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The EU Home and Home-Host Dilemma

The Resolution Perspective

Introduction

The challenges arising from bank failures during the global financial crisis (GFC) exposed significant asymmetry of information problems. The inability of the official safety net to differentiate between banks that could be a threat to financial stability and those that are not a threat to financial stability at the height of the crisis resulted in individual bank rescues and market-based support operations when in some cases this may not have been necessary. The EU reforms address issues of asymmetry of information by improving the preparation for resolution and introduce tools for restructuring failed banks to safeguard those banks in resolution undertaking critical functions in the financial system and within the real economy. The process of preparation *ex ante* minimizes the asymmetry of information problem by identifying banks that are important for the purposes of financial stability and so require the use of resolution options to mitigate the risks that could arise from a disorderly failure. Those banks considered not to be providing critical functions can be separated out and designated for insolvency/liquidation proceedings outside the formal resolution objectives and principles, if they were to fail. **5.1**

The efforts to execute resolution reconfigures the incentives by providing the resolution authority with the decision to decide whether a bank is failing or likely to fail and also minimizes the moral hazard problem by placing the burden on shareholders and some creditors rather than it being placed on the shoulders of states and taxpayers. The starting point is supervision and preparation for resolution to minimize hidden information problems between banks and supervisors at an early stage. The discovery of those hidden information problems at an early stage will enable the supervisory authority to assist the resolution authority. The resolution authorities require accurate information to improve their decision-making when it comes to failing banks to ensure their resources for the purposes of resolution are used only for those banks considered a threat to financial stability. More importantly this ensures the losses that accrue in the first instance are absorbed by shareholders and creditors. **5.2**

The asymmetry of information challenges faced at the domestic level are intensified when the decisions are associated with failing banks across jurisdictions. The decisions relating to cross border failures require a significant degree of coordination and cooperation to minimize adverse spillover effects both for resolution and insolvency decisions. At both the *ex-ante* preparation and *ex post* crisis management and containment level, the interplay between competing authorities and the significance of different parts of the bank group can create conflict where information between them is not complete. The focus on bank group **5.3**

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resolution requires a serious consideration of the techniques to manage bank failures, by deconstructing the risk profile of banks and groups from the perspective of the home and host. In part the construction of the approach to resolution leads to resolution potentially falling along national lines if a strict analysis is taken in view of the level of discretion that exists within the legal instruments. The administrative powers and techniques set out in the instruments will be analysed to assess the level of administrative discretion and how that administrative discretion is likely to play out in the scenario where the home and host may or may not cooperate since their national interests may not align. The level of discretion between home and host could lead to a position where the interests of some hosts, in view of their relative exposure either at the branch or subsidiary level, may not play out in a way that properly reflects their interests or their interests are prioritized differently in view of the economic importance they represent at the group level and at the local level. In view of this a significant level of home bias can influence decisions associated with resolution both directly and indirectly. Moreover, centralized decisions exercised by the ECB and SRB can underestimate the local importance of credit finance as a critical function and so designate narrow banks in relatively smaller Member States to insolvency-liquidation.

5.4 This chapter focuses on the relationship between home and host when it comes to resolution of banks. The relationship between home and host is not a simple binary relationship where either of the interests of the two can influence outcomes. It analyses the responsibilities of each when it comes to branches and subsidiaries. This essentially leads to two potential outcomes group resolution and entity-level resolution. However, the linchpin for cooperation remains national interests which can be partly mitigated by centralization of decision-making. The role of the ECB and SRB at the centralized level can deal with coordination and timing risks in terms of announcements. This is a significant improvement and can ensure consistency of treatment. The preparation for resolution is long and complex and this is addressed in the following section on resolvability. An analysis of the underlying requirements is necessary. It is evident a significant amount of cross-border coordination and cooperation is needed to address the impediments to orderly resolution. The construction of the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) and the decision about resolution strategies Single Point of Entry (SPE) or Multiple Point of Entry (MPE) are explored and it is evident who forms part of either approach gives rise to a range of questions. The resolution colleges play an important role to inform resolution decisions. However it will be shown that a significant level of discretion exists and the home resolution authority can play a role that influences the way information is shared. The ECB and SRB role in forming the decision of whether a bank is failing or likely to fail is then explored. The ability to intervene in the restructuring of banks inside resolution is specifically considered. The options for resolution are also explored in terms of their function in resolution. The chapter will show that a one-size-fits-all approach to resolution is unlikely and a multiple set of tools will be used in resolution. This is illustrated by the following section which reviews the outcomes of Member State resolution decisions notified to the EBA. It is evident the national resolution authorities have interpreted the public interest test flexibly than the SRB. The final part of the chapter will then explore the third-country perspective and the level of discretion that exists within the instruments to coordinate and cooperate. It is argued the level of discretion inevitably leads to a position where EU Member States can act in their own self-interest. Equally the SRB has entered in to various Memoranda of

Understanding (MoUs) with various third countries and indeed some accession countries. Notwithstanding these initiatives, effective preparations are still likely to fall along material risks. It is argued that reciprocal measures need to be in place so all can prepare for resolution at the group or entity level. The pre-commitment to this at least will minimize the potential conflicts that can invariably arise once a crisis ensues.

Resolution Framework and Legal Form—Branches and Subsidiaries

The legal form of banks influenceds the responsibility of the home and host competent authorities for the purposes of supervision, and resolution is no exception. In respect of the legal form of branches and subsidiaries, the Banking Recovery and Resolution Directive[1] (BRRD) determines the specific responsibilities of the home and host resolution authorities and how they are expected to cooperate and coordinate to form a coherent approach to bank-group resolution scheme and safeguard financial stability and minimize the potential risks of a systemic crisis. In view of the potential spillover effects of the financial crisis, Member States are expected to take into account the impact of their decisions at the *ex ante* and *ex post* levels on the financial stability of other Member States. More specifically, Member State authorities are expected to take into consideration the interests of other Member States, even when it is not of mutual benefit but rather in the interest of the host Member State, where it is more important than it is to the interests of the consolidated group.[2] It is important to note that in respect of subsidiaries, the host-home Member State resolution has the discretion to decide whether or not it will form an integral part of the home parent entity group resolution strategy. This will be determined by how material the parent entity group resolution authority considers the subsidiary to be. Equally important is the approach to deal with the subsidiary the home Member States has recommended for the subsidiary since the host-home may be unwilling to opt for the group strategy. But as will be shown below, the resolution authority of the subsidiary can exercise its discretion to resolve the problems at the subsidiary level in accordance with its concerns about market financial stability. This power to exercise national discretion does not exist for branches or significant branches. **5.5**

To simplify and delineate clear lines of responsibility, the BRRD does set out specific functions to the home and host resolution authorities. Member States responsible for consolidated supervision are responsible for group recovery plans and recovery plans for individual incorporated institutions. Where institutions have significant branches, these would need to be incorporated into the recovery plan as well. The competent authority responsible for consolidated supervision is expected to 'transmit' what is relevant of the group recovery plan to the host competent authorities of a significant branch. This is primarily likely to be **5.6**

[1] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council [2013] OJ L173/90 (BRRD), Recital 102.

[2] BRRD, Recital 132; Art. 87.

information regarding the continuity of intra-group finance or alternative forms of finance from the parent to the significant branch. In respect of subsidiaries, either a group recovery plan or an individual recovery plan may require such information about intra-group financial support. In view of the earlier finding, it is evident a significant proportion of subsidiary finance is locally sourced in foreign markets but it is nevertheless important that intra-group and interbank finance is understood to ensure the risks of a liquidity shortage can be mitigated. From the perspective of the resolution authority, the commitment to draw up resolution plans is to liaise with their counterparts responsible for subsidiaries and those responsible for significant branches. Significant branches will fall within the parent entity recovery and resolution plan, but in view of their significance in the host Member State it would be important for the host to be aware of what is likely to happen in resolution to the parent in view of its impact on the significant branch. For foreign banks with ultimate foreign parents in a third country, the sub-group in a Member State will be required to draw up a resolution plan for the European part of the group. In terms of information-sharing, the commitment is to share what is relevant to the respective entity,[3] for instance in relation to assessment of impediments to resolvability.[4] It will be important to evaluate how this discretion power is interpreted. The BRRD requires Member States to give effect to transfer orders relating to instruments of ownership, assets, rights, and liabilities from other Member States.[5] Member States are required to provide all reasonable assistance to ensure compliance with such orders. Member States 'are not entitled to prevent, challenge, or set aside the transfer under any provision of the law of the Member State where the assets are located or of the law governing the shares, other instruments of ownership, rights or liabilities'.[6]

5.7 The presence of branches and subsidiaries in a foreign Member State confers specific obligations on the host and host-home authority for the purposes of crisis management assistance. It acutely highlights the fragmented nature the group can appear to have, despite operating as a single economic entity from business and operational perspectives. This requirement means at some levels that crises within a group and sub-group structure can be isolated at the local level rather than at the ultimate risk basis at the highest level of the group as set out earlier in Chapter 1. The implications of this approach mean that at the host and home-host level a problem at the branch and subsidiary level could be contained by the local competent and central bank authorities. At the pre-insolvency period, in terms of precautionary recapitalization or emergency liquidity assistance, this falls within the national administrative discretion of the national authorities and is left to their opinion of the seriousness of the circumstances.[7] In view of this, Member State authorities need to take seriously their commitment to cooperate and coordinate their efforts to contain a crisis and minimize its spillover effects in to other interconnected markets. It also means the national authorities at the ultimate risk basis could possibly minimize their exposure or indeed show their commitment to the parent entity, therefore highlighting the importance of *ex ante* commitments to such efforts if circumstances arose.

[3] BRRD, Art. 13(1).
[4] BRRD, Art. 15(1), Art. 17(1).
[5] BRRD, Art. 64(1)(a)–(f).
[6] BRRD, Art. 66(3).
[7] See Chapter 7, 'The EU Mechanisms of Financial Crisis Management and Containment: Decentralized and Centralized Approaches'.

The material importance of the branch and subsidiary in the local market is a key determinant of such assistance being provided. It equally highlights the material importance of the branch or subsidiary to the group as well, which could step in to refinance the business. Financial support via intra-group arrangements between the parent or other subsidiaries within the group can be formally agreed *ex ante* and act as a first order line of defence if the entity is experiencing liquidity problems.[8] The requests could come either downstream, upstream or even side-stream between the different entities within the group. The relevant point here is the fact that the competent authority at the consolidated supervisory level or even at the entity level could prohibit or restrict such financing requests to ensure it does not jeopardize liquidity position of the provider. 5.8

Resolvability and the Minimum Required Eligible Liabilities

The focus on resolvability of the institution or group, from the perspective of the BRRD, is very much tied to the process of supervision and resolution in a continuum across national lines.[9] The assessment of resolvability needs to be made based on the criteria set out in the Annex Section C of BRRD. The assumption that there is no extraordinary support, central bank emergency liquidity assistance or liquidity assistance on the basis of non-standard forms of collateral is incorporated in evaluating whether the institution or group is resolvable.[10] In the context of groups, the supervisory college and the resolution college play a crucial role in determining the best way to overcome impediments at a cross-border level.[11] The competent authorities and resolution authorities can require changes in the business organization of an institution or group to resolve impediments, such as addressing the level of large exposures or divesture of assets or business lines, new or old.[12] Moreover, the competent authority or resolution authority could require the institution or group to make changes to its own funds and/or liabilities to improve the level of eligible instruments for conversion or write-down.[13] 5.9

The introduction of MREL into the resolvability assessment of banks has been an important addition to the process of assessing the options for resolution and the chances of recapitalization in periods of distress.[14] The EBA published in 2016 its report mandated by the BRRD on the implementation of MREL looking at the different challenges that exist with its adoption.[15] In many respects the introduction of MREL provides the tools for the resolution authority to work with institutions it is responsible for on a more continuous basis. In contrast to perhaps the more annual process of resolution planning 5.10

[8] See Chapter 3, 'The EU Home and Home-Host Dilemma: The Prudential Supervisory Perspective', para. 3.36.
[9] BRRD, Art. 15.
[10] BRRD, Arts 15(1)(a)–(c) and 16(a)–(c).
[11] BRRD, Arts 16(2) and 17.
[12] BRRD, Art. 18.
[13] BRRD, Arts 17 and 18.
[14] SRMR, Recital 84; BRRD.
[15] EBA, Final Report on MREL: Report on the implementation and design of the MREL framework, EBA-Op-2016, 14 December 2016 (EBA MREL Report 2016). Cf Tröger and Hans, 'Why MREL Won't Help Much' (21 August 2017), Journal of Banking Regulation Vol. 20, 2019, Forthcoming; SAFE Working Paper No. 180; European Banking Institute Working Paper No. 13. Available at SSRN: <https://ssrn.com/abstract=3023185> or <http://dx.doi.org/10.2139/ssrn.3023185>.

and in addition to working with firms that have failed and are moved to resolution or insolvency. Requiring the resolution authority to work with the other parts of the crisis management official safety net players. The development of loss absorbing (MREL or total loss-absorbing capacity (TLAC)) requirements replicates in some ways the move towards introducing common capital requirements at the international level. In this respect the international and regional focus needs to be on creating a level playing field and ensuring the rules associated with loss absorbing capacity are proportionate between large 'complex' and small 'narrow' banks, but equally important for those included in the single point of entry and multiple point of entry resolution strategy. Indeed the Single Resolution Mechanism Regulation (SRMR) goes as far to highlight the importance of loss absorbing capacity to be located across the group rather than what is advocated at the international level of it being centralised in a single location.[16] The EBA report notes that the expectation would be coordinated with the resolution authority for the entity to pass on the losses that would be absorbed by the resolution entity.[17] In view of this resolution, authorities need to develop the capacity to undertake the various responsibilities conferred to them to act as a line of defence and minimize the disruption of not having a sufficient amount of loss-absorbing capacity to prevent a disorderly resolution. This also extends the responsibility of the resolution authority and would need to be complemented to include the authority to take administrative enforcement actions against individual banks for breach of loss-absorbing requirements.[18] This would offer middle ground sanctions rather than relying on the threat of triggering whether the bank is failing or likely to fail.

5.11 The MREL requirements form the basis of internal financial resources to absorb losses and, by deciding which options are likely to be utilized in a given stress scenario, to recapitalize the institution.[19] In this respect, capital requirements are outward-facing and do form the basis of the external cushion for absorbing losses, whereas the MREL are seen as internally facing and form the basis of an internal cushion for absorbing losses by utilizing funds for recapitalization. In the former case, capital requirements form the basis of a going concern scenario and, in the latter case, MREL requirements form the basis of a gone concern scenario and the likely options for recapitalization.[20] The challenge for institutions is whether they have such internal own funds and eligible liabilities to form the basis of finance to recapitalize the bank.[21] What impact will compliance with the MREL requirements have on the business model in these jurisdictions? Is there sufficient discretion with the resolution authority to enable existing externally facing capital requirements to form the basis of internal MREL? In this respect, the competent and resolution authorities need to align their efforts to ensure banks are not moving to a position of doubling on own funds and eligible liabilities and reducing the level of finance they can utilize in the market.[22] These matters are important because they also influence decisions associated with the use of the resolution fund (RF) and the deposits guarantees scheme (DGS) during

16 SRMR, Recital 84.
17 EBA MREL Report 2016, p. 9.
18 BRRD, Art. 17(5)(i) and Art. 17(5)(j); See EBA MREL Report 2016, pp. 91–9.
19 EBA MREL Report 2016.
20 EBA MREL Report 2016, p. 86.
21 EBA MREL Report 2016, at pp. 82–3.
22 EBA MREL Report 2016, at p. 111.

the resolution process, since their roles are factored into the assessment of resolvability for the purposes of setting the MREL.

The MREL requirements are premised on a broad and, in some respects, ambiguous idea of determining the amount of loss-absorbing capacity of the bank.[23] In this respect, the resolution authority is required to take into account the supervisor's decision on how it has gone about setting capital requirements for the bank.[24] It has to ensure that the bank complies with CRD IV and CRR requirements: **5.12**

(1) own funds requirements:
  (a) CET 1 capital ratio of 4.5% of the total risk exposure amount;
  (b) Tier 1 capital ratio of 6% of the total risk exposure amount;
  (c) a total capital ratio of 8% of the total risk exposure amount;
(2) requirements to hold additional own funds in excess of the requirements above;
(3) combined buffer requirements;
(4) the Basel I floor; and
(5) applicable leverage ratio.

