follows:

- *ensuring resolution readiness*: developing resolution plans, defining clear policies as to resolution planning and crisis management, identifying impediments to resolvability and providing guidance on how to tackle them, enhancing resolution-related expertise, preparing for resolution cases;
- *setting up and managing the SRF*: defining the funding and financing of the SRF, developing and implementing an investment strategy, raising contributions from banks;
- *fostering and broadening cooperation*: implementing agreements signed in 2015, signing new agreements with partners within and beyond the EU, developing the cooperation with NRAs, establishing resolution colleges;
- *consolidating its capacity building*: recruiting new staff in line with budget, safeguarding an operational finance function, achieving a secure and independent IT architecture, ensuring the new premises are fully operational.

In addition the SRB has defined 21 key performance indicators and precise targets for each indicator in 2016 (example: removal to the new premises by end of the first quarter, setting-up all resolution colleges for which the SRB is group level resolution authority, holding 4 training events...)

As mentioned in the work programme *"the number and the nature of resolution actions are inherently unpredictable. The focus is therefore on ensuring that the SRB is adequately equipped and ready to handle successfully any resolution case that may arise in 2016"*. On [28 October 2015](#) the SRB launched a procurement procedure regarding the provision of accounting advice, economic and financial valuation services and legal advice. The estimated maximum amount for the execution of all the assignments referred to in this call for tenders is EUR 40 million for the full duration of the contract (i.e. 24 months and the 2 optional renewals). It was reported in the press that such an envelope would allow for [8 to 10 large resolution cases](#).

Designing a robust policy

Resolution planning

Resolution planning has been identified as a core priority since the SRB held its first meeting on 25 March 2015. The SRB therefore created a Committee on Resolution Planning to start collecting information and cooperate with NRAs, and discussed the modalities of its resolution planning activities with different stakeholders in an industry dialogue held on [29 October 2015](#), where it published a presentation on the guiding principles of [resolution planning](#).

The SRB will have to *"draw up and adopt resolution plans"*¹ for significant banks and cross-border groups, which involves a comprehensive exchange of information between financial institutions, NRA and the SRB, as well as other stakeholders where necessary (notably within resolution colleges for those entities which have entities established in countries not participating in the Banking Union).

Those resolution plans are documents that set out options for resolving failing institutions, that is to say that resolution plans shall analyse a full set of measures the SRB may take when an entity or group is put under resolution. Resolution planning is an ongoing process whereby the SRB assesses (i) whether it is possible to liquidate the failing bank or whether resolution actions should be taken,

¹ SRM Regulation, article 8.1

(ii) which resolution strategy should be favoured and (iii) if obstacles to resolvability are identified, how they should be removed. Those plans rely on a thorough analysis of each bank's business model, internal organisation and group structure.

Among the key issues to be addressed in those resolution plans, several have far-reaching implications for banks:

- what are the core business lines and the critical functions/infrastructures?
- how much losses can be absorbed internally at group and entity level?
- what may impair the implementation of different resolution tools?

Indeed, the answers to those questions will shape the resolution strategy to be designed in the resolution plan. In particular, the resolution plan will determine whether resolution should be dealt with at group level (single point of entry) or entity level (multiple of entry), whether structural measures should be implemented to ensure resolution tools can be implemented, or whether more bail-inable liabilities should be required from the institution (minimum requirement for own funds and eligible liabilities (MREL), see below) so that the bank may be resolved at no cost for the SRF.

Given the existence of heterogeneous business models in the European banking industry, and the potential implications of resolution plans on banks' performances (MREL) and business models (structural measures), the design of a consistent policy remains a challenge for the SRB. The Committee on Resolution Planning is responsible for preparing the Resolution Planning Manual, intended at guiding both the SRB and NRA in their resolution planning activities. The SRB has therefore set as [priorities for 2016](#) the following tasks:

