BRIEFING

To resolve, or not to resolve a bank?

Options for framing bank resolution vs. insolvency

There is an emerging consensus among stakeholders to apply resolution more widely going forward, possibly through modifications of the public interest assessment. This briefing reviews the practice of the Single Resolution Board so far and presents some observations based on past experience and policy options that the legislators might want to consider as they set out to reform the resolution framework.

In a recent briefing, we provided an overview and preliminary high-level discussion of the Eurogroup's expectations for the review of the Crisis Management and Deposit Insurance (CMDI) framework. The present briefing goes into more depth on a specific aspect of a possible reform, namely the extent to which banks in trouble are resolved rather than *"wound up under normal insolvency proceedings"*. There appears to emerge a certain consensus that resolution should apply more widely going forward: The Parliament's Banking Union annual report 2021 speaks of addressing loopholes in the resolution framework and support for reviewing and clarifying the public interest assessment, while the Eurogroup's June 2022 statement looks for a clarified and harmonised public interest assessment and resolution to apply more widely. The Parliament is currently working on its 2022 annual Banking Union report.

This briefing discusses the current situation in legislation and practice regarding the scope of resolution versus insolvency. It considers the possible objectives of broadening the scope and reflects on policy options to achieve a broader scope. Finally, it suggests some preliminary conclusions.

Box: From the few to the many

The emerging policy consensus for more resolution contrasts with a catchy phrase by the former Chair of the Single Resolution Board (SRB), Elke König. In a magazine article she said about the SRB's approach that "*resolution is for the few, not the many*". However, it is unclear to what extent this stark statement reflects the SRB's practice or not. As discussed further below, the SRB has earmarked 82% of banks in its remit for resolution. At the same time, this "earmarking" is only a preliminary decision and not binding for the decision should one of these banks actually fail. For actually failing banks, the share of positive resolution decisions is much lower than 82%.

The current EU legal basis

Article 32 of the Bank Recovery and Resolution Directive and, for the banks in the Banking Union, Article 18 of Single Resolution Mechanism Regulation determine when a bank is resolved. There are **three conditions**. First, the bank has to be **failing or likely to fail**. The legislation lists the circumstances when this condition would be fulfilled. For example, this would be the case if a bank will evidently fail to meet conditions for its

Economic Governance and EMU Scrutiny Unit (EGOV)
Authors: Kai Gereon SPITZER, Kristina GRIGAITĖ, Marcel MAGNUS
Directorate-General for Internal Policies
PE 741.496 - February 2023

ongoing authorisation, if it requires public support outside of a general financial crisis[1], or in the case of illiquidity or overindebtedness. Notably, the latter two conditions broadly mirror typical preconditions for general insolvency proceedings, while the former two tend to be broader. A bank may not be overindebted, but its minimum capital requirement may still not be met. Thus it is conceivable that a bank qualifies for resolution, but not insolvency.[2] Second, the bank must be **missing a perspective to prevent the failure** within a reasonable timeframe.[3]

And **as a third condition, the resolution of the bank must be necessary in the public interest**. The notion of necessity is further defined. Resolution has to be necessary and proportionate for reaching **certain objectives**, such as ensuring the continuity of the banks' critical functions. This could be thought of as an ***"absolute"* test of public interest**. There is an **additional *"relative"* test** to be met: the resolution may only go ahead if the same objectives cannot be achieved as well by normal insolvency proceedings. This absolute assessment **entails inevitably a number of judgements** - say, in determining what functions of a bank are sufficiently critical to justify which specific resolution actions. For instance, the SRB seems to decide if deposit taking is critical, i.e. hard to replace, by considering *inter alia* the market share of the bank in deposit taking.[4] But there is no objectively identifiable percentage of market share that makes the deposit taking function critical and there may be circumstantial elements that mean that a low overall market share may still be critical, say if there is a higher share for certain customer groups that find changing banks more difficult. We will discuss the judgemental nature of the public interest assessment further below, after reviewing the cases of past SRB decisions.

The relative test requires an additional step in the decision making. It requires a **comparison to a procedure under a national insolvency law**. This is complicated since insolvency laws differ from one Member State to the other. First, national insolvency law may comprise more than one possible procedure. The SRB would thus need to decide which procedure constitutes *"normal"* insolvency proceedings within the meaning of the EU framework in order to make the comparison. Perhaps more importantly, the point of comparison entails the outcome of yet unknown future decisions by one or more national authorities. For instance, for a loan portfolio, the national authorities may at one extreme authorise the simple run-off, repaying the estates creditors from loan and interest repayments coming due. At the other extreme, they may authorise the sale of packages of performing loans to other banks, which may maintain the client relationships of the failed bank to some extent. The latter approach may constitute the better choice under normal insolvency proceedings that seek to maximise the proceeds to satisfy the estates creditors. From the perspective of resolution objectives, the aim may be to avoid a credit crunch for the failing bank's borrowers, ensuring the continuity of a potentially critical function. However, since the continuity of this potentially critical function may - or may not - be the outcome of the liquidation procedure, the SRB would have to know that hypothetical choice at the national level to determine if resolution delivers a better outcome from the resolution objectives' perspective.