In light of these supervisory requirements, the resolution authority takes into consideration (1), (2), and (3) and in some circumstances, (4) and (5). Therefore, the MREL requirements are negotiated between the bank and the resolution authority. Moreover, the resolution authority is expected to exclude those liabilities that are not eligible for bail-in. The calculation of loss-absorbing capital is, therefore, likely to be made up of both regulatory capital and set levels of capital buffers, namely the systemic risk buffer and the counter-cyclical buffer. The level of loss absorption is likely to lead to a position where the bank is compliant with regulatory capital levels at the minimum, or even above, but that does not necessarily imply it will be recapitalized to the same level as before, maintaining, in this way, its G-SII or O-SII position. For it to retain such a position, the level of loss-absorbing capacity is likely to be extremely high which is not likely to be the aim of the resolution authority. **5.13**

The complexity of setting the MREL therefore requires very close cooperation between the supervisory authority and the resolution authority to avoid a position of what the industry refers to as doubling capital requirements, since it gives rise to an overlapping mandate between the two authorities in this process. The asymmetry of information between the two authorities means they need to work closely together in setting the MREL. In light of this fact, many of the banks in these jurisdictions weathered the GFC reasonably unscathed. Recital 8 of the MREL highlights an important principle that should influence these decisions: 'Resolution authorities should set MREL consistently with those arrangements where they are integral to the institution or group's preferred resolution strategy'.[25] This principle improves the level of buy-in to the move that introduces these reforms and improves the **5.14**

[23] Commission Delegated Regulation (EU) 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities [2016] OJ L237/1.
[24] Delegated Regulation 2016/1450 Art. 1.
[25] Commission Delegated Regulation (EU) 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities [2016] OJ L237/1.

outcomes by fitting existing business and funding models rather than it being transposed from above with little regard of the idiosyncratic features of the business. However, as noted in different parts of the report, it would be appropriate for the group resolution authority and the other resolution authorities to be informed of how the MREL will be set. If it is simply going to involve only those members of the resolution college with significant interests to the group, then a number of Member States are unlikely to be involved in how it is calculated.

5.15 The resolution authority is expected to decide the amount of loss absorbance expected to fulfil the resolution options decided by the bank.[26] In this decision, it could be decided that the bank is not expected to hold additional capital for the MREL, namely for recapitalization purposes, since the option in resolution is insolvency. Alternatively, the resolution authority has the discretion to argue that insolvency is not the appropriate option in the public interest and, therefore, requires an amount of capital for recapitalization purposes. This decision is likely to be made on the bank's assessment of its business operations. It depends on whether the bank undertakes business lines that are deemed critical by the supervisory authority in terms of their importance and lack of substitutability and perhaps the level of market concentration it could result in if critical functions formed part of a private sector sale to a direct competitor. The resolution authority then needs to assess the costs of implementing the resolution option and decide the level of contribution to achieve that resolution option the bank is expected to make to execute it. In setting the amount the resolution authority is expected to factor in the level of additional support, the bank would need to return it in compliance with regulatory capital requirements as well as supporting the intended resolution option to safeguard the continuity of the critical functions the bank undertakes. The resolution authority is expected to assess the feasibility of complying with the MREL from the perspective of the bank, but also the credibility of achieving the intended outcomes in order to maintain market confidence.

5.16 The decision to set the MREL by the resolution authority will differ on whether it is the group-wide resolution authority or the resolution authority of an individual subsidiary; more specifically, whether the resolution strategy is likely to be a SPE or an MPE or a combination of both a SPE and an MPE during resolution.[27] In this scenario, the group-wide decision on recapitalization is likely to lead to greater economies of scale and, therefore, lower levels of loss-absorbing funds, whereas the alternative is likely to mean higher or even no loss-absorbing funds at the local level. The important policy point here is that there is no uncertainty as to the options taken, even if it is a combination of a SPE and an MPE, as long as the local resolution authority is able to set the MREL adequate for the local operations to achieve the desired resolution option set for the bank to safeguard local critical functions. From the group resolution perspective, while resolution options may be set out for the group as a whole to safeguard critical functions, it could be the case that peripheral banks have been designated for insolvency-liquidation. At the local level this is not likely to get much support, hence, the need to have both options of SPE and MPE at their disposal with options set out to achieve both ends. This point is given more emphasis in light of the fact that Member States have exercised their discretion to classify subsidiaries in their

[26] EBA MREL Report 2016, at p. 63.

[27] See section Single Point of Entry and Multiple Point of Entry Resolution, para 5.22.

market as O-SIIs for the purposes of countercyclical and systemic risk buffers. It is therefore important that this flows to other parts of micro-prudential decision-making as well, such as setting MREL and the contribution to loss-absorbing capacity. For the purposes of group MREL, it is important that the third country can contribute to the level set and also know whether the level of loss absorbency would cover subsidiaries in its jurisdiction as well. However, the draft technical standard is silent on the third country position. The resolution authority of a Member State should exercise their discretion to formally include entities in third countries to ensure a more orderly group resolution taking into account local entities as well or at least enabling them to decide for themselves the options most appropriate for their local needs.

The setting of the MREL incorporates the role of the RF[28] and the DGS in the decision-making process.[29] This is at two levels: **5.17**

(1) First, at the resolution level and the extent to which the criteria for resolution support is achieved by the conversion or write down of at least 8% of eligible own funds and liabilities. In this respect, therefore, as a minimum, the MREL do exist in the form of the obligation to have sufficient own funds and liabilities for the purposes of recapitalization to access the resolution fund.
(2) Secondly, at the insolvency level, with the factoring in of DGS support if losses to covered deposits ensued and payment from the DGS is executed.

The opportunity to stress test the banking system and the likelihood of requiring this support from both ends enables the resolution authority to gauge the level of the MREL at the market level as well as the institutional level. Taking into consideration the point that the RF and the DGF are exhausted if the Member State was to experience a multiple bank failure, in the case of the DGS, as argued in Chapter 6,[30] the level of contribution expected to be provided in real time is likely to open up an expectations gap considering its limited purpose in a systemic crisis or a crisis where there was a multiple bank failure. In such circumstances, the lack of a sufficiently funded resolution and deposit guarantee fund means government intervention is inevitable.[31] The outcome of such an exercise is useful to gauge the level of support necessary to enable an orderly resolution or insolvency. However, it is important to also consider the position that it may be unlikely as well that these funds would be needed for large complex banks that have other business lines which could be sold to cover such exposures. Therefore, the reliance on them would be very much a last resort for such institutions in the category of Global Systemically Important Institutions (G-SII) or Other Systemically Important Institution (O-SII). In such circumstances, it is unlikely they would be depleted of own funds and liabilities for the purposes of recapitalization. The discretion will be with the supervisory authority to determine whether authorization requirements continue to be fulfilled.[32] **5.18**

The differing mandates of supervision and resolution may need to be worked out in advance to minimize conflicts of interests and align their mandates. In part this is challenged by **5.19**

[28] EBA MREL Report 2016, at p. 130.
[29] EBA MREL Report 2016, at p. 129.
[30] Chapter 6, European Bank Insolvency and Liquidation Proceedings.
[31] EBA MREL Report 2016, at 139.
[32] EBA MREL Report 2016, at pp. 70 and 92.

the political willingness to move banks into insolvency rather than resolution. Invariably the process of structuring administrative oversight of this space will take a considerable amount of effort just as it did with capital requirements and the recent emphasis on liquidity requirements. An important element that will complement resolution authorities in this area is disclosure as another monitoring and policing mechanism. The market should be able to play a role to ensure the levels of loss absorbing at individual banks are fit for purpose, which can only be assured if banks explain their strategy to improve their loss-absorbing capacity. According to S&P Global, the greater visibility of such requirements can contribute to improving the credit rating of banks, so providing a positive incentive to improving its visibility and levels of market confidence.[33] A lack of transparency is likely to lead to asymmetry of information problems that could lead to undermining confidence in the individual bank or indeed the sector. The role of enforcement powers for non-compliance is equally important, providing the resolution authority with a set of powers if a breach of compliance is identified.

5.20 An inevitable challenge of looking at the composition of the balance sheet of a bank in a variety of ways is the problems associated with such a perspective. Moreover, the level of heterogeneity within the banking system of the EU highlights that a single approach is less likely to be effective or proportionate and so requires a significant degree of discretion at the local level. A need exists to ensure small and medium size banks do not issue bail-in-able instruments to retail customers which is common in the sector.[34] A recognition of narrow banks can equally provide critical functions such as credit finance in the market. Therefore, if the national designated authority considers institutions systemically important and requiring additional capital buffers then they also need to be considered more seriously as candidates for resolution rather than insolvency. Since the critical functions they provide in the real economy are not substitutable, for instance, then insolvency-liquidation may not be the appropriate solution. Unless techniques of insolvency consist of tools present in resolution. For instance, the Italian Compulsory Liquidation Regime, referred to in Chapter 6, used for the two banks from the Veneto region.[35]

Single Point of Entry and Multiple Point of Entry Resolution

5.21 The centralization of resolution decision-making is a significant move towards diminishing the incentives of Member States to resolve groups and/or institutions across national lines and in their own interests. This is formally achieved at the Eurozone level where participating Member States of significant banks in the capacity of home and host will have the Board to undertake resolution at the group level and so technically reduce the incentives of home bias within the SRM. The view of the Financial Stability Board (FSB) is that there is

[33] S&P Global Ratings, 'Proposals for EU Banks' Bail-in Buffer could lead to broader ALAC Rating Uplift' (August 2016).

[34] EACB Comments on EBA Public Consultation on 'Interim report on the implementation and design of the minimum requirement for own funds and eligible liabilities (MREL) 30 August 2016, p. 7.

[35] See Chapter 6, European Bank Insolvency and Liquidation Proceedings, para. 6.40.

no one-size-fits-all approach and it is perfectly feasible for both approaches to be used simultaneously and result in an orderly resolution.[36]

The SPE model assumes resolution will be initiated by the group resolution authority at the group parent level or at the holding company level. In order to execute this, a number of key requirements need to be in place or at least worked out *ex ante*. First, the parent and/or the holding company needs to have in place the appropriate amount of loss-absorbing capacity (LAC) and a pre-commitment that it will be accessible to important subsidiaries in pre-identified host states. In this model, the large proportion of the LAC is at the parent level or holding company level and if such a subsidiary experiences a loss those losses are upstreamed and absorbed by the parent or holding company, either as a whole or partially. The parent or the holding company is committed to downstream capital and liquidity for the subsidiary to enable it to continue as a going concern or enable further restructuring. Since it is likely to be part of a resolution strategy, the other parts of the resolution may well include the other tools in the resolution tool kit, namely bail-in, bridge bank, and asset separation. The challenge for an SPE approach is that the group level resolution authority needs to be well prepared to ensure full coordination and cooperation and indeed confidence and trust among the different states and minimize impediments to resolution. **5.22**

The MPE assumes resolution of a banking group will be initiated by a number of national resolution authorities. The combination may well be the group resolution authority and/or one or two other national resolution authorities. In terms of the LAC, it will need to be in place at various points within the group. It is expected that the LAC exists in sufficient amounts at the entity level. The subsidiary needs to be self-reliant on a number of levels. In particular, the national resolution authorities will need to ensure continuity of support services, such as IT services, to the entity to ensure it can continue its critical functions. These critical functions are primarily for the purposes of the domestic market and so the resolution scheme is expected to be aimed at ensuring financial stability at the local level. The challenge for the MPE approach from a coordination and cooperation perspective is greater from a cross-border perspective than that for the SPE. In view of this it is argued the MPE strategy cannot be assumed to be one of liquidation but rather a separate resolution technique such as sale of business or asset separation in addition to the SPE for the parent entity and the most material entities of the group to safeguard local critical functions. Even in circumstances where a SPE has been executed, additional measures to recapitalise the parent entity may still be purposed leading to the sale of business technique *ex post*. **5.23**

Implicit in the SRB's role as group resolution authority will be the benefit of the home Member States and those hosts that are participating Member States where important subsidiaries are located. Mindful of this, the Board is likely to want to assess, when devising resolution plans, whether or not a SPE approach or a MPE is needed to ensure orderly resolution. The Board is likely to want the quickest and most orderly outcome that will enable it to maximise **5.24**

[36] See Jeremy Jennings-Mares, Anna T Pinedo, and Oliver Ireland, 'The Single Point of Entry Approach to Bank Resolution' in Jens-Henrich Binder and Dalvinder Singh (eds), Bank Resolution: The European Regime (Oxford: Oxford University Press, 2016) para 14.11. See also Costanza A Russo, 'Resolution Plans and Resolution Strategies: Do They Make G-SIBs Resolvable and Avoid Ring Fence?' European Business Organization Law Review (2019) pp. 1–43.

coordination as the group resolution authority to the widest extent possible. This can be achieved by addressing the most significant parts of the group, but it implies that those on the 'periphery' are likely to be outside this single scheme with the assumption that insolvency is the likely option. However, the issue with this option is that it fails to consider the importance those entities on the 'periphery' have to the host Member State. An SPE approach is likely to be preferred where there is a joint decision amongst the majority of the home and host Member States. However, where a joint decision is not likely, an MPE approach is likely to be the outcome as well which will mean parts of the resolution coordination remain with some participating or non-participating Member States, since there will still be a risk that a Member State is not satisfied with the outcome of the SPE resolution set out in the resolution scheme. In light of this, it is important for the home state to put in place the right incentives for a particular approach or indeed a combination of approaches. However, this section will consider the implications for those small host states where a significant subsidiary is incorporated.

5.25 The fact that the national authorities are expected to have sufficient levels of local capital and liquidity and LAC means that the national resolution authorities will still need to work with the group level resolution authority to work out the level of capital and liquidity the former expects the bank to have. If the subsidiary is not significant for the group but it is to the host state, then there is a possibility the host state has not been given access to the group resolution plan. In many respects, this leads to further moves towards an MPE approach. The move away from centralized to decentralized capital and liquidity oversight means the cost of business can be higher for the local subsidiary since there is no advantage from the pooled financial resources as it is not able to exploit the economies of scale of a centralized treasury function. The level of host state confidence needs to be gauged where the parent entity has important subsidiary operations, as the incentives are more aligned to cooperate and coordinate for a SPE approach.

5.26 A recognition of this challenge is also highlighted by the incentives to decide whether or not the group resolution authority considers it best to adopt an SPE or MPE approach. In many ways, the former places significant importance on the group resolution authority which is also going to be the lead consolidated supervisor so ultimately the home state for the parent entity. The latter is likely to be the option where a joint decision amongst the participating Member States and non-participating Member States and those third countries is unlikely. In their case, they may consider the former is not likely to serve their interests and so opt for resolution that serves their particular circumstances, therefore, leading to multiple points of entry for the purposes of resolution. The circumstances surrounding membership of resolution colleges and the lack of reciprocal information sharing leads to a position where the MPE approach is more likely for the small host states with significant subsidiaries.

5.27 The asymmetry of information between some Member States due to their position in terms of group entities means that, for those at the periphery of the core part of the group which is less systemic for the purposes of the group and the home state parent, there is little alternative for such host states but to organise resolution in accordance with national interests which, therefore, leads to an MPE approach. However, it is important for such hosts to be able to ensure *ex ante* that with the appropriate measures in place, in terms of capital and liquidity, there is sufficient loss-absorbing capacity to provide the kind of buffer necessary for an orderly resolution of local interests. In view of this, *ex ante* MPE is similar to the *ex post* decision to ringfence to protect the local interests.