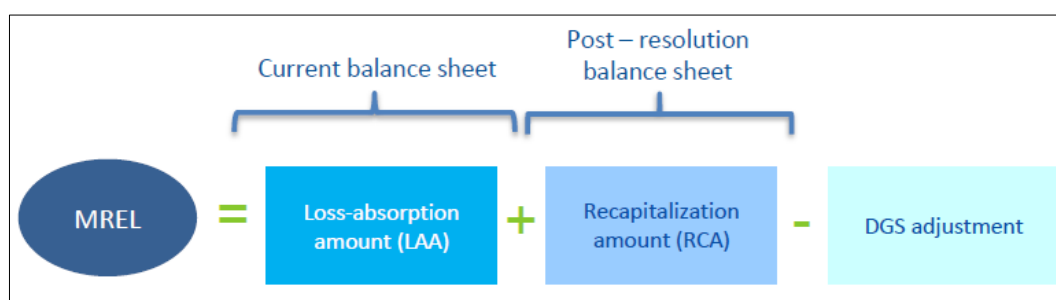
- finalising the alignment of the Resolution Planning Manual, the Crisis Management Manual and the Cooperation Framework;
- complementing the resolution Planning Manual with guidance and interpretations provided to different stakeholders;
- publishing a Guide to Resolution Planning, which would consist of those parts of the resolution Planning Manual which are directed to the entities under the remits of the SRM.
- drafting resolution plans to cover the majority of institutions under the SRB remits, while enhancing resolvability assessment and developing Internal Resolution Teams (IRT) comprising staff from both the SRB and NRA.

Minimum requirement for own funds and eligible liabilities (MREL)

One other area of focus is the design of MREL requirements. The new resolution frameworks relies on the mandatory bail-in of capital instruments and eligible liabilities for a minimum amount of 8% of total liabilities including own funds, before any capital be injected by the SRF. This rule, to be effective, must go hand-in-hand with the obligation, for financial institutions, to hold at all times a minimum amount of instruments which could be bailed-in if the bank undergoes resolution. This is the reason why the BRRD provides that banks shall comply at all times with a MREL to be determined by the resolution authority, that is to say the SRB for significant banks and cross-border groups in the Banking Union.

The BRRD provides that the MREL shall be set on a case-by-case basis, based on a number of criteria to be further developed in level 2 legislation. On 4 July, the EBA submitted to the Commission [draft regulatory technical standards](#) (RTS) on the criteria for determining MREL, which have not yet been endorsed by the Commission. On 12 January, the SRB held its second industry dialogue where it presented its methodology to determine the [MREL](#), based on the draft RTS.

Figure 2: Determination of MREL requirements



Source: [SRB](#)

The MREL will be calculated on the basis of three components: the capital requirements of the current balance sheet, those of the post-resolution balance sheet (which factors in the preferred resolution strategy), and an adjustment linked to any potential involvement of a DGS to protect insured depositors.

For each of those three components, the SRB may consider upward or downward adjustments, on the basis of a thorough case-by-case analysis of financial information at granular level, supervisory data and resolution strategies.

The SRB and resolution colleges will foresee a transition period for the implementation of the MREL by banks under its remits. The SRB included the need to implement a harmonised framework for MREL in its [priorities for 2016](#). The outcome of this analysis will substantively impact the funding plan of banks under its remits since they could have to raise significant amounts of MREL-compliant liabilities. This, in addition with the new standards developed at international level on Total Loss-Absorbing Capacity for systemic banks (TLAC, see box below), will make this exercise extremely sensitive, not the least because the banking market is still characterized by heterogeneous national features across the Banking Union.

Total Loss-Absorbing Capacity (TLAC)

On 9 November 2015, the Financial Stability Board (FSB) issued its [TLAC standard](#) for Global Systemically Important Banks (GSIB). The aim of the TLAC requirement is similar to the philosophy underpinning the MREL: to make banks hold sufficient amount of bail-inable debt in order to ensure investors shoulder most of the burden in crisis times.

The major difference is the scope: TLAC standards are developed by the FSB at international level and only apply to the 30 banks which have been deemed global and systemically important by the FSB. One other fundamental difference is the approach taken, since the FSB sets a minimum standard to be complied with by all GSIBs, while the MREL will be calibrated on a bank-by-bank basis, taking into account individual capital requirements and preferred resolution strategies.

While the MREL will become binding in 2016 when the SRB adopts resolution plans for banks under its remits, the TLAC will become binding from 2019 onwards, with a three-year transition period. From 2022 onwards, the minimum amount of loss-absorbing instruments for GSIB shall be no less than the greater of 18% of risk-weighted assets or 6.75% of total assets as measured in the leverage ratio.

In addition, the level playing field may be undermined by diverging national legislations regarding the implementation of the BRRD and, most notably, the recent proposals made at national level to amend the hierarchy of claims in several participating Member States. The hierarchy of claims determines which specific categories of instruments will be impacted first when a bank is resolved.