1 More precisely, the legislation refers to *"a serious disturbance in the economy of a Member State"*.

2 An amendment to BRRD of November 2022 will require Member States to ensure that banks are "wound up under national law" when they are not resolved even though they are found failing or likely to fail.

3 As regards a *"reasonable timeframe"*, in the context of providing Emergency Liquidity Assistance the European Central Bank (ECB) has for example spelled out that a credit institution is considered solvent - even if it does no longer meet the minimum regulatory capital levels - if there is a credible prospect of recapitalisation within 24 weeks after the end of the reference quarter during which capital levels fell below the regulatory minimum, a grace period that can even be prolonged in exceptional cases.

4 To our knowledge, the SRB has not publicly set out a clear threshold above which it considers market shares relevant, for example as regards deposit taking. Our analysis of the resolution of the Sberbank Europe group, a failed banking group that was headquartered in Austria, with seven legally separate bank entities in other countries, however suggest that market shares of 2% and above (in terms of assets held or branches operated) already qualifies to be considered significant.

The SRB issued a document and two updates thereof which describe its approach to the public interest assessment.

Reviewing the SRB's practice to date

The public interest assessment is already applied at the resolution planning stage, at which a hypothetical plan is developed for all banks. At that stage already, the SRB takes a preliminary view as to whether a bank's resolution is in the public interest, which however does not necessarily determine the decision taken if and when the bank fails. Developments up to that point in time, including in the wider financial system, may lead to a different final decision. The outcome of this planning-stage public interest assessment for individual banks is not publicly known. What is however known is that in the yearly resolution planning cycle of 2021, the SRB reported that **82% of the banks in the SRB's remit are earmarked for resolution**[5] (accounting for 97% of total exposure at risk) and the remainder is considered *"earmarked for liquidation"* by the SRB. This information has been published for the first time in July 2022, 7 years after the creation of the SRB, so that it is not possible to say how the public interest assessments have evolved over time and if political expectations to apply resolution more often have already had an impact on the SRB's assessment. The SRB considers that the banks *"earmarked for liquidation"* are *"mostly made up of public development banks and smaller banks with a specific business model"*.

The public interest assessment at planning stage however does not prejudge the public interest assessment at the point of failure of a bank, which determines whether the failing bank is actually resolved or not. There have been 9 cases where the SRB took a decision whether to apply resolution, so far. Out of these, in 6 cases, it was decided that resolution was not in the public interest. In no instance was resolution rejected because of the "relative" assessment of whether the resolution objectives could be as well achieved by insolvency.

ABLV

On 23 February 2018, the SRB took two decisions not to resolve ABLV Bank AS and ABLV Bank Luxembourg S.A., which - following allegations of money laundering - were declared failing-or-likely-to-fail by the ECB. As to the former bank, in 2016, the SRB had adopted a resolution plan with bail-in as preferred strategy, but the plan noted that normal insolvency proceedings would be feasible under certain circumstances. In a 2017 update of the plan, however, the SRB concluded that resolution was not in the public interest since the functions of the bank were not critical and its dismissal would neither significantly impact financial stability in Latvia nor in other Member States. This stance is confirmed by the actual resolution decision. The decision essentially reflects on the bank's market shares in different activities and concludes that the market shares could easily be absorbed by other providers. While most numbers and percentages are omitted from the public version of the decision, it appears that the shares were substantially smaller than those of the next largest competitors in the Latvian market. A particular consideration seems to have been that deposit taking was for a good part from non-residents. The bank challenged the decision *not* to resolve it, but the ECJ confirmed it.

As to ABLV Luxembourg, public interest was also dismissed on the same grounds as for its parent. The market share in deposit-taking is once more omitted from the public version, but a market share of 0.09% in private banking is cited. According to press reports, a Luxembourg court however at first did not accept to pursue the liquidation of the bank but appointed administrators to sell it intact. This illustrates the point made earlier that a bank that is failing from an EU law perspective but not resolved does not automatically qualify for normal national insolvency proceedings. The liquidation procedure was nevertheless opened more than a year later when no buyer had been found.

[5] In comparison, in case of the failed Sberbank Europe group, 5 out of 8 entities in the group were resolved, representing approximately 45% of the total assets, and 3 entities were liquidated, representing approximately 55% of the total assets.