The Resolution Colleges

The SRM highlights the importance of cooperation within the SRM and with non-participating Member States and third countries.[37] However, it does not offer much in the way of clarifying how the SRB will lead resolution colleges as the group resolution authority for the banks it is responsible for. Therefore, specific reliance needs to be given to the BRRD for clarification and directions as well as to the EBA's draft guidelines for the role of the group resolution authority and resolution colleges.[38] As with the SSM and the role of the ECB, and here with the role of the SRB, it is rather surprising that little is mentioned of the respective supervisory and resolution colleges[39] since they are such a crucial vehicle for coordination and cooperation among the Member States and third countries. The focus on the group and the 'material' subsidiaries implies that a number of Member States at the 'periphery' are members of the resolution college albeit may not be privy to the information within core resolution college. 5.28

The BRRD requires the establishment of resolution colleges for groups that operate within the EU.[40] The rationale of such colleges is necessary to ensure an appropriate platform for consultation between the respective authorities, both at the crisis prevention level and the crisis management level. The consideration of the recovery and resolution plans is the first matter to be settled. Those plans will be an important basis on which to assess the resolvability of groups and possible impediments to orderly resolution.[41] The selection of competent and resolution authorities as members of the resolution colleges is perhaps a rather contentious matter with the resolution authority for the group taking a lead role over other members selected where subsidiaries and significant branches are located. The level of cooperation and coordination required seeks to minimize the impact of such decisions on the markets and the wider financial and economic stability.[42] While the written arrangements within the EU provide the basis for an *ex ante* understanding of how the resolution of the group is likely to be executed with the objectives, conditions, and principles in mind, the matter of who is and who is not a member of the resolution college could pose challenges in terms of the timing of decision-making and those in the non-core part of the resolution college respecting the decisions of the lead resolution authority for the purposes of leading the resolution for the group.[43] Despite the fact that the membership criteria are indicated,[44] 5.29

[37] SRMR, Art. 31 and Art. 32.
[38] Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges.
[39] SRMR Recital 91 and Art. 33(2)(b).
[40] BRRD, Recital 15; Art. 88(1)(a)–(i).
[41] BRRD, Recital 17; Art. 13.
[42] BRRD, Recitals 33 and 96.
[43] BRRD, Recital 97.
[44] BRRD, Art. 88(2)(a)–(h).

the directive leaves it to the lead resolution authority to decide which members to invite to attend a given meeting.

5.30 A special regime applies to cross-border groups with principal business activities in a third country and with a European presence in the form of a subsidiary or significant branches.[45] In this type of case, the competent authority and resolution authority for those entities will need to set up a European resolution college. The authority of the host Member State where a subsidiary or group holding company is located will take responsibility for it as group resolution authority. However, if those institutions are located by way of branches, then it is likely that the resolution authority of the significant branch will take responsibility and co-ordinate the organization of the European resolution college.

5.31 A crucial element in the cooperation between Member States themselves, as well as between third countries, is information exchange.[46] In this respect, the institution's or group's consolidated supervisor and the resolution authority are responsible for ensuring relevant information is exchanged between the respective authorities. In order to prevent the creation of panic amongst the Member States, resulting in disjointed responses, the information exchange needs to be timely. In this respect, consent is required for the onward sharing of information. In such cases, resolution authorities will be expected to provide their EU counterparts with 'all the relevant information in a timely manner';[47] and in respect to third countries, the resolution authority must seek the consent of the third country's resolution authority for the onward transmission of that information.[48] The consent is unlikely to be always forthcoming unless the information is heavily redacted.

5.32 Member States with different levels of exposure and interests located within them can pose considerable challenges for the lead resolution authority in terms of managing expectations of their counterparts. This risk could arise where a subsidiary of the group is placed in resolution by its resolution authority. In this case, the relevant resolution authority will be required to notify the group-level resolution authority and the members of the resolution college. In such a case, the group resolution authority is expected to assess the impact of the decision on the group as a whole.[49] After the assessment at group level, the resolution authority will be expected to provide a group resolution scheme and share it with the resolution members within 24 hours or a longer period, depending on what was agreed.[50] If the group-level resolution authority has not initiated a resolution scheme within that timeframe, then the resolution authority for the subsidiary can continue with its resolution actions. In such circumstances, the EBA is expected to mediate in order for national resolution authorities to come to a joint decision.[51] Irrespective of the consensus-based approach, the BRRD does envisage disagreements amongst Member States. In those cases, the dissenting resolution authority need to identify the reasons for not following the group-level resolution authority and the resolution plan, which it must then circulate amongst the other resolution authorities.[52] The resolution authorities in such circumstances are still

[45] BRRD, Recital 101, Art. 89.
[46] BRRD, Art. 90.
[47] BRRD, Art. 90(2).
[48] BRRD, Art. 90(3).
[49] BRRD, Art. 91.
[50] BRRD, Art. 91(4).
[51] BRRD, Art. 91(7).
[52] BRRD, Art. 91(8).

required to cooperate closely and inform the resolution college about the measures they are taking to coordinate their efforts at the group level.[53] A number of similar measures apply to the group-level resolution authority responsible for the parent undertaking of the group. However, the extent to which the group resolution scheme includes all parts of the group and the parent essentially depends on the extent of the problem and whether it is likely to impact other parts of the group after determining whether the parent and/or other parts of the group are failing or likely to failure.[54] The resolution authorities responsible for the different parts of the group will also need to determine whether to follow the resolution scheme and so act jointly, or whether to act separately but still inform the other resolution authorities of the actions taken.[55] The BRRD requires that a resolution authority, which decides to act independently, must notify the group-level resolution authority and other resolution authorities and provide reasons for the departure.

The issues highlighted explore a number of underlying sets of assumptions and incentives which suggest resolution coordination could remain a challenge and lead to a misalignment of incentives if they are not addressed effectively. The EBA does take a monitoring role to assess their work.[56] The lead taken by the group resolution authority to invite members and observers provides the group resolution authority with a significant amount of discretion as to which members and observers to invite. The resolution college's technical standards set out the important areas featured in a coherent resolution framework, namely coordination and cooperation at the crisis prevention and at the crisis management stage. The identification of members and observers is an area that is quite contentious since it provides the very basis of who can contribute to the dialogue and decision-making process and ultimately benefit from the reporting and decisions for oversight of their respective banking and financial system. The underlying assumption is that membership is almost automatic based on the general criteria provided, but that is not the case in practice. The group resolution authority primarily decides and other members closer to the interests of the group resolution authority can influence its decision as well. The group resolution authority will also invite observers to participate in the resolution colleges and in most cases this is likely to be those third countries with large exposures to the parent or holding company. While their ability to contribute formally is limited, that could differ from one resolution college to another since the group resolution authority has the discretion to set specific terms and conditions for observers. While resolution colleges can allow other members of an official safety net onto the resolution colleges as observers, in practice, this was not really taken up by other parts that did not either have supervisory or resolution responsibilities. For instance, in one case the central bank that lacked both a resolution and a supervisory authority was not on either college. In some cases, third countries with, in their view, a significant subsidiary were not invited to join the resolution college.[57] In fact, in some instances, since the move to adopting resolution authorities and administrative powers to orchestrate resolution are non-existent, it means some third countries are not 5.33

[53] BRRD, Art. 91(12).
[54] BRRD, Recital 99; Art. 91(8).
[55] BRRD, Art. 92.
[56] EBA, Report on the Functioning of Resolution Colleges in 2017, July 2018.
[57] EBA Annual Report (2018) 'Resolution colleges for third-country banks. 'In 2016, the EBA was not aware of the organization of resolution colleges for subsidiaries of third-country banks. In 2017, the EBA was made aware of six such colleges, held mostly by means of conference calls.' At p. 8.

able to credibly have any expectation of joining. Nevertheless, the central bank, considering it would be the backstop for the significant subsidiary, should be able to join in such cases, if invited. There is no official right to appeal a decision regarding a Member State or a third country joining the resolution college other than lobbying the Member State of the group resolution authority.

5.34 The group resolution authority leads the management of the resolution college.[58] It arranges the meeting and decides which members and observers will be invited to the meetings either on an annual basis or ad hoc. The EBA reports found a number of annual meetings postponed which meant resolution plans were not reviewed.[59] The annual meetings are attended by the majority of members and observers whereas, at the more ad hoc meetings, only a select few are invited. The first important exercise undertaken by the resolution college is the mapping of entities and authorities responsible for their resolution.[60] The complexity of some groups with sub-groups with different business lines means a resolution college can have sub-resolution colleges of members and observers preparing for resolution for that particular part. The EBA Report found that minutes of meetings were not circulated and assessments of impediments to resolvability still a challenge that needed to be addressed.[61] This could lend itself to an option of having different resolution positions, one of an SPE and one of an MPE, being prepared at resolution college level. However, it is important to note that while members are expected to be informed about decisions and have a contribution to the decision-making process, observers, on the other hand, are not part of that process and are implicitly excluded. It could be the case, however, that a third country is given special status, albeit equivalent to a member, where the terms and conditions allow them to participate more fully.

5.35 The benefits of the resolution college are considerable since it enables members to put in place the channels to share information and data to improve the understanding of the group and the respective entities to prepare resolution, either on a group level or subgroup level. However, the EBA Report found the commitment to them by the different stakeholders as a result of expertise varied so undermined the importance of the work on resolution plans.[62] It is important to note that while resolution colleges are a conduit for information sharing, the information is not shared equally to all parties, even within the members, and the position of observers is such that no information, such as resolution plans, is expected to be shared bar only the broad conclusions of the resolution planning exercise. This is particularly the case with resolvability: the joint decision on resolvability may mean members and observers are part of the process of improving resolvability and resolution planning from the perspective of the group resolution authority but then not necessarily have the opportunity to see the full assessment. It can be the case that observers are asked for information and data to develop group resolution plans but do not have the opportunity to see them in the end. This obviously leads to a position where they do not necessarily have a clear idea of the position on group resolution. The other option is

58 Regulation 2016/1075 Art. 50.
59 EBA Annual Report (2018) at p. 8.
60 Regulation 2016/1075 Art. 50.
61 EBA Report (2018) at p. 9.
62 EBA Report (2018) at p. 10.

that they are provided with the broad conclusions which lead to a decision of moving to an MPE position of a separate resolution plan and resolution scheme. This in itself requires considerable planning at the capital and liquidity management level for it to be exercised in an orderly manner.

There are a number of points at the planning stage that require joint decisions.[63] These are likely to be negotiated areas where Member States are likely to bargain to ensure national interests are safeguarded.[64] It is likely that ensuring the integrity and the interests of the group as a whole has benefits since it safeguards national and international franchise value. The way to achieve this is probably going to occur on business lines. However, for this to be executed, the joint decisions at the planning stage need consensus on a number of areas. First of all, there needs to be confidence in the group resolution authority to undertake resolution with the interests of host states in mind. The SRB is likely to have such credibility and large home Member States with large groups with presences in other hosts of systemic importance to the group are likely to work closely together since their incentives are aligned. However, there is a misalignment of incentives when it comes to host states that have 'significant subsidiaries', in a number of cases classified as O-SIIs. In this case, the SRB's focus is likely to take a prima facie narrow banking view of such subsidiaries. Therefore view them as suitable for liquidation and insolvency proceedings rather than resolution which secures continuity of critical functions and minimizes the destruction of value of the franchise.[65] This defeats the objective of having broad reciprocal arrangements in the interests of the EU as a whole, since the SRM's focus on material subsidiaries does imply the respective Member States are unlikely to have a significant voice in the resolution college. **5.36**

The interests of other hosts are likely to be addressed along national lines taking in to account the relative impact on the group as a whole.[66] This means that incentives are not aligned to the group as a whole and, therefore, national authorities will need to address them using their own resources. This is not necessarily a bad option for the purposes of resolution since an SPE option is likely to be a compromised position. However, what is crucial is the importance of *ex ante* working towards this position rather than the resolution college working for its own interests instead of the interests of all, regardless of the resolution plans in place. Preparation is likely to take time since capital and liquidity levels have to be worked out and to ensure that they are in the right places and offer the appropriate loss-absorbing capacity needed. The challenge here is to ensure continuity of critical functions with the appropriate support and back office facilities. The question the national resolution authority needs to ask *ex ante* is, 'which resolution options are likely?' In order to address this question, it will be required to undertake its own resolution plan. The BRRD does not incentivize much else and the subsidiary is likely to need its own capital and liquidity lines on a self-reliant basis. It is possible for the group to step in on a voluntary basis **5.37**

[63] Regulation 2016/1075 Recital 66, Art. 54(2) and Art. 61.

[64] Regulation 2016/1075 Art. 94: Joint decisions taken at each subsidiary level in the absence of a joint decision at consolidated level.

[65] See EBA, Decision on the Settlement of a Disagreement, Addressed to: Single Resolution Board and Banca Națională a României 2017 joint decision on group resolution plans and resolvability for […] 27 April 2018 analysed in Chapter 2, section EBA Mediation: Single Resolution Board and Banca Națională a României, para 2.46.

[66] Regulation 2016/1075 Art. 94. See also Regulation 2016/1075 Art. 108 Disagreements and decisions taken in the absence of a joint decision.

if the problems it is facing are in other parts of the group and not necessarily with the dominant home operation.

5.38 The interesting position with the resolution college's technical standards is the fact that it has built into it the opportunity for dissent and the option to put forward an alternative option in terms of resolution schemes.

Early Intervention: Aligning Supervision and Resolution

5.39 The important synergies between supervision and resolution on a going concern and gone concern basis are set out in the context of preparation for resolution of distress institutions and groups. The intensity of the level of supervision will increase as matters escalate in terms of seriousness of the issues identified by the supervisor. The powers of early intervention in this respect are, therefore, similarly interlinked to the relationship between supervision and resolution. This is a critical phase, in that the more work undertaken at the point of supervision the more efficient the competent and resolution authorities are likely to be in avoiding formal resolution or improving its chances of achieving the resolution's objectives. At other levels though, it is important that the supervisor and the resolution authority work closely together to minimise the risks of asymmetry of information in the exercise of their roles. This is particularly acute in the setting of the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) by the resolution authority and its reliance on capital requirements set by the supervisor. The decisions associated with failing banks has led to arguments that two public interest tests reside at the national level and that adopted at the centralized level co-managed by the ECB and SRB.[67] The power of early intervention is an integral part of supervision and resolution. The lack of clarity has been criticized since there is a lack of predictability for some about the ultimate outcomes.

5.40 The infringements emphasize the balance sheet; the competent authority and resolution authority will need to be mindful of the fact that such risks to balance sheet insolvency are a time lag indicator of ensuing problems, and, once they materialize, it could be too late. Certainly, the recent EBA 2015 Guidelines[68] rightly place appropriate emphasis on a broader range of significant events as well, including conduct of business failures, and prudential failures.[69] It may be argued that the introduction of infringement limits the discretion of the competent authority. Evidence of one of those infringements may result in there being little time to resolve the matter. In light of this, a range of other indicators such as management behaviour and culture could be factored into the decision-making process as precursors to the explicit infringements indicated above. When it is evident that an infringement has occurred, the competent authority can require the institution or group

[67] See Danny Busch, Governance of the Single Resolution Mechanism in Danny Busch and Guido Ferrarini (eds) European Banking Union, (Oxford: Oxford University Press) (2015) 281–335.

[68] EBA, Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Art. 32(6) of Directive 2014/59/EU, EBA/GL/2015/07, 26 May 2015.

[69] See generally Chapter 5 EU Member State Resolution Decisions and Chapter 6, ABLV Case and the Cross-Border Dimension and Liquidation Cases and Other DGS interventions for the reasons why the banks are considered to be failing or likely to fail.

management body to initiate measures set out in the recovery plan or take alternative actions within the decided timeframe to resolve the infringement. The competent authority or the resolution authority could inter alia ask the management to restructure its debt or find a private sector purchaser, for instance. In circumstances where there is personal culpability of management, the competent authority should have the power to be able to remove them and appoint new management or a temporary administrator. The EBA's guidelines leave the competent authority with the discretion to determine when the trigger is expected to be pulled, as the guidelines does not explain the level of evidence it needs to pull the trigger, should it 'reasonably likely' or 'highly likely' infringe on the requirements. The evidentiary burden for the administrative decision will determine how much time the competent resolution authority will need to allow for the institution to work out its position. Moreover, the guidelines will implicitly require the competent authority for resolution and prudential purposes to cooperate and coordinate with the markets and conduct of business regulator, since some of the significant events can possibly trigger events that are market-based, linked to rogue trading or fraud. Even though this is necessary, it does not change the fact that it will mean cooperation agreements will need to be in place to ensure this type of information is shared in a timely manner.