Therefore, amending the hierarchy of claims can potentially (i) have redistributive effects among existing creditors and (ii) create advantages/disadvantages for banks when complying with MREL. The various initiatives taken by Member States underline the diverging incentives regarding the protection of depositors, the need to make the bail-in tool credible, and the cost for banks of raising

additional amounts of bail-inable liabilities. [Moody's](#) indicated that "the lack of uniform hierarchy of claims across the region adds further complexity to the resolution of banks across borders". [BBVA](#) complained that divergent senior debt treatment across Member States would distort the banking sector and make fund raising more complex, while [Rabobank](#) defends that "there is no one size fits all solution".

Amending the hierarchy of creditors: diverging proposals in several Member States

Recent proposals in France, Germany, Italy and Spain could substantially modify the hierarchy of claims, in order to clarify, among senior liabilities, which ones will bear losses first in the event of resolution. It is to be noted that article 108 of the BRRD already provides that insured deposits enjoy preferred status, while uninsured deposit from individuals and SMEs exceeding the EUR 100 000 ceiling rank higher than other senior unsecured and non-preferred depositors.

Figure 3: Hierarchy of claims before and after the BRRD

PRE-BRRD				POST-BRRD		
insured deposits				insured deposits		
Senior debt	Corporate deposits	Derivatives	SME and uninsured household deposits	SME and uninsured household deposits		
T2 instruments	Subordinated debt			Senior debt	Corporate deposits	Derivatives
Additional Tier 1				T2 instruments	Subordinated debt	
Additional Tier 1				Additional Tier 1		

The problem arises from the need to bail-in creditors, including senior debt if needed, up to a minimum amount of 8% of total liabilities including own funds before accessing resolution funds: senior debt includes both senior unsecured bonds and deposits from large companies as well as liabilities arising from derivative contracts. Bailing-in senior unsecured bonds while excluding other instruments enjoying the same rank in the hierarchy of claims could indeed entail legal risk.

Three solutions exist to structure the subordination of senior instruments (source: [BBVA Research](#)):

- the first one is **structural**: to issue senior debt at the level of the holding company and to adopt a single point of entry resolution strategy: long term funding as well as deposits from large companies located in operational entities are not impacted by the bail-in of liabilities at the level of the holding company. This model fits well with [globally active and highly integrated wholesale institutions](#), and was developed by the [US FDIC and the Bank of England](#) to enhance the resolvability of GSIBs;
- the second one is **statutory**: the hierarchy of claims is amended so that senior unsecured bonds rank lower than other senior unsecured liabilities. This is the solution proposed in [Germany](#). A similar alternative, proposed in [Italy](#), is to make deposits from large companies rank higher than other senior unsecured liabilities. The main advantage of the German approach is that all senior unsecured bonds become easily bail-inable (and therefore would certainly qualify for [MREL/TLAC](#)); however this solution has retroactive impacts on current creditors (current senior unsecured bondholders are suddenly rank lower in the hierarchy of claims), and might have adverse impacts on the funding of operations;
- the third option is **contractual**: to create a new category of instruments (senior debt with subordination clauses embedded, also known as "tier 3"), which would rank lower than senior bonds but higher than subordinated debt. This is the solution favoured in [France](#) and in [Spain](#).

Figure 4: Hierarchy of claims according to DE, IT and FR proposals

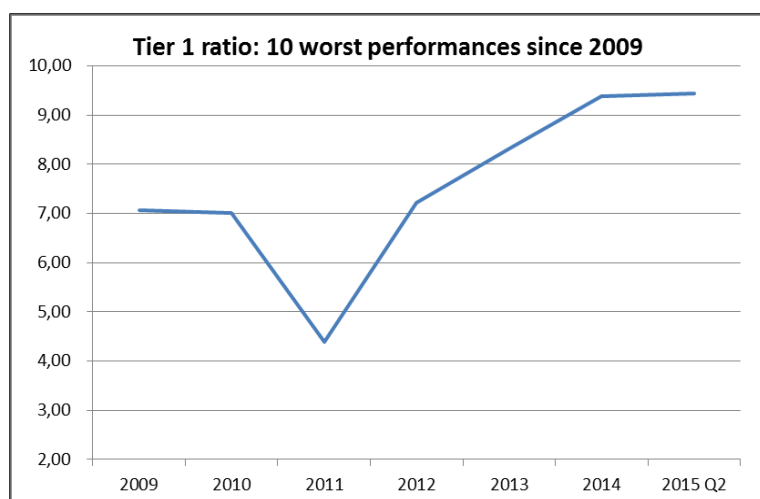
Germany			Italy		France		
insured deposits			insured deposits		insured deposits		
SME and uninsured household deposits			SME and uninsured household deposits		SME and uninsured household deposits		
Other senior debt	Corporate deposits	Derivatives	Corporate deposits		Senior debt	Corporate deposits	Derivatives
Tradable senior unsecured bonds			Senior unsecured debt	Derivatives	Senior debt with subordination clauses		
T2 instruments	Subordinated debt		T2 instruments	Subordinated debt	T2 instruments	Subordinated debt	
Additional Tier 1			Additional Tier 1		Additional Tier 1		