The Veneto banks

On 23 June 2017, the SRB took two decisions not to resolve Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A. At the planning stage,[6] the SRB had in both cases decided that there was a public interest in resolution since insolvency was not *"credible"*, mainly because of the potential impact on market confidence and contagion to other banks. The actual resolution decision concludes in 2017 that significant developments had taken place in the meantime, diminishing the banks' systemic relevance in terms of size, importance, complexity and interconnectedness. For instance, the banks' total assets had declined by 15% and 22%, respectively; nevertheless, the combined total assets of the banks stood at EUR 62.5 bn, still. The SRB points out that neither bank had been classified by the Italian authorities as systemically important and that the EU-harmonised systemic relevance score was for both *"well below"* the threshold for systemic banks of 350 basis points.

The SRB also concluded that at the point of failure, the institutions did not have critical functions essential to the real economy of Italy or for financial stability in Italy. With regard to taking deposits from non-banks, the SRB notes that the market share in Italy had declined to about 0.9% in each case and that the outflows had been well absorbed by other banks. The SRB's decisions mention furthermore that the banks provide loans to more than 300.000 households, 80.000 SMEs and 14.000 other entities. The decisions compare these numbers to the Italian economy overall and conclude that the lending activity can be replaced acceptably and in reasonable time.

The particularity of these two banks is that they were subject to special liquidation procedures afterwards, in which the deposits and the (performing) lending activities were acquired by a private bank in return for a symbolic euro and a state-guaranteed loan of EUR 5.3 bn initially. The acquiring bank also received a grant of EUR 4.8 bn from Italy. See this earlier EGOV briefing for more details. The grant was authorised as state aid, and according to the authorisation by the European Commission, Italy justified the State aid as necessary to avoid *"the disruption of value of the concerned banks, with related big losses for senior creditors, imposing a sudden termination of the creditor relationships for households and SMEs"*.

First, the Italian government reclaimed that a piecemeal liquidation, which it considered the alternative under Italian insolvency law to its actions, to lead to *"the disruption of value of the concerned banks"*. In other words, Italy acted because it believed that a sale of the *"good"* part of the business in its entirety would conserve economic value that would be lost in case the activities were dismantled. While the sale of business is in the SRB's resolution toolkit, conservation of value is however not among the SRB's statutory resolution objectives and hence not taken into account in its public interest assessment.

Second, as regards the deposit-taking activity, Italy was motivated by avoiding losses to the depositors. The SRB by contrast considered public interest to lie only in the continuity of deposit taking, i.e. if the depositors would have been able to place the money with other banks that would have been left to them after eventual losses in the banks' liquidation.[7] Among the SRB's statutory objectives, there is only the *"protection of covered deposits"*. This is understood by the SRB to mean only those deposits up to the coverage level of the deposit guarantee scheme, which the SRB indeed considered to be well-protected by the scheme. Along those lines, the SRB could not pursue a broader objective of protecting depositors more broadly as the Italian government did.

Third, Italy did not share the view of the SRB that the lending activities of the banks are sufficiently substitutable. More specifically, Italian authorities argued that *"the credit crunch could hit around 55,000 firms,*

---

6 There are preceding events to the failure of those two banks, said to be the end of a "*long and troubled journey*". For more details on a planned capital increase, the role of Italy's bank bailout fund Atlas, the pursuit of a precautionary recapitalisation, and the argumentation around systemicness, see in particular the analysis of Silvia Merler: *"A tangled tale of bank liquidation in Venice"*.

7 This would obviously only concern the deposits that are not guaranteed according to Directive 2014/49/EU.

for an aggregated shortfall of ca. [EUR] 22bn, without taking into consideration the second round effects". Andrea Enria, at the time chair of the EBA, remarked that it looked like **two different definitions of public interest** had been applied, one at the EU level and another one by national authorities. Regarding the conservation of enterprise value and regarding deposit taking, this seems to be the case indeed. As regards lending activities however, it appears that the SRB and the Italian authorities applied the same test, essentially if the performing borrowers would continue to be served, but simply arrived at different conclusions.

Finally, one of the resolution objectives consists in protecting public funds by minimising reliance on extraordinary public financial support. However, the notion of extraordinary public financial support is defined in law to be aimed at preserving or restoring the viability, liquidity or solvency of a bank. The state aid in the present case rather aimed at supporting wider public objectives such as the continuity of critical functions, but not at the viability of the bank itself. The SRB's decision does not discuss the possibility that in the course of national insolvency proceedings, taxpayer funds might be used.

Banco Popular

On 7 June 2017, the SRB decided to resolve Banco Popular Español SA. At the planning stage, the SRB had decided that there was a public interest in resolution since insolvency was not *"credible"*, given the potential impact on the Spanish real economy and financial system. This was confirmed in the final decision. The SRB pointed out that the EU-harmonised systemic relevance score was at 402 basis points and thus above the threshold for systemic banks of 350 basis points. The SRB also found that the bank provided critical functions that were not in an acceptable manner and within a reasonable timeframe replaceable. This was so for instance for deposit taking, since the SRB found that the banks accounted for a share in the Spanish market of *"between 5 and 10%"*. The SRB comes to the same judgement for lending to SMEs, were it found that a share of the Spanish market *"between 15 and 20%"* made the bank not substitutable.