The competent authority can appoint a temporary administrator, not with the remit to decide in lieu of them, but primarily for the purposes of identifying the financial position and putting in place proposals to either preserve or restore the institution's or group's financial position. In the case of groups, early intervention powers require a lot more coordination since a decision like that will have an impact on the confidence in other parts of the group. In this scenario, the consolidated supervisor is responsible for notifying the other competent authorities and resolution authorities. The competent authorities in a group scenario may face the challenge and indeed criticism of either not intervening early enough or intervening too late, and so prematurely giving rise to conflicts. Moreover, where multiple administrators are appointed by competent authorities, there is the risk that the powers and authority of temporary administrators could differ, giving rise to an inconsistent approach across the EU for single entities or groups. **5.41**

The regulatory space between supervision and resolution simply provides a continuum for points of intervention so that the competent authority intensifies supervision to ascertain the extent of a problem that has surfaced. Indeed Enriques and Hertig refer to this space as 'shadow resolutions' outside of formal resolution which they argue undermines the credibility of formal resolution decisions.[70] Since the former can be captured by political reasons possibly protecting the integrity of a 'national champion', for instance. The classic example of this would be the decision by the Co-operative Bank in the UK to orchestrate a voluntary bail in with its creditors as part of its measures to improve its capital position.[71] In such circumstances it could well be the view capital levels need improving and the bank may well seek to sell non-core businesses to improve their capital levels. The opportunity **5.42**

[70] Luca Enriques and Gerard Hertig, 'Shadow resolutions as a no-no in a sound Banking Union' in Ester Faia, Andreas Hackethal, Michael Haliassos, and Katja Langenbucher (eds) *Financial Regulation: A Transatlantic Perspective* (Cambridge: Cambridge University Press) (2015) 150–66.

[71] Barney Reynolds, 'UK Co-operative Bank: Resolution via Negotiated Bail-in Outside the BRRD' (2013) in *World Bank, Bank Resolution and 'Bail-In' in the EU: Selected Case Studies pre and post BRRD* (2016) 73–5.

to take such actions at the supervisory stage is likely to be on the surface as decisions taken by the firm rather than the supervisor. In this respect, the bank appears to be in control and its autonomy intact, leading to a position where business judgement is the order of the day in terms of decisions. But market speculation may not assist and may have a detrimental impact on the success of such decisions, especially if the option is to raise capital in the markets. The important point here would be that the matter is undertaken confidentially. This could be a challenge when a supervisory recommendation is given to several banks simultaneously, which is not likely to lead to credible outcomes, for instance, raising capital or the sale of parts of the business to improve capital requirements which may lead to negative market responses. A concern as well would be a decision to put a bank into resolution can spook the markets to think of other banks equally being vulnerable after reviewing their balance sheet and identifying similarities. While resolution is premised on it not leading to a destruction of value it invariably would and the loss of confidence is likely to be visible for those banks publicly listed in the market. The formal criteria is now analysed at the centralized and decentralized level.

5.43 The SRMR requires the ECB or the NCA to notify the SRB of its decision to exercise early intervention powers.[72] On the basis of the information the SRB is expected to notify the Commission and prepare for resolution.[73] Within this time, the ECB or the NCA is expected to provide information to the SRB and prepare, if it is obliged to, or order the NCA to produce a resolution scheme for the institution or the group.[74]

5.44 The composition of the SRMR and BRRD are broadly in line with one another when deciding whether a bank is failing or likely to fail.[75] The SRB or the NRA will have to assess the circumstances the bank finds itself and consider the possibility of a private sector solution for the failing bank.[76] In this respect the feasibility of the potential private sector interest needs to be assessed and whether it can be agreed within a relatively reasonable amount of time, albeit this is not stipulated in the provisions. The final requirement that needs to be considered is whether resolution is in the public interest.[77] This has been the most contentious of issues since it has been argued that the SRB and NRA interpretation of public interest outcomes for failing banks has differed from one another.[78] The SRB is viewed to have taken a stricter view and placing banks in to national insolvency-liquidation rather than resolution. The two Italian cases in the Venato region and in contrast the Croatian bank decisions explored in chapter 6 are illustrative of this contrasting position where concerns about sub-regional real economy surfaced and assessed differently.[79] The former were declared not in the public interest to be put in to resolution since they were not undertaking critical functions at the time of the ECB-SRB decision. The principle point in terms of public interest assessment is whether normal insolvency proceedings would lead to the

72 SRMR, Art. 13.
73 SRMR, Art. 13(1).
74 SRMR, Art. 13(2).
75 SRMR, Art. 18(1)(a)–(c) and BRRD, Art. 32(1)(a)–(c).
76 SRMR, Art. 18(b) and BRRD, Art. 32(1)(b).
77 SRMR, Art. 18(c) and BRRD, Art. 32(c); see also Jens-Hinrich Binder, 'Proportionality at the Resolution Stage: Calibration of Resolution Measures and the Public Interest Test (3 July 2017); also, 'The Principle of Proportionality and Its Applicability in EU Banking Regulation' (February 2017), available at SSRN: <https://ssrn.com/abstract=2990379>.
78 See generally, Chapter 6, 'European Bank Insolvency and Liquidation Proceedings'.
79 Chapter 6, 'European Bank Insolvency and Liquidation Proceedings', para 6.40.

same outcomes as resolution in line with the objectives and principles explored below. The Venato cases in some respects highlight that even relatively large banks can be placed in liquidation if the national insolvency-liquidation proceedings are conducive. This is contentious since resolution does not necessarily lead to a destruction of franchise value in comparison to insolvency-liquidation. Therefore, resolution is considered a more palatable option from the perspective of the bank. Moreover it very much depends on the scope and powers of national insolvency and liquidation law. The lack of predictability of outcomes is the principle concern that is naively focused on a case by case comparison of looking at apples if they were pears, which is always likely to identify inconsistencies.

The basis for triggering the decision of failing or likely to fail requires an assess of what could broadly be termed regulatory infringements either relating to the balance sheet or other requirements associated with authorization that could lead to the withdrawal of authorization, for instance evidence of financial crime.[80] However the primary reasons are either balance sheet or cashflow infringements that call in to doubt the bank's ability to meet prudential requirements on a continuous basis. In this respect, decision to intervene is made when the bank is balance sheet solvent but not according to prudential supervisory standards. This can be a point of contention if in normal insolvency proceedings the court decides the bank is balance sheet solvent and disagrees with the supervisory authority's outlook for the bank. The SRMR in Article 18(4)(c) requires consideration whether the entity will in the near future be unable to pay its debts or other liabilities as they fall due. In this respect the SRB will assess the speed with which the banks financial position is deteriorating, for instance the rate at which deposits are being transferred out of the bank. **5.45**

The cases primarily show how the courts have interpreted the position of the bank in national insolvency proceedings differently to that of the supervisory authority. This shows the need for harmonization and alignment of bank resolution and insolvency proceedings. As with administrative resolution-led proceeding, insolvency providing should also be couched within an administrative framework and require the courts to accept the administrative decision.[81] Rather than open up the administrative decision for review based on different criteria of whether the bank is failing and not necessarily taking in to the wider external factors that have likely been taken in to account to form the decision.[82] **5.46**

The notion of failing or likely to fail is a judgement call which requires considerable refection of both internal and external circumstances which could either lead to the bank or the group failing. The idea of failing is perhaps simpler since it requires assessment of the balance sheet and liquidity of the bank and indeed other requirements that could compromise authorization. The notion of likely to fail is couched in more discretion and requires the **5.47**

80 SRMR, Art. 18(4)(a)–(d) and BRRD, Art. 32(4)(a)–(d).

81 BRRD, Art. 85(4)(b): '[T]he decision of the resolution authority shall be immediately enforceable and it shall give rise to a Page 11 rebuttable presumption that a suspension of its enforcement would be against the public interest.'

82 Jens-Hinrich Binder, Michael Krimminger, Maria J Nieto, and Dalvinder Singh, 'The Choice between judicial and administrative sanctioned procedures to manage liquidation of banks: a transatlantic perspective (2019)14(2) Capital Markets Law Journal 178–216; see also Sabino Cassese, A New framework of administrative arrangements for the protection of individual rights in ECB Legal Conference 2017, Shaping a new legal order for Europe: a tale of crises and opportunities, 4–5 September (2017) 239–55.

supervisory authority and the resolution authority to determine whether in the future it is going to fail. A critical element in this decision is ultimately the level of due diligence undertaken vis a vis the source of the problem. If consideration is given to the cases explored in this work relating to areas such non-performing loans then it can be difficult to gauge whether the extent of the problem is going to mean it is likely to fail. This is primarily reliant on the valuation process that is required to be undertaken to gauge the option of resolution or insolvency and the outcome of the no-creditor-worse-off in resolution than would be the case in insolvency. The time for the valuation has been a point of concern since it is reliant on when the problems surface. The three stage process for deciding how to resolve the bank requires months to complete but has been required to need to be done in a matter of weeks.

5.48 Valuation of assets and liabilities will play a critical role in the resolution process, since it will determine its success in terms of contributing to the decision regarding which resolution tool will achieve the resolution objective, conditions, and principles.[83] The process of valuation is not a perfect science and is primarily determined by the quality and accuracy of the information the institution holds and the timeliness of the information given to them. While considering the conditions for resolution the independent valuation will include the following matters: whether the conditions for write- down and conversation of capital have been achieved and the impact on the dilution of shares; the eligible debtholders of the outcome of the bail-in; which assets and liabilities are to be transferred to the bridge bank; and the decision on which assets and liabilities will be included in the sale of business tool.[84] A key factor in the success of the independent valuation will be the timing of intervention to ascertain value within the institution and the size of the losses. The valuation will need to be structured according to the priority of claims on the assets in the institution.[85] If the valuation cannot be done on time, then a provisional valuation is possible. This is perhaps the most critical aspect of the resolution process to determine the outcomes of the bank and the different stakeholder interests in both resolution and insolvency.

5.49 The no-creditor-worse-off is an integral outcome of the valuation process to ascertain the implications of the bank entering in to resolution in comparison to insolvency. If the resolution authority decides the bank is going to enter into domestic insolvency-liquidation then the principle becomes redundant. It would be left to the domestic proceedings to gauge what is therefore recoverable to cover creditor's claims. The resolution authority needs to try and decide as accurately as possible in the circumstance that no creditor of an entity in resolution shall incur greater losses than would have been incurred had the entity been wound up under normal insolvency proceedings. Since the resolution authority is exercising administrative discretion to intervene in the affairs of the bank to protect public interest objectives before it reaches balance sheet insolvency-liquidation. The no-creditor-worse-off principle provides a balance between the competing public and private interests to ensure the administrative decision is proportionate

[83] BRRD Art. 36.
[84] BRRD Art. 36(4)(a)–(g).
[85] BRRD Art. 36(8).

to its outcomes. The expropriation of private property requires appropriate due process to be followed to ensure compensation is payable if the outcome insolvency would have been better than that achieved in resolution.[86] While resolution is premised on consistent principles and objectives the counterfactual of insolvency-liquidation is far from consistent at the EU level.[87] In view of the fact that several models exist between corporate and some form of modified insolvency-liquidation proceedings. In part as was experienced in the Italian Venato cases modified proceedings can consist of resolution type options and the avoidance of a fire sale of assets can be a material part of the assessment of how best to deal with banks in such scenarios.[88] Moreover, in some jurisdictions the courts in insolvency proceedings can be more sympathetic to the interests of the bank and require a higher evidentiary burden to be reached to determine insolvency. In view of this, the courts can form the opinion that the resolution authorities decision was premature to the extent it did not allow the bank and its directors sufficient amount of time to orchestrate a private alternative to the proposed public solution. Moreover, the cases so far show that public assistance can play a significant role in a bank in distress which would need to be discounted in any potential assessment of compensation.[89] It would be important for the courts to consider all these factors when assessing such compensation claims.

In a group context it is likely the no-creditor-worse-off principle will lead to different outcomes for the creditors of the different incorporated entities. Since the counterfactual is different in each Member State the comparing treatment of stakeholders is not going to be possible. But this does not negate fact that domestic creditors Member State by Member State will assess how their interests have been affected in resolution and consider whether to peruse compensation. A resolution scheme is likely to consist of different resolution options in the different Member States for instance for the core and non-core entities of the group. In the former the bail-in tool and or the asset separation tool is likely to be utilized and in the latter the sale of business tool is a significant possibility. Since the aim of the resolution scheme is likely to restructure and recapitalize the core home country part of the group and the retrenchment from some hosts through the sale of business tool to recapitalize the home operations mean creditors interests will be affected differently. **5.50**

The cross-border dimension is equally important to consider in the contest of this decision and its timing. The position at the centralized level shows that the ECB and the SRB are well placed to address potential coordination risks between Member States participating in the Banking Union as is shown in the decisions regarding ABLV Latvia and Luxembourg.[90] At the national level each subsidiary is a separately incorporated authorized bank and so while some Member States may agree the group is failing or likely **5.51**

[86] Victor de Serière and Daphne van der Houwen, 'No Creditor Worse Off' in 'Case of Bank Resolution: Food for Litigation?' (2016) Journal of International Banking Law and Regulation, Issue 7, p. 376, available at SSRN: <https://ssrn.com/abstract=2856370 or http://dx.doi.org/10.2139/ssrn.2856370>.
[87] See Chapter 6.
[88] See Chapter 6, section 6.40.
[89] *Harbinger Capital Partner v Caldwell and Another* [2013] EWCA 492.
[90] See Chapter 6, The ABLV Case and the Cross-border Dimension, 6.31.

to fail some Member States may not agree with the decision and could base on their own assessment take a different decision about the subsidiary in their jurisdiction. In another set of circumstances the competent authority and resolution authority may be of the view the subsidiary independent of the group is failing or likely to fail. These scenarios highlight how an entity-by-entity-based approach is ultimately taken and a group based approach is quite possibly a voluntary affair.

Resolution Objectives, Conditions, and Principles

5.52 The resolution objectives are to ensure continuity of critical functions, avoid significant adverse effects on financial stability, protect public funds, protect covered depositors and investors, and protect client funds and client assets.[91] While regulation and supervision of financial services is implicitly mindful of these objectives, it is important to emphasize the importance of them being put in an explicit setting, coinciding with the wider concerns of financial stability, since it provides a clear expression of whose interests the competent and resolution authorities are primarily concerned about. Notwithstanding the hierarchy of interests, the resolution authority is required to evaluate the use of the resolution tools keeping in mind the importance of minimizing the costs of resolution and maintaining value within the institution or group to minimize unnecessary losses to shareholders and creditors. This is the case despite the fact that it does not explicitly make reference to those respective groups at this point. Therefore, while banks are traditionally considered to be special and require a special resolution regime, once the resolution and special insolvency regimes are in place to address the idiosyncratic risks of banks, their uniqueness is minimized. The reforms rightly address the importance of critical functions and the extent to which continuity of them is safeguarded through supervisory and resolution intervention rather than the institution undertaking such critical functions.[92]

5.53 The stabilization tools explained below provide the first line of defence when it comes to dealing with banks in distress either individually and/or in combination with one another. The directive sets out the resolution tools but does not imply one resolution tool or another is likely to take a dominant role, albeit the institution will need a sufficient amount of capital instruments that can be written down or converted so as to recapitalize the bank or fund the resolution measure. The more likely scenario is that this power will be exercised in conjunction with other resolution tools. Moreover, when there is a wider market-based situation of distress, governments may utilize market-wide tools so that critical functions and business lines can continue, and a sufficient amount of value can be retained to ensure creditors are not in a position where they are worse off than in a hypothetical insolvency proceedings. Notwithstanding the utility of the resolution tools and the central bank facilities and extraordinary facilities to resolve distress banks, they, on their own, may not be a complete panacea.

[91] SRMR, Art. 14 & 15; BRRD, Arts 31–34.
[92] Eva Hupkes, 'Protect functions, not institutions', The Financial Regulator (January 2004) pp. 43–99.