The evolution of vulnerable SSM banks since December 2013

This section briefly discusses whether the financial position of the weakest banks directly supervised by the SSM has improved since the crisis. The analysis focusses separately on 5 indicators, and, for each of them, describes how the 10 weakest performances observed at each reporting date have evolved from December 2009 to June 2015.

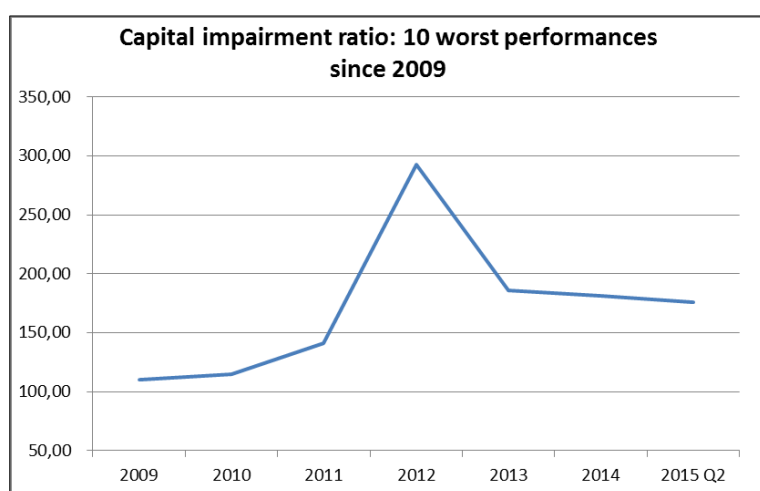
Methodology: The sample includes, for each indicator, 76 to 106 banks directly supervised by the SSM for which the indicator is available in Bankscope for at least 6 of the 7 reporting dates. Banks are sorted from the weakest to the strongest, and the average of the 10 weakest performances is then calculated for each period (NB: the list of the 10 worst performing banks is different for each indicator and each reporting date) and reported in the graph.

Figure 5: Most vulnerable Tier 1 ratios of SSM banks from December 2009 to June 2015



It seems that the weakest capital positions of SSM banks have improved steadily over the period. Figure 5 shows, for each reporting date, the average Tier 1 ratio of the 10 worst performing banks included in our sample. It shows that their tier 1 ratios significantly deteriorated in 2011, but since then have recovered and now reach levels which are substantively higher than in 2009 for most of them. Indeed, while the 10 lowest tier 1 ratio were all less than 8% in 2009, at the end of June 2015, 7 out of 10 are now more than 9%.

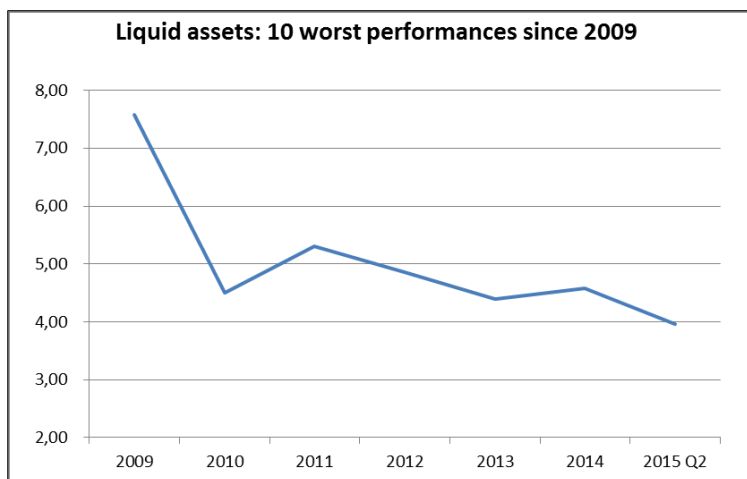
Figure 6: Capital impairment ratio of worst performing SSM banks from December 2009 to June 2015