The *"relative"* public interest test, i.e. whether winding up of the entity under normal insolvency proceedings would meet the resolution objectives to the same extent, is not discussed in the decision. While the SRB notes in its decision that *"normal insolvency proceedings"* under Spanish law aim at maximizing the value of the assets for the benefit of creditors and entail different procedures, it does not further shed light on why these procedures would not also attain the resolution objectives to some extent. It is merely stated they do not to the same extent. When the decision discusses the critical functions of the bank, the underlying assumption is that insolvency proceeding would disrupt these functions and that the liquidation would not entail the sale of some activities intact to other banks ensuring continuity and possibly conserving enterprise value.

PNB Banka

On 15 August 2019, the SRB decided not to resolve the Latvian AS PNB Banka, which was previously declared failing-or-likely-to-fail by the ECB, inter alia on grounds of persistent breaches of capital requirements. At the planning stage, the SRB had taken a decision on 2 August 2019 that normal insolvency proceedings were credible and feasible for the bank, so that resolution was not in the public interest. This was confirmed by the final decision. As to systemic relevance, the SRB pointed to the small size of the bank (a share of 2.7% of the total assets of all Latvian banks) and its limited interconnectedness with the rest of the financial system. Nevertheless, it also mentions that the bank reached an EU-harmonised score for systemic relevance of 530 basis points, in excess of the threshold score for systemic relevance in Latvia of 425 basis points.[8] As to critical functions, the SRB points out the low market shares in deposit taking (for instance, 2.1% for resident deposits) and domestic lending (0.7%) to conclude that the functions of the bank can be replaced.

[8] The Latvian authorities did nevertheless not classify the bank as systemic arguing that applying the respective EBA guidelines must take into account the specificities of the Latvian banking market, which does not rely on external wholesale funding.

Sberbank

On 1 March 2022, the SRB took decisions over the Austrian Sberbank Europe AG and two subsidiaries in Croatia (Sberbank d.d.) and Slovenia (Sberbank banka d.d.). At the planning stage in 2020, the SRB thought that the resolution of Sberbank Europe AG may be in the public interest as its subsidiary banks were too dependent on the parent entity to survive the latter's insolvency. However, already at the time the SRB reasoned that the activities of the parent in Austria alone did not justify resolution.

The SRB finally decided however not to resolve the parent, but to resolve the two subsidiaries[9] mentioned before. As to the parent, the SRB found its functions less critical for the subsidiaries at the point of failure than before. Interestingly, the decision also reasons that the insolvency framework of Austria allows the continuity of the functions in the insolvency procedure. In other words, the resolution objective of continuity of critical functions would be fulfilled to a certain extent even if insolvency is chosen over resolution.

Further on the parent entity, the non-confidential version of the decision does not mention figures regarding market shares, but it can be inferred that the SRB reviewed such numbers and found them small. The SRB also pointed out the parent had not been classified as a systemic bank. Consequently, the potential impact of insolvency on third parties was not considered to justify resolution.

As to the two subsidiaries mentioned above, the SRB had earmarked them for resolution at the planning stage because of a likely severe impact on the financial markets and the real economies of Croatia and Slovenia, respectively. In the final decision, the SRB concluded in the same way. Current numbers were omitted from the public version of the decision. In the case of the Croatian bank, it is only visible that it was the 8th largest in the country, in the case of the Slovenian bank, it is indicated that it had not been classified as systemically relevant. The reasoning of the decision refers to the possibility of indirect rather than direct contagion on the wider local banking system and points out that resolution would be instrumental to maintaining or restoring confidence. Furthermore as regards critical functions, the SRB concluded that the Croatian bank procured none, while the Slovenian bank's lending to SMEs was considered critical. Again, numbers underpinning this assessment were omitted from the public version of the decision.

Some observations on the practice of public interest assessments

The above overview of the SRB's practice does not purport to capture all facets of the past assessments. Moreover, any possible insights are based solely on the public versions of the SRB's decisions (as an aside, one might question the grounds of confidentiality concerns over, say, market share information of already defunct banks). Nevertheless, the overview in the previous section allows the conclusion that **the harmonisation of the public interest assessment, which the Eurogroup called for, will not be a trivial undertaking**.

Whether functions are critical is apparently considered by the SRB in the light of the market share of the failing institution. One could imagine identifying a threshold percentage of market share that classifies a function as critical. However, **a given market share might be more substitutable in one market than in another**, depending on local competition, for instance. Also the definition of the relevant market is a problem. A small nation-wide market share may hide a particular importance in a regional market or for a particular group of customers, potentially one particularly vulnerable to disruptions of banking services.