The Sale of Business Tool

The resolution authority is required to have in place the power to be able to transfer ownership and its assets and liabilities of the institution to a private purchaser.[93] The SRB would decide and then instruct the national resolution authority to execute the sale of business tool.[94] **5.54**

The BRRD requires the resolution authority to follow a number of measures. The resolution authority will be required to take reasonable steps to get commercial terms and put in place a process of marketing the assets, rights and liabilities.[95] The latter is limited in terms of disclosure if it poses material risks to financial stability. The transfer or retransfer of shares, assets and liabilities will enable the resolution to assist with ensuring the commercial terms of the business. A particular issue associated with regulation and supervision of the purchaser is to ensure the acquirer has the appropriate authorization to undertake the business acquired.[96] This will require involvement of the competent authority to assess whether the acquirer is indeed fit and proper to undertake the acquired business. This is likely to be considered at the point of initiating interest in the acquisition. The BRRD does recognise that the need for speedy and orderly resolution may mean the due diligence to gauge whether the acquirer's authorization criteria is met runs the risk of the competent authority not agreeing with the authorization. In some respects it forms a kind of cooling off period for all parties involved. It is therefore important for the competent and resolution authority to work closely together at the point of assessing which resolution tool or combination of tools is the most appropriate to resolve the problems at the institution in distress. This would avoid circumstances where the resolution authority has to ask the acquirer to divest their ownership within the divestment period.[97] The new acquirer will need to be assessed for the purposes of membership of payment systems and clearing and settlement system, and compensation schemes.[98] The competent and resolution authorities will also need to minimize the risk of conflicts of interest in the way it evaluates the commercial terms between private sector bidders during the process of executing the sale and transfer of assets and liabilities.[99] **5.55**

In the context of a cross-border group resolution the sale of business tool could be used to primarily assist the process of recapitalizing the parent entity. Therefore, foreign entities may well be the first to be sold to assist in restructuring the core business. While this makes perfect commercial sense from the host-home perspective the sale of business tool for an entity within a group resolution could lead to concerns about concentration risk within the market. This would particularly be the case for Member States that have a very high preponderance of foreign banks. The sale could lead to greater foreign bank concentration risks. It is argued that such issues do need considering by the group resolution authority when thinking about how best to restructure the group and not simply restructure in view of the interests of the home parent entity. **5.56**

93 BRRD, Art. 38(1).
94 SRMR, Art. 24.
95 BRRD, Art. 38(2)–(3).
96 BRRD, Art. 38(7).
97 BRRD, Art. 38(9)(a)–(f).
98 BRRD, Art. 38(12)(a)–(b).
99 BRRD, Art. 39.

The Bridge Institution Tool

5.57 The bridge bank tool has been an important tool in the resolution toolkit in a number of jurisdictions.[100] The bridge bank is expected to take responsibility of the critical function.[101] It will take responsibility by either a transfer of shares or instrument of ownership or assets and liabilities to the bridge bank.[102] The initiation of the bridge bank can be undertaken at the initiative of the resolution authority and does not require shareholder agreement.[103] This avoids the resolution authority seeking approval of the shareholders, which may not always be forthcoming, and enables the resolution authority to undertake the set-up of the bridge bank to achieve the resolution objectives and principles. The bridge bank will either be owned by a public authority or the resolution authority.[104] The bridge bank is not expected to be the bad bank. The balance sheet of the newly created bank needs to be regulatory compliant so the resolution authorities need to transfer and or reverse transfer assets and liabilities to ultimately improve its marketability.[105] This can have adverse consequences for those left in the residual bank since they can be tarnished with a reputation of holding non-performing loans or other bad assets. In two notable instances it has led to litigation in the UK and Ireland.[106] Since the bridge bank is publicly owned, such transfers can be undertaken during the life of the bridge bank. The bridge bank will undertake the regulated activity of the bank in resolution and so the new institution benefits from the franchise value of the business.

5.58 Once the assets are transferred, the shareholders or creditors have no further rights to the transferred assets.[107] The management of the bridge bank can have their liability configured so that it can be limited to an extent where they are exempted from liability unless the act or omission is one of gross negligence.[108] The resolution authority will set out the constitution of the bridge bank and it will craft its commercial strategy and its appetite for risk. However, the bridge bank is expected to cease existing when it merges with another bank by way of sale of the business to a third party.[109] The BRRD provides a timeframe for the life of the bridge bank of up to two years with the option for the resolution authority to extend the period in extraordinary circumstances.[110] The following cases highlight some of the challenges associated with using the bridge bank:

Goldman Sachs International v Novo Banco SA

5.59 The *Novo Banco* case was heard in the UK courts pursuant to a facility agreement entered into by the parties.[111] The facts concerned the resolution of distressed Portuguese bank

[100] SRMR, Art. 25; BRRD, Art. 40.
[101] BRRD, Art. 40(1).
[102] BRRD, Art. 40(1)(a)–(b).
[103] BRRD, Art. 40(1).
[104] BRRD, Art. 40(2)(a)–(b).
[105] BRRD, Art. 40(3).
[106] Hodge Malik and James Potts, 'The competing interests between bank and borrower when a bank in resolution sells debt' (2017) 32 Butterworths Journal of International Banking and Financial Law 268–70.
[107] BRRD, Art. 40(12).
[108] BRRD, Art. 40(13).
[109] BRRD, Art. 41(3)(a)–(e).
[110] BRRD, Art. 41(5)–(6).
[111] The agreement contained an express choice for English law in settling any disputes. *Goldman Sachs International v Novo Banco SA* [2015] EWHC 2371 (Comm), at 7.

Banco Espírito Santo SA (BES) through operating a bridge bank, 'Novo Banco', created by the Bank of Portugal in its capacity as resolution authority as per the BRRD.[112] As a resolution measure, the assets and liabilities of BES were transferred onto Novo Banco, with the exception of certain 'excluded liabilities.'[113] The point of contention was whether the liabilities arising out of the facility agreement (consisting of a $835 million loan granted to BES by a Luxembourg entity)[114] were to be considered in this category as well. The Bank of Portugal issued a ruling in December 2014 according to which the loan in question was not an 'excluded liability' and therefore remained in the residual bank, effectively negating the transfer.[115] However, the claimants, which included Goldman Sachs pursued Novo Banco as the borrower arguing it had replaced BES via a statutory transfer.[116]

Novo Banco applied to set aside the proceedings as well as to obtain a stay of the proceedings in accordance with Articles 86 and 66(3) of the BRRD. The latter provides, inter alia, that creditors and third parties affected by the transfer of assets or liabilities are not entitled to prevent, challenge or set aside the transfer 'under any provision of law of the Member State where the assets are located or of the law governing the shares, other instruments of ownership, rights or liabilities'. Novo Banco contended that the UK courts had no jurisdiction under Regulation (EU) 1215/2012[117] to hear the claims. Instead, it should be recognized that there had been no transfer of the liability according to the Bank of Portugal's ruling. Under Portuguese law, the latter was regarded as an administrative act which may only be reviewed by administrative courts.[118] On the contrary, the claimants argued that the ruling had no effect in English law, under which the facility agreement was concluded. They deemed irrelevant the Bank of Portugal's ruling status as a matter of Portuguese law.[119] **5.60**

The UK High Court dismissed Novo Banco's application for three reasons. Firstly, Regulation (EU) 1215/2012 applied to civil and commercial matters, at the exclusion of administrative ones.[120] The court was persuaded by the claimants' argument that theirs was a private law (debt) claim based on rights contained in the facility agreement,[121] and therefore fell under the material scope of the Regulation,[122] as opposed to Novo Banco's interpretation.[123] Moreover, the defendant was not a public body, nor it did it exercise public powers.[124] Thus, the court held that it did indeed have jurisdiction to decide the matter. Secondly, the court stated that it would not pronounce on the validity of the Bank of Portugal's ruling, but rather on its effect in English law.[125] The non-justiciability or act of state doctrine[126] was further inapplicable due to the Bank of Portugal acting as a resolution **5.61**

112 *Goldman Sachs International v Novo Banco SA* [2015] EWHC 2371 (Comm).
113 BRRD, C Mecklenburg, *supra* n 141, at 10.
114 BRRD.
115 Arguing instead, inter alia, a re-transfer to BES under BRRD, Art. 40(7). BRRD at 34.
116 BRRD.
117 Regulation (EU) 1215/2012 of the European Parliament and of the Council on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) ('Recast Brussels Regulation').
118 *Goldman Sachs International v Novo Banco SA* [2015] EWHC 2371 (Comm), at 53(6).
119 BRRD at 61.
120 Recast Brussels Regulation, Art. 1(1).
121 *Goldman Sachs International v Novo Banco SA* [2015] EWHC 2371 (Comm) at 71.
122 Recast Brussels Regulation, Art. 25.
123 *Goldman Sachs International v Novo Banco SA* [2015] EWHC 2371 (Comm) at 73.
124 BRRD at 72.
125 BRRD at 109.
126 According to which adjudication on the 'validity, legality, lawfulness, acceptability or motives of state actors' is prohibited. BRRD at 110.

authority for BRRD purposes, as opposed to being an emanation of the Portuguese state.[127] Thirdly, the court clarified that a stay of proceedings would only be enforced in 'rare and compelling' circumstances,[128] which was not the case in *Novo Banco*.

5.62 The Court of Appeal overruled the High Court decision[129] and the Supreme Court unanimously upheld the Court of Appeal decision.[130] In many respects the decision was a relief in that it upheld the fundamental purpose of the BRRD of providing a coherent EU wide resolution strategy that recognizes the decisions of Member State national resolution authorities. An important element of the decision was to take in account the resolution decision as a whole rather than in a piecemeal fashion that ignored the wider administrative purpose of what is entailed in a resolution scheme as part of reorganization measures. The home Member State resolution authority and or the courts are expected to take the lead role in such decisions. Indeed the decision emphasizes the importance of other Member States taking 'active steps to enforce transfers of assets or liabilities made in the course of a reorganization in the home state and to prevent challenges to such transfers in their own jurisdictions'.[131] In view of this the English court did not have jurisdiction. Lord Sumption explained the Directive would be undermined 'if the acts of the designated national resolution authority were open to challenge in every other Member State'.[132]

Bayerische Landesbank v Hypo Alpe Adria Bank International AG (now HETA Asset Resolution AG) ('Heta')

5.63 The facts *Bayerische Landesbank v Hypo Alpe Adria Bank International AG* (now HETA Asset Resolution AG, 'Heta') related to the resolution of distressed financial institution Hypo Alpe Adria International AG ('Hypo').[133] This consisted of establishing a bridge bank, namely Heta, to which Hypo's assets and liabilities were transferred, save for 'excluded liabilities'.[134] In addition, the March 2015 administrative measure to initiate Heta's resolution was supported by a 15-month moratorium on its liabilities, issued by the Austrian Financial Market Authority (FMA). Acting as the resolution authority for the purposes of the BRRD and the Federal Act on the Recovery and Resolution of Banks (BaSAG),[135] FMA considered the temporary moratorium necessary to prevent Heta's insolvency.[136]

5.64 The administrative decision taken by the FMA was contested by certain creditors as it deferred the maturity of some of Heta's eligible liabilities, thereby postponing the payment due date (until 31 May 2016).[137] Bayerische Landesbank ('BayernLB') challenged the

[127] BRRD at 111.
[128] BRRD at 118.
[129] *Guardians of New Zealand Superannuation Fund & Ors v Novo Banco, SA* [2016] EWCA Civ 1092.
[130] *Goldman Sachs International v Novo Banco SA* [2018] UKSC 34.
[131] BRRD, para. 22.
[132] BRRD, para. 34.
[133] *Bayerische Landesbank v Hypo Alpe Adria Bank International AG* (now HETA Asset Resolution AG) (Az 32 0 26502/12) (8 May 2015).
[134] BRRD.
[135] The relevant legislation through which BRRD was transposed in Austrian law.
[136] DC Bauer, 'Resolving Austria's HETA—major milestone for the European bank resolution regime', 6 September 2015, <https://www.dlapiper.com/en/uk/insights/publications/2015/10/global-insight-15/resolving-austrias-heta/>.
[137] BRRD.

moratorium on the grounds of insufficient legal basis as well as its qualification as a BRRD measure.[138] In this sense, BayernLB argued that the objective of the Recovery Measures for Hypo Alpe Adria Bank International AG ('HaaSanG') and its Regulation on the Application of the Measures ('HaaSanV') were different as compared to those under the BRRD: whereas the former intends to terminate Heta's banking activities, the latter seeks to ensure their continuation. Furthermore, the moratorium cannot be qualified as a resolution regime for the purposes of Article 66 of the BRRD corroborated with Article 2 because the measures are applied against a bad bank (i.e. Heta) as opposed to a credit institution as required.[139] Heta's licence had been revoked and it was subsequently converted into an asset management firm.[140] Notwithstanding Heta being explicitly made subject to the BaSAG, the Munich court refused to recognize the moratorium, deciding that its application to Heta was outside the scope of the BRRD.[141] Consequently, German courts were not obliged to give effect to other resolution authorities' measures and Heta was ordered to pay Bayern around €2.3bn.[142] Heta appealed against this decision; the European Commission also initiated proceedings against the Republic of Austria for its failure to transpose the BRRD in an adequate manner. Therefore, highlighting the importance of the competent and resolution authorities to think through the implications of terminating authorization when the continuity of authorization is crucial for an orderly resolution. Moreover, the competent and resolution authorities need to clearly understand resolution is not a catch-all term to also include bank and insolvency administration. The directive is quite clear on this matter in particular what is a resolution tool and what is an insolvency tool for the purposes of managing the resolution process, and the residual bank for the purposes of winding up and liquidation of assets and liabilities.

Asset Separation Tool

The asset separation tool provides the mechanism to transfer and carve out rights, assets and liabilities to the asset management vehicle.[143] This approach gained significant prominence during the GFC and became known as the 'bad bank'. The Asset separation tool has been shown to be used to deal with non-performing loans of problem banks.[144] The main difference to the GFC however, and the other resolution tools, is that it cannot be applied alone but in conjunction with other resolution tools—most notably the bail-in tool. Once the institution is in resolution, the resolution authorities will need to work out how to improve the viability of the bridge bank and ensure the resolution objectives are complied with. The asset management vehicles contribute significantly to achieving that purpose. The asset management company will be separately incorporated but either partially or wholly owned as a public authority.[145] The assets and liabilities transferred to the asset management vehicle 5.65

[138] See Regulation (EU) No. 575/2013, Art. 4(1); Directive 2013/36/EU, Art. 2(5); *Bayerische Landesbank v Hypo Alpe Adria Bank International AG* (now HETA Asset Resolution AG) (Az 32 0 26502/12) (8 May 2015).
[139] BRRD.
[140] BRRD.
[141] BRRD.
[142] BRRD.
[143] SRMR, Art. 26; BRRD, Art. 42.
[144] Chapter 4, 'Regulation and Supervision of Non-Performing Loans and Loan Loss Provisioning, Public and Private Mechanisms to Reduce NPLs: A Portfolio-based Approach', para 4.40.
[145] BRRD, Art. 42(2)(a)–(b).

are more likely to be those deemed bad assets and liabilities—essentially non-performing, but attempting to execute the sale to maximize the value or ensure orderly liquidation.[146] This will place the asset management vehicle at arms-length and enable them to manage the winding-down of bad assets without institutional and political interference. The resolution authority is required to ensure the asset management vehicle is separately constituted but has the authority to appoint management and approve remuneration policy.[147] The resolution authority will need to work with the asset arrangement vehicle to work out its strategy and appetite for risk. More importantly, the resolution authority has the authority to limit the liability of the asset management vehicle to the shareholders or creditors of the rights, assets or liabilities transferred to it,[148] unless the asset management vehicle acts with gross negligence in the discharge of its responsibilities. The process of resolution is not static but a fluid relationship which will involve the various stakeholders in resolution to ensure assets and liabilities are transferred or re-transferred fully and or partially from the various parts of the institution in resolution, from the institution itself, the bridge bank and the asset management vehicle to ensure the objectives and principles of resolution are complied with.