The asset quality of the worst performing banks has significantly deteriorated since 2009. The capital impairment ratio compares the amount of non-performing loans which are not covered by provisions to the amount of equity of the bank. A high ratio means that the capital position is vulnerable to further provisioning of non-performing loans by the bank. Figure 6 shows that despite an improvement in the capital position of SSM banks (see notably EGOV briefing [PE.542.681](#)), banks which are the most vulnerable to

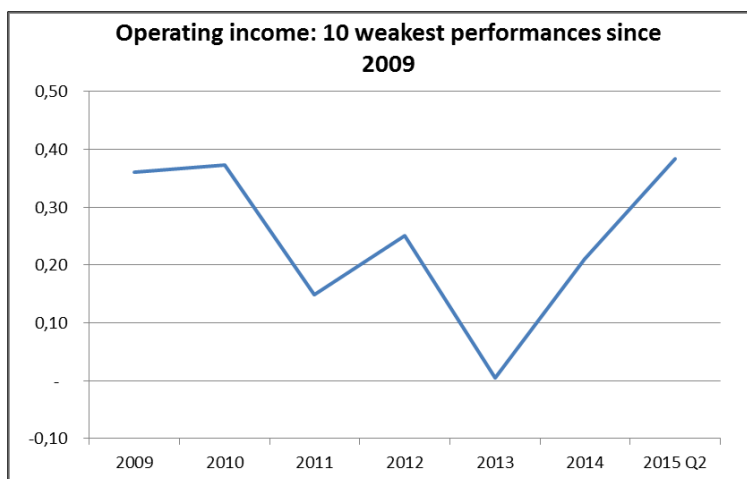
further impairments have become even more vulnerable. This reflects the significant rise of non-performing loans in those countries which are the most hit by the crisis.

Figure 7: Liquidity ratio of worst performing SSM banks from December 2009 to June 2015



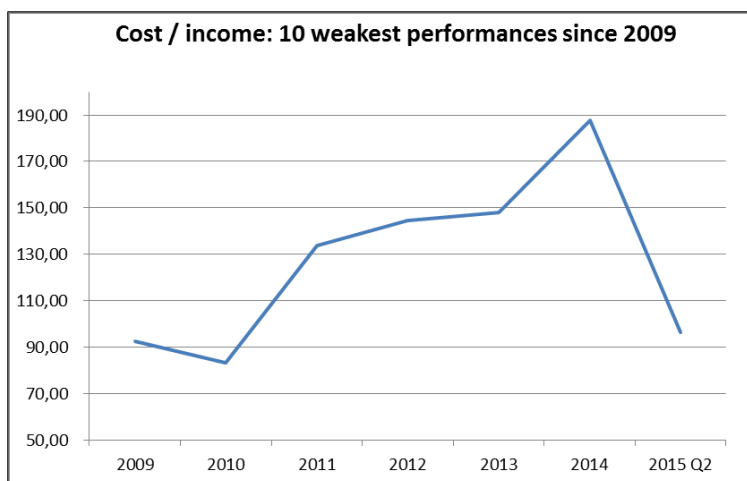
The liquidity position of the SSM worst performing banks has significantly deteriorated since 2009. The liquidity ratio reported in Figure 7 compares the amount of liquid assets to the amount of deposits and short term funding. Figure 7 shows that the lowest ratios among SSM banks have been decreasing since 2009, which means the liquidity positions as measured in Figure 7 have not improved since the start of the crisis.

Figure 8: Weakest operating income ratios of SSM banks from December 2009 to June 2015



The worst performing banks have recovered the level of operating income they had reported in 2009. The operating income ratio measures the operating revenues (interest margin, fees, trading income) against average total assets. It does not take into account either operating expenses, nor impairments, taxes or other exceptional revenues. The weakest performances in terms of operating income observed in June 2015 are similar to the ones observed in 2009.

Figure 9: Weakest cost/income ratios of SSM banks from December 2009 to June 2015



The weakest performances in terms of cost/income ratio haven't improved since 2009, with 3 banks reporting a ratio of more than 1 at the end of June 2015 (only one in 2009). The cost/income ratio is the difference between operating revenues (interest margin, fees, trading income) and operating expenses, measured as a ratio. A cost/income ratio greater than 1 means the banks does not produce the revenues needed to cover its operational costs (staff, buildings).

Conclusion: When looking at 5 different indicators, it appears that the weakest performances reported by SSM banks in our sample have not improved since the start of the crisis, except the Tier 1 ratio which has substantively improved. Indeed, the bottom 10 capital impairment ratios, liquidity ratios and cost/income ratios have mainly deteriorated over the period for the banks included in the sample.