Moreover, **judgement and the wider political preferences of stakeholders** may influence decision-making. This is evident from the Veneto banks, case. The same SME lending function that the SRB found

9 Three other subsidiaries of the group were resolved by authorities in other jurisdictions, outside of the Banking Union, involving the National Bank of Serbia, the Federation of Bosnia and Herzegovina Banking Agency, and the Banking Agency of Republika Srpska.

substitutable made the Italian authorities wary of a credit crunch. Ultimately, frictions are unavoidable when a bank exits the market as a lender. Banks have private knowledge about their borrowers. Other banks will be happy to work with clients to obtain that knowledge and replace the loans of the defunct bank. But that can take time and not every borrower's liquidity may allow for that time. And in some cases, the knowledge about borrowers may be so much based on long-standing relationships that it just cannot be rebuild; a particular problem when hard financial information or liquid collateral may not be easily available, or may be less reliable. Last but not least, there may also be groups of borrowers that are of more doubtful credit quality and will for good reasons find it difficult to obtain funding from other banks at market terms. Depending on the composition of a bank's clientele, the economic frictions resulting from the bank's failure may be more or less important and reasonable experts may disagree about how large and durable such frictions will be in any given case.

The judgement regarding critical functions is subject to difficulties on two levels. First, there is the challenge of "objectively" estimating the impact on the economy that results from the bank potentially disappearing. As discussed above, this is not easy and different views are unavoidable, but at least in principle this is a question accessible to expert judgement. Second, there is the **inherently wider judgement** of what impact on a local economy following a bank's failure is acceptable. For instance, the willingness to impose hardship on borrowers may differ from one polity to another. The European legislator may want to consider fine-tuning the legislative framework as to how judgments by the SRB should reflect such political preferences. We will discuss in the last section of this paper that appropriate framing may be one approach and that avoiding a binary decision between resolution or liquidation may be another.

The **systemic relevance of the failed bank** is another area where objective criteria appear to be difficult to devise. There may be a harmonised measure of *"systemicness"* defined by the EBA Guidelines at European level that is indicative of the potential damage from a bank's dismissal to the wider financial system. However, reviewing the practical application in resolution cases, it turns out that *"objectively"* systemic banks went into insolvency while less systemic banks were resolved. For instance, in the Sberbank resolution cases, one might argue that the public interest assessment has rested less in the *"objective"* systemicness and rather in the possible impact on wider market sentiments against the background of a tense geopolitical context and fears of economic repercussions. Such perceived *"indirect systemicness"* can be justified, but is **not easily moulded into objective criteria**.

Furthermore, the Veneto banks' case also shows that **in the eyes of some of the decision-makers involved, the notion of public interest in the EU framework may not be complete/precise**. The motivations of Italian authorities reported in the EU state aid decisions suggest that they saw in the **protection of depositors and senior creditors**, possibly also in the **conservation of enterprise value**, additional sources of public interest. These sources of public interest motivated actions that are typically in the toolkit of resolution authorities - but that are not foreseen in the EU legal framework as valid motivations - i.e. resolution objectives - for applying that toolkit. Not all possible sources of public interest may enjoy consensus at European political level. Nevertheless, the question of possible additional sources of public interest is worth keeping in mind when building a political agreement about further harmonisation of the public interest assessment.

Finally, and not directly related to the public interest assessment itself, the ABLV Luxembourg case also entails an interesting lesson. **It is not because the SRB thinks that a bank can be liquidated that the national framework will necessarily deliver that outcome**. In fact, the national instances operate independently under their own national framework once the SRB has decided against the application of the directly applicable EU resolution framework. They may not follow the view of the SRB that the bank should be liquidated. By consequence, the competent national instances may well conclude against starting liquidation proceedings or steer the process towards unexpected outcomes such as a restructuring or the sale of a business in its entirety, in function of the objectives and possibilities of national insolvency law.

Objectives of expanding resolution

Later in this briefing, we would like to turn to some policy options available to broaden the scope of resolution and to harmonise the public interest assessment. Neither more resolution nor a harmonised public interest assessments can be an end in itself, however. Hence it is worthwhile to consider the **possible broader objectives of legislative change, which are also a useful background to the evaluation of any policy options**. As we discussed in our earlier overview briefing, the Eurogroup's statement has not formulated broader objectives of the reform, while members of the European Parliament have expressed the hope that a reform could remove obstacles to the completion of the Banking Union. How could a reform of the public interest assessment **support the completion of the Banking Union**?

One idea could be that more **predictability of outcomes** may facilitate the pooling of resources in a European deposit guarantees scheme, since the contributing banks would know better when and how their contributions would be used for crisis management. The benefits of predictability may extend further to other areas of the euro area's safety net. This is most obvious for the Single Resolution Fund, but ultimately extends also to the ESM as the Single Resolution Fund's future backstop and to the ESM's wider function to assist euro area countries in financial distress. Since it could strain a Member State's financial strength, the use of public funds in the liquidation of banks may - in the context of the solidarity in the euro area - also warrant political coordination.