The Bail-in Tool

5.66 The bail-in tool is the newest tool in the lexicon of bank resolution tools and is perhaps the most controversial given its purpose but part of the controversy appears to be that its viewed as a single solution and not part of a wider set of tools for bank recapitalization.[149] As Zhou et al explains, '[Bail-in] should supplement, not replace, other resolution tools that would allow for an orderly closure of a failed institution.'[150] In reality the bail—in tool is the private sector solution but as it's been shown in other parts of the work (Chapter 7) public assistance is equally available and necessary in the form of liquidity assistance, for example. Considering banks that have not been classed as a threat to financial stability have required public assistance in liquidation for those that are a threat to financial stability are possible likely to require public assistance to provide some implicit support to the initiative as a precaution to the market over reacting, if nothing else.[151]

5.67 The bail-in tool is equally perhaps the tool that deals in an administrative format with the home and host dilemma since it is an attempt *ex ante* to pre-commit to an administrative resolution strategy that is likely to recapitalise the group as a whole. This is likely to benefit the core material entities in the group. However other entities will be treated in such a

[146] BRRD, Art. 42(3).
[147] BRRD, Art. 42(4)(a)–(d).
[148] BRRD, Art. 42(13).
[149] Jianping Zhou, Virginia Rutledge, Wouter Bossu, Marc Dobler, Nadege Jassaud, and Michael Moore, 'From Bail-out to Bail-in: Mandatory Debt Restructuring of Systemic Financial Institutions', IMF Staff Discussion Note, April 24.
[150] p. 3.
[151] Rainer Palmstorfer, 'Bail Out or not to Bail Out? The current framework of financial assistance for Euro Area Member States measured against the requirements of EU Primary Law' (2012) European Law Review 771–84; Viral Acharya, Hyun S Shin, and Tanju Yorulmazer, 'Crisis Resolution and Bank Liquidity' (2011) 24 The Review of Financial Studies 21–66.

strategy is relatively unclear. It is likely the other parts of the group will be utilized through a sale of business strategy as mentioned before to assist with the process of recapitalization through bail in. Such a strategy is likely to gain support by the core part of the group since it will mean the extent of the bail in process is minimized. A particular challenge is connecting the simplicity of the concept with the complexity of the instruments it is attempting to utilise to recapitalize the bank. This essentially causes a pricing problem since the market can accurately calculate the risk. As Tröger rightly points out, '[d]esirable market discipline can only be induced if investors can predict the risk of their capital instruments being written-off or converted with reasonable certainty.'[152] The extent it will be used beyond the G-SIB and D-SIB constituency is also debatable. Therefore, the formulaic approach to its application in the EU framework causes in part the problems as well since not all banks have bail-in-able debt and more controversially retail customers are not prepared to be bailed in.[153] In more recent times concerns have arisen of subordinated debt held by retail consumers and the moral question of whether they are appropriate stakeholders to bail-in since they were not possibly aware they faced such a risk.[154] This risk of mis-selling would need to then feature in any potential valuation process if resolution is the preferred option.[155]

The bail-in power is primarily aimed at recapitalizing the bank and potentially turning its affairs around so that it complies with authorization requirements and can continue to undertake regulated activities or fund resolution measures.[156] The bail-in tool allows write-down of equity and certain debt instruments as well as the conversion of debt instruments into equity. The bail-in tool is perhaps the most sensible principle to start with in resolution but questions have equally been raised about its limits. This is partly, due to the complexity of bank finance and the unintended consequences of bail-in of certain instruments. The potential risk of contagion is equally raised as a concern in the market as a result of its announcement. The first mover problem is a concern on pricing in specific markets as a result of the potential risk of the power being exercised more widely in the sector.[157] Therefore, while the bail-in tool attempts to reduce the risk of moral hazard there is a need to assess the impact of adverse selection risk once the tool is administered and the market attempts to reprice liabilities. The trade-off between the two requires assessment at the point of execution, but the importance of privatizing losses is a critical policy position which should always be maintained and can be honoured even if the bail-in tool is not fully applied but partly applied and utilized with other techniques that attempt to distribute losses amongst **5.68**

152 Too complex to work: a critical assessment of the Bail-in tool under the European bank recovery and resolution regime' (2018) 4 Journal of Financial Regulation 35–72 at 37.

153 Rene Smits, 'Is my money safe at European banks? Reflections on the 'bail-in' provisions in recent EU legal texts' (2014) 9(2) Capital Markets Law Journal 137–56; Paul De Grauwe, 'The new bail-in doctrine: A recipe for banking crises and depression in the eurozone', CEPS Commentary, 4 April 2013.

154 Silvia Merler, 'Four small banks: resolution via bridge bank and asset management vehicle tools to avoid full bail-in in World Bank, Bank resolution and Bail-in in the EU: selected case studies pre and post BRRD' (2016) pp. 36–44.

155 Willem Pieter de Groen, 'Valuation reports in the context of banking resolution: what are the challenges?' European Parliament (2018) p. 12.

156 Anna Gardella, 'Bail-in and the Financing of Resolution within the SRM Framework' in Danny Busch and Guido Ferrarini (eds), *European Banking Union* (Oxford: Oxford University Press) (2015) pp. 373–407; Jianping Zhou, Virginia Rutledge, Wouter Bossu, Marc Dobler, Nadege Jassaud, and Michael Moore, 'From Bail-out to Bail-in: Mandatory Debt Restructuring of Systemic Financial Institutions', IMF Staff Discussion Note, 24 April SDN/12/03 (2012).

157 Emilios Avgouleas and Charles Goodhart, 'Critical Reflections on Bank Bail-ins' (2015) Journal of Financial Regulation 1(1) 3–29.

stakeholders of the bank that are best able to absorb them. Equally, the different levels of technical capacity of the supervisor also needs to be taken in to account to try and ensure it could work and the outcomes are appreciated for the entity and supervisor involved.

5.69 The Member State is required to work out in advance with the institution or group which liabilities are eligible for bail-in.[158] However, the resolution authority is prohibited from bailing-in a number of liabilities such as deposits covered by the DGS, secured liabilities, any liabilities held for a client that qualify as either client assets or client money, liabilities that arise from a fiduciary relationship, liabilities (to other institutions) with an original or, in certain cases, remaining maturity of less than seven days, employee remunerations and salaries with the exception of material risk takers, commercial trade creditors, tax and social security authorities, and the DGS. Nevertheless, the resolution authority does have some discretion in deciding which debt instruments are eligible for bail-in when considering the available time, market conditions, and the implications for financial stability. But this could be limited by the pre-designed depositor preference rule determining which deposits (retail or wholesale) are within or sit outside of the provision giving them priority over other claims.[159] However, the exclusion of otherwise eligible bail-in liabilities has to be proportionate and should not undermine safeguarding critical functions. The assessment of included and excluded liabilities in a write-down or conversion needs to be mindful of the principle that no shareholder or creditor is worse off than in a hypothetical insolvency proceeding. If only certain creditors within a creditor's class are subject to the bail-in, affected creditors should be compensated. The write-down and conversion of capital instruments needs to comply with the priority of claims set out in insolvency proceedings so that Common Equity Tier 1 instruments are written down in proportion to the losses incurred. Furthermore, necessary, the Additional Tier 1 and Tier 2 instruments must be either written down or converted into Common Equity Tier 1 instruments. Nevertheless, the resolution financing arrangement can be expected to make a contribution of up to 5% to the resolution of the institution provided that at least 8% has been bailed in by shareholders and those with eligible liabilities. The level of equity and liabilities bailed in needs to be proportionate so that the institution continues to meet the authorization criteria.

5.70 The bail-in tool requires institutions to have in place own funds and eligible liabilities at a percentage of total liabilities and own funds of the institution. In this respect, eligible liabilities need to be fully paid up, unsecured, with a maturity of at least one year, should not arise from a derivative or should not be a publicly insured deposit. The resolution authority and the competent authority are expected to work together to ensure the institution has sufficient eligible liabilities and is resolvable. This is likely to form part of the assessment to produce recovery and resolution plans at the preparation stage. The resolution authority and the competent authority will need to work together to work out the minimum requirement that institutions will need to hold at an institutional and group level. This requires them to also assess whether the DGS could contribute to the financing of the resolution. The move

158 For a detailed technical analysis see Bart P M Joosen, 'Regulatory capital requirements and bail-in mechanism' in Matthias Haentjens and Bob Wessel, *Research Handbook on Crisis Management in the Banking Sector* (Cheltenham: Edward Elgar Publishing) (2015) pp. 175–235.

159 Niall Lenihan, Maike Luedersen, and Martin Schulte, 'The hierarchy of creditor claims in bank insolvency' (2016) Forum Financier/Droit Bancaire et Financier 413–25; see Chapter 6, Creditors Interests in Insolvency—Depositor Preference, paras 6.45–6.51.

towards ensuring institutions meet minimum requirements will then form the basis of data submitted to the EBA so that it can report on the move towards compliance with these requirements to the European Commission.

The resolution authority will need to assess the amount of eligible bail-in liabilities to determine whether there is enough to convert into Common Equity Tier 1 capital. It needs to keep this under review to determine whether or not there is enough for the institution in resolution or a bridge institution. The resolution authority will also need to assess whether there are enough bail-in liabilities to meet the needs of the asset management vehicle, if that resolution tool is utilized in conjunction with bail-in. The level of bail-in liabilities varies considerably in light of the business and financing model of institutions, which means the institutions will need to change them to ensure they have enough. **5.71**

The resolution authority will also need to set out their treatment of shareholders so that they are informed about how their rights and interests will be impacted by the write-down and bail-in policy. The BRRD requires shareholders to be aware that the resolution authority can either cancel or transfer existing shares or other instruments to bailed-in creditors. This will comply with the principle that shareholders will bear the first losses in a resolution, and then creditors. The resolution authority during the process of write-down and transfer needs to review whether it is sufficient or not, as it could mean they will have to compensate or re-transfer. It will need to value the shares and liabilities to determine the possible rate of conversion and write-down depending on the class of instruments and in accordance with the predetermined sequence according to the Member State's insolvency law. Moreover, in circumstances where the resolution authority decides to exercise its resolution powers and only partly bail-in equity and liabilities, then the original shareholder and creditors will need to be compensated based on an estimation of the recovery rate in a hypothetical insolvency proceeding under normal insolvency law. **5.72**

The resolution authority will need to ensure that all administrative requirements such as registers and listing of shares are amended and changed to ensure the application of bail-in. It will also need to ensure that all procedural impediments to conversion are removed. The designated liabilities will require amendment to include a contractual provision to recognize bail-in. Thereby, liabilities governed or being otherwise subject to the laws of a third country become bail-in eligible in particular. In this respect, the contractual parties agree to abide by the write-down or conversion. The move towards complying with the provision is an onerous one and will require the EBA to assist with technical guidance to assist resolution authorities in devising a list of liabilities which are included and excluded from bail-in. **5.73**

The introduction of the bail-in tool as the option of 'first resort' poses a range of challenges for the respective authorities, leading to possible misalignment of incentives, which could leave the significant subsidiary in a rather vulnerable position. This is partly due to the fact that the bail-in is considered the tool of first resort if the bank exceeds the minimum 8% threshold. The guiding principle in these matters is that no shareholder or creditor should be worse off than insolvency, so ultimately this is a starting point rather than an end point with valuations and compensation claims considered during and after the resolution.[160] **5.74**

[160] BRRD, Art. 74(1)–(4) and Art. 75.

The narrow form of financing within many Member States means the subsidiaries are unlikely to be holding the right forms of debts to bail in. The move to changing the composition of financial markets is not likely in the short to medium term but it is a long-term outlook. In light of this, the option to get recapitalized in normal market circumstances is an unlikely one. The current vulnerabilities in the economies and financial markets are evident from the lack of ability of the respective central banks to introduce meaningful counter-cyclical and systemic risk capital buffers to improve the resilience of the financial systems. Moreover, the possibility of increasing these is problematic since it leads to lower levels of finance in the economy which is likely to have an impact on the speed of recovery. In the context of a counter-cyclical buffer, it is expected to be set at zero since in most regions there is little indication of excessive credit risk build-up but rather a considerable amount of non-performing legacy assets. It has been noted that the systemic risk buffer only addresses future expected losses rather than the existing legacy assets so offering limited protection. Moreover, the possibility of raising finance in the respective financial markets is likely to be limited or non-existent given the heavy reliance on a narrow form of bank finance. The existing problem of non-performing loans is also going to act as a heavy burden on these institutions. In light of the sheer size of these losses, in some cases the banks are exempted from complying with the systemic risk buffer. The level of concentration in the banking market as the primary form of finance is also likely to pose challenges since only a handful of foreign banks in the respective countries comprise around 60%–90% of the market.

5.75 The first losses will need to be absorbed by shareholders and, in this case, the significant subsidiaries are in many cases wholly owned by the group parent and so the group parent is inevitably going to bear the first losses in any write-down of equity. The incentive, therefore, for the parent is to try to ensure the liability structure of the subsidiary is such that the creditors of the significant subsidiary absorb a significant proportion of the remaining losses. To ensure this, the banks are expected to build up a solvency buffer, MREL, made up of liabilities that are expected to be in distress loss absorbing and so minimize the chances of relying on public funds to bail out the bank. The MREL requirements are applicable to all European banks, as opposed to the TLAC requirements which are applied to the G-SIB.

5.76 In the European context, the minimum threshold is set at 8% in the BRRD, but some Member States are expected to set considerably higher levels to act as a suitable buffer to absorb a significant proportion of the losses of a systemically importance institution. Despite this, some banks in the European Union will be exempt from holding MREL. Notwithstanding those banks, it is the case that the smaller Member States should move towards having such liabilities in place, since many of the banks rely heavily on deposits to fund their businesses and have little long-term unsecured debt. Since there is a lack of a developed debt market, it is likely that the subsidiaries in question are able to issue the appropriate debt instruments in the local market. A particular concern is the likelihood of them being issued to an overly concentrated financial sector which would cause its own risk of contagion.

5.77 The structure and prepositioning of bail-in-able debt has been a particularly important topic and it has required careful preparation between the resolution authorities to work with banks and their groups to address how bail-in could work. The prepositioning of bail-in-able debt does offer in many ways an *ex ante* answer to Herring's[161] home and host dilemma since the pre-commitment to it signals to the host authority a clear indication of its importance to the group and the parent regulator. While some may be disappointed with the outcome at least preparations could be put in place to prepare for a standalone resolution or insolvency-liquidation. However, such decisions could well see in the future the supervisory authority ensuring local banks are more capitalized (hoarding capital) than others in the market that maybe part of a bail-in strategy.

EU Member State Resolution Decisions

The cases of resolution actions in the EU highlight that a single one-size-fits-all approach has not been taken and a more purposive approach has been adopted. A reasonable number of cases now exist to evaluate the use of resolution tools and more importantly the combination of tools used. More controversially the question of consistency has been a concern in instances where bail-in has been avoided due to its implementation date being put forward, whereas in other jurisdictions banks were expected to exercise the right voluntarily. It is likely the bail-in tool will only play a limited role in small bank resolutions and in relatively small Member States in comparison to the other resolution tools explained above. Therefore, while it may be the tool of first resort for large complex banks, it is likely to play a limited role in cases relating to narrow banks reliant on deposits as a source of funds. **5.78**

In Hungary, the option utilized regarding Magyar Nemzeti Bank[162] was the sale of business tool and the asset separation tool to divest a portfolio of project finance loans. The sale of business tool requirements are set out in Article 42(2) of the Hungarian Resolution Act (transposing the BRRD into Hungarian law). With regard to the asset separation tool regarding state aid, MNB obliged the Bank to comply with the commitments approved by the European Commission based on the 'Commitments Letter'. Using the sale of business tool (divesting certain portfolio elements of the Bank), seven loan claims were sold to OTP Bank Nyrt (the biggest domestic bank in terms of total assets). The asset separation tool applied pursuant to decision SA.40441 2015/N of the European Commission. As a preparatory step, assets intended to be divested but which could not be sold to voluntary buyers on the market were transferred to MKB Pénzügyi Zrt to encourage the implementation of the asset separation tool. MNB transferred the shares issued by MKB Pénzügyi Zrt to the Hungarian Resolution Property Management Private Company Limited by shares (MSzVK) and the shares issued by RESIDEAL Zrt to MSzVK (RESIDEAL is a special company dealing with the real estate management). MSzVK paid real market value for the shares (above the market price), which entitled the bank to receive compatible State aid approved by the European Commission. MNB transferred all issued shares of the Bank to MSzVK (the provider of **5.79**

[161] R Herring, 'Conflicts between Home and Host Country Prudential Supervisors' in D D Evanoff, G G Kaufman, and J R LaBrosse (eds), International Financial Instability: *Global Banking and National Regulation* (New Jersey: World Scientific 2007) pp. 201–21.