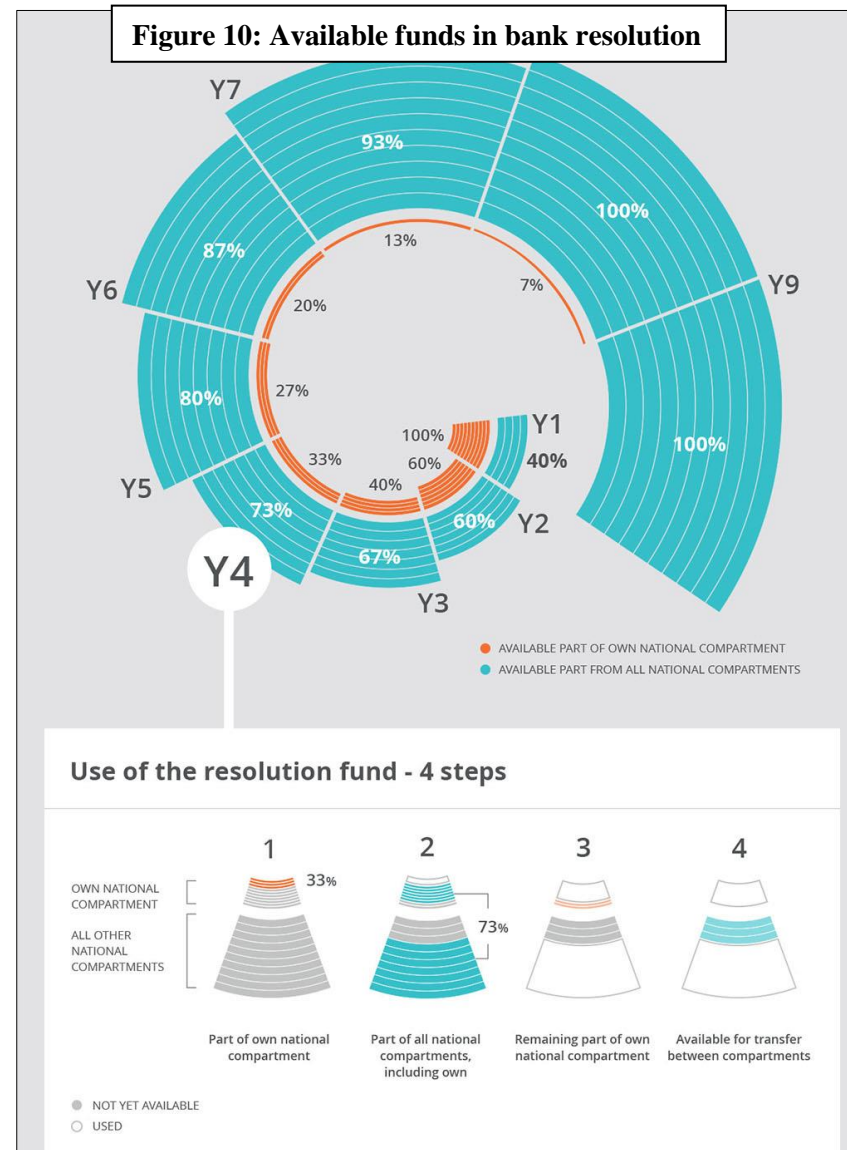
Annex 1 Gradual mutualisation of national compartments

At the end of 2019 (year 4), the expected amount of ex-ante contributions is expected to be about EUR 30 billion. If bank A in country X is resolved in year 4, then the respective contributions of national compartments will depend on the costs borne by the SRF, and on the size of the compartment of the country where the bank is established. Assuming the costs borne by the SRF is EUR 5 billion, and that the size of country X's national compartment is EUR 2 billion, then:

- step 1: 33% * EUR 2 billion, that is to say EUR 0.66 billion, will be deducted from compartment X. The remaining amount available in the SRF is EUR 29.34 billion, including EUR 1.34 billion for compartment X.

- step 2: 73% * EUR 29.34 billion, that is to say EUR 21.42 billion (including EUR 0.98 billion for national compartment X), remains available for the resolution of bank A. Only EUR 4.34 billion (remaining costs borne by the SRF after step 1) will be used for that purpose and mutualized among all national compartments.

- If available resources under step 2 were not sufficient, then the remaining resources available in compartment X would be used (step 3), before extraordinary ex-post contributions could be raised in country X. Finally remaining resources in other compartments could be temporary transferred to compartment X (step 4), or the SRF could borrow funds in line with SRM Regulation.



Source: Council of the European Union, [2015](#)

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