Another consideration is the **level playing field in the Banking Union**. With this objective in mind, it is important that failing banks actually exit the market rather than unfairly compete after receiving public support. In this sense, the non-resolution cases considered in this paper all led to the dismissal of the failed bank. Even in the cases where public funds were used, the outcome was the liquidation of the banks concerned and the public support did not keep failed banks in business. Nevertheless, also the bail-out of uninsured depositors and senior creditors in liquidation is not fully anodyne from a level playing field perspective. If expectations for government support become entrenched for some banks but not for others, they may lead to differences in funding costs and to moral hazard - even if the issue is arguably less severe than if bail-out concerned equity and subordinated debt. The cases show that equity and subordinated debt was exposed to losses from the liquidation of the estate each time, although not because of the legislative framework of the banking Union but because of the administrative practice of the Commission as competition authority. Moreover, if the sale of activities to another bank is supported with public funds, there is a **risk that the public support subsidises the buying bank** unless the sales process is a fully competitive one. A European authority managing the sale might be best placed to ensure a competitive process.

Protecting senior creditors and uninsured depositors could be a legitimate policy objective in principle, both in liquidation - where it is possible, at national discretion - and in resolution - where it is possible for depositors, but not for bondholders. If this or other additional policy objectives are considered desirable in handling failing banks, the legislator may want to consider the merits of **pursuing such additional policy objectives in a coordinated fashion as resolution objectives** within the banking union. Or, in view of the budgetary and level playing field implications, allowing the pursuit of additional policy objectives only in national insolvency proceedings may lead to suboptimal outcomes. An interesting question in this context is also if market exit is a necessary consequence of not resolving a bank. Since national insolvency proceedings can also lead to the restructuring or sale and continued operation of a failed bank, it may be possible that the national insolvency procedure leads to a bank continuing in business when that SRB saw no public interest in its resolution. Could such an outcome even be facilitated by public funds? The hurdles of the state aid framework would normally be higher in this type of case than for liquidation aid; however, the hurdles reside in administrative practice of the Commission rather than in the Banking Union's legal framework.

Policy Options

Like the European Parliament, also the Eurogroup supports **clarifying and harmonising the public interest assessment**. Moreover, the Eurogroup "***expects*" resolution to apply more widely**, including to smaller and medium-sized banks, where sufficient MREL and "*industry-funded safety nets*" are available. Nevertheless, the Eurogroup wishes to also have appropriate flexibility for market exit of failing banks in a manner that preserves the value of the bank's assets. In tendency, applying resolution more widely has the potential to support the broader policy objective formulated in the previous section. In the Banking Union, it means that the SRB - as opposed to national instances - would more often be in charge to handle failing banks and also that the directly applicable EU legal framework rather than diverse national insolvency rules apply more often. This improves the predictability of the treatment of failing banks and it also has the potential of further levelling the playing field in the Banking Union.

There are **different policy options that could lead to the outcome of more resolution and more predictability** of the public interest assessment. The choice among the policy options could be guided by how well they attain the broader policy objectives discussed in the previous section and possibly others on the mind of the legislator.

To achieve the objective of framingthe SRB's decision better, a starting point could be **quantitative thresholds in function of when the legislator believes that the resolution objectives are at risk**. For instance, the wording of the public versions of the SRB's decisions suggests that the SRBchiefly looked at market shares when determining whether critical functions of a failing bank have to be preserved. Such thresholds would deliver much predictability - in particular, if applied mechanically. However, as we discussed against the background of the SRB's decisions, setting them appropriately is difficult. They would have to be set rather low in order to ensure that the objective of more resolution is attained with sufficient certainty; and for the banks below the threshold, resolution based on public interest would have to remain an option to avoid that a banks goes into liquidation when there is nevertheless a public interest in its resolution. Setting low thresholds could however be seen to increase the risk of *"false positive"* decisions, i.e. cases where the public interest in ensuing resolution action might reasonably be called into question by stakeholders.

A way to reduce the risk of *"false positive"* decisions could lie in higher thresholds for mandatory resolution, combined with a **strong, but rebuttable presumption of public interest** for all banks or for a defined set of banks below those thresholds. This would sacrifice some degree of predictability. Such a rebuttable presumption could also be applied to all banks or a subset of banks, without thresholds for mandatory resolution. Doing so might sacrifice some more predictability.