[162] <https://www.eba.europa.eu/documents/10180/1460574/1+July+2016_Central+Bank+of+Hungary+notification+regarding+termination+of+resolution.pdf> [accessed 18 March 2019].

state aid) for a symbolic purchase price as compensation and as a precondition for the received state aid to comply with the rules of the internal market of the EU.

5.80 In Italy, a number of small banks opted for resolution.[163] With regards to Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, and Cassa di Risparmio della Provincia di Chieti, all assets and liabilities (including bad loans) of the banks were transferred under resolution to four bridge banks (Nuova Banca delle Marche, Nuova Banca dell'Etruria, Nuova Cassa di Risparmio di Ferrara, and Nuova Cassa di Risparmio di Chieti) and this was followed by the transfer of bad loans to an asset management vehicle (AMV). The Resolution Fund intervened in order to capitalise the four bridge banks, cover transaction losses and capitalise the AMV and provide guarantees if needed.

5.81 Portugal exercised resolution in the case of Banif-Banco Internacional do Funchal, SA.[164] Banif-Banco Internacional do Funchal, SA (Banif) and most of its assets and liabilities is being sold to Banco Santander Totta for €150m. Distressed assets will be transferred to a vehicle asset management. The voluntary sale involves a public support estimated at €2.255m intended to cover future contingencies, of which €489m comes from the resolution fund and €1.766m directly from the State as a result of the options agreed between the Portuguese authorities, the European institutions and Banco Santander Totta as regards delimiting the perimeter of assets and liabilities to be sold. This measure follows the European Commission's in-depth investigation of the State aid received by Banif, after the shareholders and the Banif Board of Directors initiated a sale of the institution to avoid the risk of it being declared illegal and subsequent demands for its restitution. Also in Portugal, in the case of Banco Espírito Santo (BES), SA, resolution was initiated.[165] A bridge bank ('Novo Banco, SA') was set up by the Bank of Portugal to transfer the assets and liabilities of BES with the exception of 'excluded liabilities' (certain issues of non-subordinated bonds issued by BES and intended for institutional investors). The original resolution decision provided that Bank of Portugal, as the Resolution Authority, may at any time re-transfer assets and liabilities between BES and Novo Banco. This measure was based on public interest reasons and was necessary to ensure that the losses of BES are absorbed by this institution's shareholders and creditors and not by the resolution fund or the taxpayers. In addition, Bank of Portugal made a final adjustment to the perimeter of the assets, liabilities, off-balance-sheet items, and assets under management transferred to Novo Banco. There was clarification that no liabilities have been transferred to Novo Banco that were contingent or unknown at the date the resolution measure was applied to BES. The shareholding in BES Finance was retransferred to BES, which is necessary to ensure full compliance with and application of the resolution measure as regards the non-transfer to Novo Banco of subordinated debt instruments issued by BES. There is clarification that it is the Resolution Fund's responsibility, upon the fulfilment of certain conditions, to make neutral for Novo Banco—through an appropriate measure—potential negative effects of future decisions resulting from the resolution process and giving rise to liabilities or contingencies.

[163] <https://www.eba.europa.eu/documents/10180/1890369/IT_notification_BRRD_5June2017.pdf/223a5aa0-12c4-48e8-b548-72750f7625fc> [accessed 18 March 2019].

[164] <https://www.eba.europa.eu/documents/10180/1315419/Comunicado+BdP_BANIF.pdf> [accessed 18 March 2019].

[165] <https://www.bportugal.pt/en-US/OBancoeoEurosistema/ComunicadoseNotasdeInformacao/Pages/combp20151229-2.aspx> [accessed 18 March 2019].

Denmark exercised resolution option in respect of Andelskassen J A K Slagelse.[166] Finansiel Stabilitet (FS) took over the management of Andelskassen to secure a controlled resolution of the bank. FS established a subsidiary (Broinstitut I A/S) which will take over the ownership of the bank. Existing contributed capital was written down to zero in the first instance. The Danish Guarantee Scheme for Depositors and Investors is required to contribute to cover the bank's losses (on first valuation). Additional measures have included the FS setting up a bridge institution (pursuant to s 21 of the Act and Article 40 of the BRRD) which shall contribute new capital to the institution and take over its ownership. A bail-in tool for loss absorption was carried out pursuant to s 24 of the Act (implementing Articles 43 and 46 of the BRRD) in respect of all other subordinated obligations of the institution, so that such obligations are written down to zero. 5.82

In the case of Greece and the resolution of Cooperative Bank of Peloponnese Coop Ltd,[167] the licence of the bank was withdrawn and its assessment indicated that the bank was failing or was likely to fail. In this case, the bank had no eligible liabilities for the purposes of recapitalization through a bail-in to convert into equity to reduce the capital shortfall. The bank was required to recapitalize once it was found to have a capital adequacy ratio of -7.02%. In this case, the sale of business tool was also utilized since, in comparison to the bridge bank, it was the least costly option to reduce the resolution costs and ensure minimum or no disruption to the continuity of critical functions. In the case of Panellinia Bank SA, the withdrawal of the bank's authorization without the simultaneous adoption of resolution measures would 'very seriously jeopardise the continuity of the banking operations of all cooperative banks and would thus negatively affect cooperative credit, and consequently, financial stability'. Panellinia Bank's property items (assets, liabilities, and contractual relationships) were transferred to Piraeus Bank SA to protect deposits. Emergency liquidity assistance (ELA) was provided by the Eurosystem. 5.83

Cross-border Group Resolution

The cross-border resolution of institutions and groups requires a significant degree of timely cooperation and coordination between the home and host Member State or between Banking Union participating and non-participating Member States. The SRB is expected to cooperate closely with national resolution authorities.[168] However, it has not, to date, set out the guidelines for cooperation and coordination. It is expected that the ECB and the SRB will publish an MoU with national resolution authorities in non-participating Member States. The national resolution authority will also assist with information to enable the SRB to formulate its decisions. The SRB will represent entities in participating Member States. In light of this, the SRB will represent the national resolution authority when working out how best to cooperate and coordinate with national resolution authorities 5.84

[166] <https://www.eba.europa.eu/documents/10180/1413812/Resolution+of+Andelskassen+JAK.pdf> [accessed 18 March 2019]; <https://www.eba.europa.eu/documents/10180/1224279/Notification+-+BRRD+Article+83%284%29%20-+International+Authorities.pdf> [accessed 18 March 2019]; <https://www.eba.europa.eu/documents/10180/1321242/Andelskassen+JAK+press+release.pdf> [accessed 18 March 2019].

[167] <https://www.eba.europa.eu/documents/10180/1486246/Bank+of+Greece.pdf> [accessed 18 March 2019].

[168] SRMR, Art. 31.

of non-participating Member States. More specifically, the SRB is expected to enter into MoUs with non-participating Member States' national resolution authorities that have an institution which is part of one of the G-SIIs. The lack of success in ensuring binding commitments in the past where MoUs were present would lead one to conclude that such an approach is unlikely to get the binding results sought by the SRB.

5.85 It is expected that the SRB will communicate its plans, decisions, and/or measures with the national resolution authorities in non-participating Member States.[169] While this is a positive step forward, it is not very clear whether the documents will be provided or whether it will simply communicate the fact that they have been decided, leaving the national resolution authorities in the non-participating Member States with limited assistance with their resolution decisions. This should mitigate significant impediments to cross-border resolution for those banks considered significant. An equally important dimension is cooperation and coordination with third countries, in the capacity as either home state or host state supervisor.[170]

5.86 The BRRD requires Member States to work out in advance the role and responsibilities of competent and resolution authorities.[171] The process of cooperation and coordination between the various parties across borders will be partly assisted by the forward planning undertaken at the preparation stage with the recovery and resolution plans. However, these plans will form the starting point and the catalyst for early intervention and resolution may not necessarily arise from a scenario captured by the plans, although they will provide the authorities with a very good idea of the critical functions and business lines which will need to be considered during the resolution phase, and indicate which tools best address the problems experienced at the institution or group level.

5.87 In this respect, the BRRD identifies the broader hurdles relating to subsidiaries and branches located in other Member States; furthermore, and broader still, it seeks to minimize the adverse effects on financial stability in the EU and Member States.[172] Thus, 'due consideration is given to the objectives of balancing the interests of the various Member States involved and of avoiding unfairly prejudicing or unfairly protecting the interests of particular Member States, including avoiding unfair burden allocation across Member States'.[173] As noted earlier, the advance planning is likely to enable authorities to work out burden allocation rather than burden sharing equally, notwithstanding the uneven form it may take both from a supervisory, resolution, and liquidation perspective. In many respects, while the BRRD provides a legal framework to mandate cooperation, it primarily takes one Member State or third-country resolution authority to act in its own public interest and initiate insolvency proceedings to undermine the purpose of the BRRD. The broad powers and purposes of the resolution authority may resonate with other competent and resolution authorities but may not readily fit with the narrow approach taken by the courts. This is perhaps frustrating from the perspective of the resolution authority given that the purpose of the BRRD is to put in place a resolution process that minimizes costs based on the

[169] SRMR, Art. 8(2) and Art. 32.
[170] SRMR, Art. 32.
[171] BRRD, Art. 87(a)–(l).
[172] BRRD, Art. 34(2).
[173] BRRD, Art. 87(h).

resolution authorities' economic assessment, with the principle that shareholders and creditors take the first losses but no shareholder or creditor will be worse off with the application of the resolution tools than with liquidation.

Relations with Third Countries

A considerable amount of cross-border banking and finance exists within the EU and a proportion of it has significant origins or presence in third countries.[174] In the accession countries the presence of EU Member State banks is significant. The BRRD attempts to put in place a framework of cooperation and coordination between EU Member State competent and resolution authorities and third country counterparts so that the level of disruption to markets and impact on financial stability is minimized. The experience of those third countries considered in this report would suggest that the efforts fall short of the aspirations set out in the BRRD and the SRM. The incentives, it is argued, remain to promote self-serving interests so cooperation and coordination is likely to occur when it serves the interests of the home or serves the mutual interests of a select few home and host states. This could perhaps be improved if the EU resolution colleges and the international crisis management groups coordinated and cooperated better, with a super college arrangement for sharing information between members and observers. **5.88**

The BRRD provides a broad context for cooperation linked to crisis prevention and crisis management arrangements.[175] The crisis prevention tools, such as information sharing to complete recovery resolution plans, will involve the competent and resolution authorities separately. However, while the EU resolution framework advocates a separation of roles for supervision and resolution, their third-country counterparts may only consist of one authority that is both a supervisor and a resolution authority. Indeed, in some third countries, it is likely a resolution authority may not exist and a court-based system does exist, and coordination and cooperation with the competent authority is the first port of call. This is likely to result in the third country being unable to participate in the resolution college as well. This situation is likely to reduce with the introduction of special administrative led resolution regimes. In many respects the requests for information in the context of resolution exist within the broader supervisory mandates associated with techniques such as consolidated, supervision, and arrangements for information sharing in relation to financial conglomerates. This assumes the incentives in supervision are aligned for cooperation and coordination which is not necessarily the case in practice, as the study have shown earlier. While the information requests and data requests are honoured by third countries, the arrangements are not reciprocal in return and broad outcomes and decisions are shared without any meaningful dialogue. It is, therefore, not surprising to find the level of reciprocity in terms of information sharing regarding prevention or crisis management is also weak or non-existent. **5.89**

[174] Maria J Nieto, 'Third Country Relations in the Directive Establishing A Framework for Recovery and Resolution of Credit Institutions' in Jens-Henrich Binder and Dalvinder Singh (eds), *Bank Resolution: The European Regime* (Oxford: Oxford University Press 2016) pp. 137–56.
[175] BRRD, Art. 93.

5.90 The BRRD sets out the expected approach for those institutions or groups that have a parent located in a third country, a significant branch, or a subsidiary in a Member State.[176] In relation to these entities, the BRRD anticipates cooperation to inform the resolution process and sets out *ex ante* the expected role of the EU competent and resolution authorities. However, in practice, it is likely there are more incentives for the EU resolution authority to cooperate and coordinate with large systemically important third countries where perhaps the systemically important parent is incorporated. On the other hand, there are less incentives for the EU resolution authorities to cooperate and coordinate with host states with significant subsidiaries that pose little systemic risk exposure to the parent. The BRRD encourages Member States to enter into bilateral agreements with third countries to work out how they will attempt to work with one another in resolution. In practice, however, MoUs have not worked well and are likely to simply emphasize well-intentioned cooperation with third countries that pose larger systemic risk exposures to their interests. As a stopgap measure, the BRRD provides an interim measure to recognize and enforce third-country resolution proceedings until such agreements are made. The European resolution colleges are expected to play an important role in this regard, to provide a platform for coordination and recognition of proceedings emanating from a third country. As the study will show in the following section, the third countries are classed as observers on resolution colleges and there is not really an explicit commitment to share information with them in the resolution colleges unless it implicitly serves the group resolution authority's interests. Here, the group resolution authority can exploit its position by conferring better terms and conditions to some observers than others, provided it does not result in them having better terms than members. However since subgroups can also exist within the resolution colleges.

5.91 The BRRD offers limited assurance of third-country cooperation and coordination for resolution. It provides a number of eventualities that primarily mean at best that the resolution authorities will commit to a number of *ex ante* arrangements to recognize and enforce third-country resolution proceedings which will be dependent on Member States' own discretion. It could result in one Member State recognizing and cooperating with a third-country resolution authority and possibly in other Member States' resolution authorities not cooperating to the same extent.[177] In this respect, the BRRD expects Member States to give due consideration to such matters and the financial stability in those Member States. As a minimum, the Member States are required to be in a position where they can exercise their powers of resolution regarding:

- assets of third-country institutions in a Member State or governed by Member State law;
- rights and liabilities booked in a branch located in a Member State;
- transfer of shares;
- exercising contractual powers to support third-country resolution proceedings; and
- rendering enforceable rights to terminate, liquidate, or accelerate contractual rights that arise from resolution actions that relate to third-country resolution proceedings.[178]

176 BRRD, Art. 93(1)(a)–(c).
177 BRRD, Art. 94.
178 BRRD, Art. 94(4)(a)–(d).

Taking into account the third countries considered in this project, the position is likely to be one where the resolution authority needs to be preparing for an MPE approach since it is unlikely to be involved in the group's possible pursuit of an SPE approach which is likely to apply to the more systemic parts of the group rather than the non-systemic parts. **5.92**

The BRRD does provide a basis for Member States to act in their own public interest when considering whether or not to recognize third-country resolution proceedings.[179] This is quite possibly the likely outcome of the reforms introduced by the EU for the very reasons highlighted above. For example, this may apply if: **5.93**

- the third-country proceedings would have an adverse impact on financial stability in the Member State;
- independent resolution of the branch is necessary;
- the third country would not confer the same treatment of creditors and depositors with similar legal rights;
- there would be material fiscal implications for the Member State; or
- it would be contrary in light of national law.

The lack of reciprocal information sharing and crisis simulation participation of these third countries means that on all fronts it is noteworthy to recognize that it is important for the third country in the accession region to develop their own crisis management arrangements which are fit for their own purposes. This is likely to take a considerable length of time since it needs to be developed at the crisis prevention level with recovery and/or resolution plans as well as the building up of the administrative arrangements for crisis management. The significant challenge is to try and ensure the LAC at the significant subsidiary level is sufficient for the local interests. **5.94**

In relationship to third-country branches located in a Member State, the authorities will need to decide whether third-country resolution proceedings or Member State resolution proceedings are to apply.[180] When the circumstances listed in BRRD, Article 95 are present, the Member State acting in the public interest, or when the third country is unable or unwilling to act in the wider interest, will need to be in a position to exercise resolution proceedings in accordance with the resolution's objectives, conditions, and principles. **5.95**

The BRRD also requires the EBA to consider entering into non-binding cooperation agreements with third countries to put in place their intentions *ex ante* to organize resolution of entities set up in the European Union. However, the cooperation agreements should be general and not made in reference to a particular third-country entity in the Member State. The BRRD explicitly provides that they are not legally binding on the Member State. Notwithstanding the non-binding nature of the agreements, they are expected to assist with: **5.96**

- recovery and resolution plans;
- assessment of resolvability impediments to resolution;
- early intervention measures; and
- the resolution powers and tools.