While any solutions with rebuttable presumptions sacrifice predictability to an extent when compared to rules that can be mechanically applied, they would allow the SRB to deny resolution in cases where it really sees no necessity and thus avoid false positive public interest assessments. The question is **how to implement a strong presumption in practice**, ensuring that it leads effectively to more resolution as intended. The expectations of the legislator could be expressed in recitals or the legal text could be revised to make resolution the rule and require particular justifications for non-resolution. However, without a material change to the criteria themselves, it cannot be ruled out in principle that the same reasoning used in past negative public interest assessments might also be used to rebut a legal presumption of public interest. Hence, the presumption may signal the legislator's underlying intentions, but it cannot be guaranteed to have a clear effect in practice.

Selected quotes on the scope of resolution

European Parliament annual Banking Union report 2022:

[The European Parliament s]upports the review and clarification of the public interest assessment criteria so that the SRM is applied in a more consistent and predictable manner and relies on objective thresholds.

Eurogroup June 2022 statement on the future of the Banking Union:

[…], the Eurogroup in inclusive format agrees on the following [...]:

- A clarified and harmonised public interest assessment.
- Broadened application of resolution tools in crisis management at European and national level, including for smaller and medium-sized banks, where the funding needed for effective use of resolution tools is available, notably through [minimum requirements for bail-inable liabilities] and industry-funded safety nets.

From the Commission's public and targeted consultation (individual contributions in alphabetic order):

Summary report: In general, the majority of stakeholders considered that the resolution toolbox already caters for all types and sizes of banks, provided that the available tools are applied consistently in case of a failure of banks that are of public interest. […] Most respondents acknowledged that the [public interest assessment] must offer room for interpretation by authorities, but considered that the provision, as regulated now, gives opportunity for many different interpretations, thereby creating level playing field issues and uncertainty. [...] There were mixed views […] more generally […] on the opportunity to amend the Level 1 as observed issues are mainly related to resolution authorities' interpretation of the rules.

European Association of Cooperative Banks: The determination of the scope of resolution framework only in order to differentiate between banks on the basis of their size may simplify the matter but is not fit for purpose. Also the business model, funding structure and risk profile are relevant criteria. The future framework should not change for banks without systemic impact, in particular in respect of banks members of an IPS. All banks, and especially small and mid-size ones without a systemic impact […], should not be subject to disproportionate resolution preparation and resolution requirements, […].

European Banking Federation: More ex-ante clarity is needed on the expected outcome of the Public Interest Assessment should a bank become [a failing or likely to fail] case. […] We would like to recall that the CMDI is designed to apply to all banks in the EU, regardless of their size, complexity, interconnectedness and business activities. It is therefore also suitable for small and medium-sized banks. […] We also point out that the resolution tools currently in place have been developed for the resolution of those banks that in high likelihood would qualify for resolution according to the Public Interest Assessment under the current BRRD rules.

European Central Bank: Broader application of the resolution framework would enhance the level playing field and access to best-practice resolution tools, but this does not remove the need to revisit the liquidation framework. [...] The Single Resolution Board (SRB) should be granted administrative liquidation powers for banks under its remit, giving it the ability to start and manage the liquidation of the assets of banks not subject to resolution, in a way that allows their exit from the banking market.

European Savings and Retail Banking Group: More level playing field is needed in the context of the application of the EU resolution framework. [...] An EU orderly liquidation tool for medium-sized banks does not seem appropriate […]. Criteria linked to the Public Interest Assessment (PIA) should be more transparent and predictable.

Finance Watch: The legal basis for the public interest test (Art. 32(5) BRRD II) provides resolution authorities with a significant level of discretion, which appears appropriate given the wide range of scenarios it is intended to cover. It has proven difficult, however, to ensure its consistent practical implementation. This is attributable primarily to divergences between national insolvency frameworks. In some instances, e.g. the case of Veneto Banca and Banca Popolare di Vicenza, national insolvency arrangements produce outcomes that are similar to those typically associated with resolution, even though the public interest test was negative. Such outcomes are detrimental to the credibility of the resolution framework as a whole and create an unlevel playing field for financial institutions.

Single Resolution Board: We consider that, overall, the existing legal provisions regarding the [public interest assessment] are adequate. [...] The main challenges we face for a consistent [public interest assessment] across the EU are: (1) differences between [national frameworks for normal insolvency] can lead to different outcomes for [public interest assessment], so harmonisation of [national frameworks for normal insolvency] would be very helpful in this regard, and (2) access to consistent data at regional level and on DGS capacity.

The way a rebuttable presumption operates could be strengthened through **procedural means**. For instance, **the SRB could be obliged to obtain the agreement from another instance** to confirm its departure from the legal presumption. For instance for all banks or banks of a certain size it might be required to obtain the agreement of national authorities that a failing bank is not of systemic relevance or does not provide critical functions. It might thus be possible to avoid inconsistent views between national instances and the SRB and enhance the predictability of outcomes. As a lighter-touch alternative, the SRB could also conduct a dialogue with the relevant national authorities about resolution objectives such as the assessment of critical functions and financial stability impact. Such a dialogue could be documented it in a transparent fashion. That way it could be ensured that the views of national authorities are taken into account in the SRB's decision. Thus, it may be possible to ensure that divergences of views would be more limited than in the past. Or, where such differences persist after a dialogue, a transparent documentation may at least make them more tractable for the legislator.

A possible **problem with *"false positive"* decisions** is that they may lead to legal challenges. Resolution does interfere with property rights and existing contracts and may impose financial losses on banks stakeholders, creditors and owners. Such interference can be justified when there is a sufficient public interest. In consequence, creating legal thresholds and presumptions of public interest without a differentiated case-by-case assessment may mean that at times, such decisions can be more difficult to defend if challenged in court. However, it should not be forgot that **also the alternative to resolution, insolvency proceedings, interferes with property rights**. A particularity of the European resolution framework is that because of the *"no creditor worse of"* principle, the interference from a creditor perspective is not worse than that in national insolvency proceedings. Successful legal challenges - at least from creditors - may therefore be less likely when it can be demonstrated that the bank to be resolved would otherwise have undergone insolvency proceedings. However, as discussed in the first section of this briefing, not every bank that meets the *"failing or likely to fail"* test also meets the criteria for national insolvency proceedings such as overindebtedness and illiquidity. Therefore, a more differentiated assessment of public interest might be worthwhile for banks that would not qualify for national insolvency proceedings, while it might be possible to **consider a streamlined public interest assessment when a bank would clearly be subject to national insolvency proceedings** if not to resolution. It might also be worth considering if it is possible to harmonise, for banks, the entrance criteria for national insolvency proceedings, aligning them with the *"failing or likely to fail"* test. If the entry criteria are the same, it is more difficult to argue that interventions in property rights would have been avoided absent resolution.

A further issue to consider is that the Eurogroup wishes to also have **appropriate flexibility for market exit** of failing banks in a manner that preserves the value of the bank's assets. When more banks are subject to the resolution legislation rather than insolvency, it might therefore be **advisable to review the possibilities to achieve market exit of banks *within* the resolution framework**. The resolution framework already entails sale and transfer tools that facilitate transferring valuable balance sheet positions out of a failing bank, thereby preserving their value and possibly the critical functions linked to those balance sheet positions. In fact, a sales process of entire business activities, organised transparently at European level, might often yield better revenues for the institution's creditors and might be more likely to foster cross-border solutions in the Banking Union than national insolvency proceedings. Once this has happened, steps can be taken to let the remaining activities run off or sell individual assets, ensuring the market exit of the failed bank including the ultimate defeasance of the legal entity by national instances. If the review of those tools ensures that they are effective and efficient, it may be possible **to rely more often on the resolution framework for those banks that are supposed to exit the market**, rather than to immediately apply national insolvency proceedings, which make predictability more difficult.

Up to this point, we have simply assumed that there can be *"false positive"* decisions to apply the resolution framework. Whether this is the case, however, ultimately depends on the design of the resolution framework. It is possible to conceive **a single framework that is flexible enough to deal proportionately with all banks that are failing or likely to fail**, balancing adequately public interest in the SRB's actions with interventions in property rights and ensuring market exit of failed banks where appropriate. Such framework would have to ensure through the way that it operates - rather through entry criteria into it - that any interventions in private property rights are proportionate to the public interest in such interventions. This should be possible when the interventions respect the *"no creditor worse of"* principle and when it is likely that the bank would be anyway subject to insolvency proceedings intervening in property rights if, hypothetically, the resolution framework didn't exist.

Such framework would also have to be sufficiently flexible to allow for market exit of failed banks, allowing for the sale and transfer of business activities to third parties where possible to preserve value and maybe to ensure the continuity of lending and other services for bank customers, even when the services do not qualify as critical in the current legislation. In principle, tools to transfer activities already exist in the framework and could be used to this end. It could be assessed whether the existing tools also enable - or could be modified to enable - the work-out and wind-down of the remaining activities, either respecting a creditor hierarchy specific to the European framework or respecting that of a relevant national insolvency framework. In that case, the resolution framework could handle the failure of a bank down to the point where the legal entity can be cancelled from the national register. Alternatively, the existing framework already provides for winding up a *"residual entity"* under national law. A possible attraction of this kind of a comprehensive framework might be that it could be completely or almost completely laid down in directly applicable European law and for all important purposes applied by a European authority, **ensuring to a large measure predictability and a level playing field in the Banking Union**. Moreover, as we discussed earlier on in this paper, the current binary public interest assessment often may result in judgements with inherently wider political elements, which could be largely avoided if the procedure itself systematically ensured that viable functions of the failed bank are transferred and continued while the non-viable ones are liquidated.

Contact: egov@ep.europa.eu

This document is available on the internet at: www.europarl.europa.eu/supporting-analyses