[179] BRRD, Art. 95(a)–(e).
[180] BRRD, Art. 96.

5.97 Moreover, the cooperation arrangements could include arrangements for sharing information, forming separate recovery and resolution plans, and the possible resolution tools to be expected to be used.

5.98 A particular problem identified by the GFC was the lack of a coherent cross-border resolution regime which primarily led to Member States taking action in their public interest, taking a territorial rather than a universalist approach. The extent to which the BRRD remedies this is debatable. The BRRD certainly enables the competent and resolution authorities to *ex ante* work out the possible options they are likely to initiate in resolution and to enter into non-binding cooperation arrangements. It appears to be dependent on a case-by-case basis. In some instances, the BRRD limits the Member State's authority when it sets out options for resolution of third-country entities. For example, when it requires two or more entities operating in the EU when it could be the case that an individual subsidiary or indeed significant branch could well pose risks to markets functioning efficiently and to the financial stability in the respective Member State and beyond.

5.99 The implications of the wider lack of coordination are material since a decision by a third country to trigger resolution before the EU group resolution authority does could have a detrimental impact on market confidence in the group and so undermine achieving its intended aims.

International Cooperation Arrangements

5.100 As part of the SRB's role to represent national resolution authorities, it is expected to enter in to cooperation arrangements with non-participating Member States and third countries to assist with the process of improving arrangements for cross-border resolution.[181] In respect of third countries, the SRB has entered in to a number of international cooperation arrangements with its counterparts, namely Canada (CDIC),[182] United States (FDIC),[183] Brazil (Central Bank),[184] Mexico (Mexico's Institute for the Protection of Bank Savings),[185] and Serbia, (National Bank),[186] and Albania (National Bank).[187] These soft law arrangements are in addition to formal membership of crisis management groups—the equivalent to resolution colleges. It expressly indicates that the cooperation arrangement does not create binding obligations or supersede domestic law. The commitments, therefore, are likely to be only as good as the relationship built up by the SRB and their respective counterpart, which is likely to be cemented better by the national resolution authorities and the

[181] SRM Regulation, Art. 32.

[182] Cooperation Arrangement Concerning the Resolution of Financial Institutions with Cross-Border Operations in Canada and The European Banking Union (2017).

[183] Cooperation Arrangement Concerning the Resolution of Insured Depository Institutions and Certain Other Financial Companies with Cross-Border Operations in the United States and The European Banking Union (2017).

[184] Cooperation Arrangement between the Banco Central Do Brasil and The Single Resolution Board (2018).

[185] Cooperation Arrangement between the Institute for the Protection of Bank Savings and The Single Resolution Board (2018).

[186] Cooperation Arrangement between the National Bank of Serbia and the Single Resolution Board (2018).

[187] Cooperation Arrangement between the Bank of Albania and The Single Resolution Board (2018).

relationship and confidence each jurisdiction has to each other. The important principle behind this initiative is the political will to work together for common ends which is primarily an orderly resolution with minimum disruption.

The cooperation arrangements share a common template, explaining the position and responsibilities of the SRB to its international counterparts in the arrangements. A significant part of the arrangement explains how the Banking Union reforms have introduced new relationships within the Eurozone and non-Eurozone Member States. It specifically explains the relationship between the SRB and national resolution authorities as points of contact for the Eurozone, namely execution of resolution schemes at the Eurozone regional level and at the national level, resolution planning, resolvability assessments, and determining levels of minimum levels of own funds and eligible liabilities respectively. It highlights the importance of cooperating to safeguard financial stability in the respective jurisdictions and so recognises the importance attached to working with one another to achieve that goal., the principle focus being 'their willingness to cooperate with each other in the interest of fulfilling their respective statutory objectives; enhancing communication and cooperation; assisting each other in the planning and the conduct of an orderly Resolution of an Entity'. Following on, this theme highlights that the decisions taken by resolution authorities duly consider the potential impact of their resolution actions on the respective financial stability of the named country and the EU. The arrangement goes significantly further in terms of a commitment, namely to essentially work together with other parts of the official safety net on matter relating to resolution: 'the Authorities seek to enhance cooperation in the analysis of Entities' Resolution issues, planning for potential Resolution scenarios, and appropriate simulations, contingency planning or other work designed to improve preparations of the Authorities for managing and resolving crises involving Entities'.[188] While there is no commitment to formal cooperation in resolution and who is likely to take the lead in resolution, the cooperation arrangement does indicate the importance of promoting efficiency and preserving value in the resolution entity and a commitment to maximize recoveries and minimize losses and moral hazard. From the third-country perspective a single point of contact is useful if it has a bank with multiple operations within the Eurozone. **5.101**

The principles of promoting efficiency and preserving value require good relationships regardless of whether the materiality of the interest is not necessarily mutual. This is dependent on whether there is recognition that both parties have a mutual interest in participating, in view of their risk exposure and indeed commitment *ex ante* to assist both parts to prepare for resolution in whatever form it may take. Nonetheless, in many instances it will be recognized that the risk exposure is not likely to be of mutual interest from a home and host perspective. In view of this, it is important to provide legitimacy to cooperation and coordination arrangements to show recognition that, despite **5.102**

188 To the extent possible, in respect of any confidentiality and other restrictions, the Authorities intend to:

(i) discuss approaches to Resolution planning;
(ii) share ideas and strategies; and
(iii) facilitate mutual understanding of Resolution plan rulemaking, rules, practice and implementation in each other's jurisdiction.

unequal materiality of the entity, cooperation, and coordination arrangements are in place. For example, as shown in Chapter 1, the exposure of European banks in Serbia and Albania, potential accession countries, is very high. But these exposures may not be material to the group parent entity in the Member State; in many instances these are, Eurozone Member States, so within the umbrella of the Banking Union and SRB jurisdiction. In view of this, preparations for a resolution scheme, which may include, for the respective entity an MPE strategy, requires preparation in terms of managing, for instance, a decision to sell the business and so placing greater pressure on the country as a result of foreign bank concentration risk. Moreover, the resolution scheme for the Banking Union should enable a sharing of information, albeit at a strategic level, to prepare for dealing with disruption to intragroup funding, if the foreign third country entity is reliant on it for the purposes of liquidity. But, as shown in Chapter 1, the entities in those countries may be significantly reliant on local corporate and retail depositors for funding and less reliant on intergroup funding. This should insulate the entity in smaller third countries from the problems arising at the group level. But there may be a tug of war over the entities capital which could be well over the minimum levels and may lead to a position where it is reduced to improve the capital position of the parent or another material entity within the group. The argument that the entity is narrow and so likely to be dealt with in liquidation does not necessarily hold up from the country perspective, in view of the entities' critical importance of providing credit in the local market.

5.103 The SRM opens the door for the potential of an international agreement for recognition and enforcement of third-country resolution proceedings.[189] This is an important step, in principle, towards offering a route towards a binding obligation with third countries but at this juncture no agreement has been entered in to with a third country. The likelihood of a binding agreement is small, despite the recognition of how important it is to have clear commitments in such times to ensure orderly resolution on both sides. However, this requires something far more than the cooperation arrangement measures and indeed resolution colleges/ crisis management colleges are offering. The SRM Regulation would essentially require the exercise to be undertaken on a case-by-case basis, reviewing both sets of laws to determine what impediments exist for either the third country or the SRB to recognise such decisions. The SRM Regulation expects the SRB to refuse recognition or enforcement of resolution proceedings if, inter alia, they adversely affect the financial stability in a participating Member State or if the treatment of depositors or creditors is not the same. To reduce this risk, the role of colleges is critical but the outcomes for all members may not be equal in terms of commitments to share information.

Reconfiguring Home Bias for Significant Subsidiaries—The Resolution Perspective

5.104 The SRM and the BRRD provide a good starting point for effective coordination and cooperation in the resolution of cross-border banks. The SRM with the SRB at the helm

[189] SRM Regulation, Art. 33.

mitigates some of the conflicts of interests that can arise in cross-border resolution at the Eurozone level with the introduction of a single decision-making body. The move to a single, more consistent, approach to resolution of groups is likely to have a wider beneficial effect. The resolution framework does have a wider margin of discretion than its supervisory counterpart so there is a significant role for national resolution authorities to play in supporting the single resolution scheme adopted by the SRB. Moreover, there is a significant margin of discretion to enable resolution authorities that are non-participating Member States to exercise national discretion to formulate national resolution plans and schemes.

The significance of home bias remains present due to the approach, in practice, to resolution that is likely to be taken. In this respect, the dominance of the group resolution authority in the decision-making process means that it is expected that significant subsidiaries that are important to the viability of the group as a whole are likely to feature more importantly in the resolution scheme. The level of reciprocity in terms of building up resilience and information-sharing and decision-making is argued to be aligned in the interests of the group resolution authority and at the detriment of some small Member States and third countries that have significant subsidiaries from their financial system perspective. The resolution policy framework needs to be better aligned, in terms of proportionality, for significant subsidiaries from both the perspective of the group as a whole and the perspective of Member States. It is argued that a more coherent policy framework is likely to lead to a more orderly resolution from a group perspective and a single subsidiary perspective. Therefore, better aligning the interests of home and host Member States and third countries where a significant subsidiary is located. This would enable the resolution authorities of the significant subsidiary to work out whether there are potential impediments to resolvability such as cross-sharing of IT platforms and other back-office functions that the parent provides to the subsidiary. The level of discretion currently enables the group resolution authority to decide that it will not share such plans with a wider range of Member States and third countries. **5.105**

The importance of improving the resolvability of a group and of a significant subsidiary that is not included in the group resolution plan cannot be underestimated. It is the starting point for orderly resolution. It would be important for an orderly resolution to have the resolution authorities that have been designated for the purposes of capital buffers to automatically be appointed onto resolution colleges as either members or observers. This would avoid a position where a subsidiary that is relatively small in comparison. The level of discretion at the resolution colleges needs to be better structured so that information is shared on a more reciprocal basis. This could improve group resolution as well as resolution of significant subsidiaries at the periphery of the group *ex ante*. It would be beneficial since it would enable both sets of authorities to work out the resolution plans in a more coordinated manner and minimize asymmetry of information, as well as Member States and third countries acting in their own self-interest. There are obvious challenges here from a group and from a single significant subsidiary perspective associated with building up the appropriate level of MREL and the associated issue of taking an SPE or MPE approach. In terms of the MREL, it will be important for the resolution authorities to decide what will constitute eligible **5.106**

MREL. Moreover, the implications of including uncovered deposits of corporate and financial institutions on the wider economy should be considered as well. The wider implications of the principle of burden sharing and having 8% minimum own funds and eligible liabilities for write-down and conversion for the purpose of bail-in need to be assessed since they are closely related to access to resolution funds. The principle of burden sharing for subsidiaries in these respective Member States and third countries has a disproportionate effect on them, despite the fact that they have relatively high levels of own funds.

5.107 The policy framework needs to better explain its position on narrow banks for the purposes of resolution and insolvency. The idea of a narrow bank is a rather unhelpful term since the policy position appears to assume it is not systemically important. In a number of Member States, significant subsidiaries have been required to hold additional capital buffers based on criteria set by the EBA. In such cases, the O-SIIs have been determined to pose a systemic risk to financial stability. The O-SIIs are, to all intents and purposes, narrow banks, and if one were to apply the policy of resolution by way of insolvency this would limit the options the Member States are likely to want to use to act in their public interest, as is analysed in Chapter 6.

International Soft Law Instruments Focus on Home and Host Resolution Issues

5.108 The BRRD put in place equivalence requirements as well as reference to recognition of proceedings. The EBA Opinion on Argentina equivalence assessment of supervision mentions resolution but does not assess its equivalence to the BRRD.[190] This is quite surprising considering the critical importance of resolution and planning as a continuum of supervision. The principal international soft instrument in the field of resolution is the FSB Key Attributes of Effective Resolution Regimes.[191] These were originally endorsed by the G20 in November 2011 at the Cannes Summit.[192] The tone of the FSB Key Attributes does differ from its Basel Committee counterpart. This is perhaps because of the legal basis of resolution and liquidation of banks. An interesting emphasis in Annex 2 puts forward the idea of a 'presumption in favour of cooperation in the event of the firms resolution'.[193] The accession countries have put in place resolution powers and so there is a relatively high degree of functional equivalence. In part, this is due to the fact that reliance is placed on the BRRD as a template for such reforms. One avenue for third countries would be to seek information about resolution plans from the entity in their jurisdiction. The bank may complain that the request for information is duplicating information given to the parent entity authorities. Nevertheless, it is a recourse to ensure it can prepare for the resolution option

[190] EBA, Opinion of the European Banking Authority on the Equivalence of supervisory and regulatory requirements in relation to Argentina 22/05/19 <https://eba.europa.eu/documents/10180/2622242/EBA+Opinion+on+Third+Country+Equivalence+-+Argentina.pdf>; ANNEX—Republic of Argentina, <https://eba.europa.eu/documents/10180/2740473/Annex+to+EBA+Opinion+on+third+country+equivalence+-+Argentina.pdf>.

[191] FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions, 15 October 2014, <https://www.fsb.org/wp-content/uploads/r_141015.pdf>.

[192] Communiqué, G20 Leaders Summit, Cannes, 4 November 2011.

[193] Ibid, Annex 2, p. 31.

that is proposed by the parent authorities. As shown in Chapter 1, a significant proportion of their banks have the ultimate owner that is a significant bank and so falls under the ECB supervision. The SRB would be the group resolution authority and so the chair of the resolution college, and it would be its decision whether these countries could participate as Observers. Since they have an Observer status within the supervisory colleges, it would be difficult to reject their participation in the resolution college. In this respect, the accession countries have a preferential relationship, which other third countries may not benefit from. In respect of observer status, it can attend meetings but not necessarily vote, yet it certainly can express its views on proceedings.

One of the most critical roles by home and host cooperation plays out in the execution of the resolution strategy. At the EU level, this is led by the parent entity resolution authorities. However, they will need to be mindful of those parts of the group located in third countries. The home and host may need to cooperate since critical services may be relied upon by the subsidiary in the third country. Equally, the options of resolution are likely to require the home to notify the hosts, with the possibility of cooperation likely to achieve more efficient and cost-effective ends. The resolution college and its third country participants should agree beforehand whether or not resolution measures are likely to be mutually recognized. This should in part ascertain whether the resolution authority of the parent will be recognized and accepted by the third country. Equally, concerning the parent entity resolution authority, in many of these cases the SRB will likely expect notifications of their possible intention to exercise resolution of a subsidiary that is part of a group. **5.109**

Reflections on the Principal Issues

The chapter showed a number of challenges remain to address the asymmetry of information problems that can arise in resolution decision-making. The home and host dilemma remains albeit to a lesser extent. The formal processes of preparation exist in theory but in practice political will remains a critical obstacle. In view of this coordination and cooperation risks exist that are now pronounced in policy frameworks. It has been argued while not all will participate in the core parts of decisions it is imperative that all have at least sufficient information and data to prepare a standalone resolution or insolvency and liquidation. This is particularly acute in the third country perspective. However, it cannot be underestimated that it cannot exist even within centralized supervision and resolution. Since in part the ECB and SRB are reliant on national interpretations of EU law. A concern for some Member States will be the underlying policy assumption that narrow banks that provide credit finance are not critical and therefore will be resolved through national insolvency proceedings. This will inevitably lead to different outcomes when banks are failing or likely to fail with Member States likely to take a different view to the SRB about their banks. Another issue that has surfaced in the analysis is the sheer scale of technical expertise now required to operationalize so many new elements to execute orderly resolution. The role of resolution colleges is equally important to ensure preparations for resolution schemes. However, while Member States are members of colleges in substance some members have more of a role and ability to inform decisions than others. The level of **5.110** discretion in the instruments and the assessment of resolution colleges shows this. In part a significant problem faced by Member States is the complexity of the issues that require joint decisions. It is clearly evident that such pre-commitments are not present when it comes to third countries which will mean it will depend on the willingness of each party to be proactive. In view of the large presence of third country banks in the EU at a branch or subsidiary level this is likely to make it a challenge to undertake the task on a bank or country-by-country basis.