Freshfields Bruckhaus Deringer

INSTITUTE FOR LAW AND FINANCE
Goethe-Universität Frankfurt am Main

Conference on Banking Union

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Welcome

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THE CONSOLIDATED SUPERVISION IN THE AGE OF THE SSM

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Vice-Chair Administrative Board of Review - ECB*

Frankfurt, 18 April 2016

* The opinions expressed in this presentation are solely those of the author and do not represent the official policy or position of the ABoR

OUTLINE

1. Introduction
2. Different rules can undermine consolidated supervision
3. The scope of consolidated supervision in the CRD IV and CRR
4. The ECB powers *vis a vis* parent companies under SSM Regulation
5. The “supervised group” as defined by the Framework Regulation
6. The consolidated supervision of cooperative banking groups
7. Conclusions

Introduction

The financial crisis lesson: the national character of prudential supervision determines at least three sets of negative consequences for cross-border banking groups:

- Cross-border cooperation between supervisors was weak
- The compliance and enforcement of consolidated measures in different jurisdictions was very difficult
- Coordination failures between competent authorities amplified the systemic risks

Introduction

Have we solved all these problems with the creation of the SSM?

The answer is no due to:

- Regulatory differences **notwithstanding the Single Rulebook**;
- The regulatory differences **are relevant even within the SSM** because of:
  - The separation of regulation and supervision in the new Banking Union framework
  - The lack of harmonized company law rules on groups to which the provisions on consolidated supervision of banks refer

Introduction

Regulatory differences:

- there still remains different rules and divergences in the application of prudential requirements to cross-border banking groups because option and discretion left to national competent authorities by the CRD IV and CRR
- the problem is even more severe in the case of groups operating in countries that adhere to the SSM and in countries outside the SSM because of no clear division of roles and responsibilities in the process to get to the joint decisions

The lack of harmonized company law rules on groups

- implies weak powers of supervisory authorities with respect to the parent company when it is not a supervised banks
- makes it difficult the application of prudential supervisory measures in a consistent manner on a consolidated basis

Different rules could undermine consolidated supervision

There still remains options and discretions even within the Single rulebook that leaves the way for different rules at national level

- This can give rise to cross-border divergences in the application of prudential requirements to cross-border banking groups (Babis, European Business Law review 2015).
  - flexibility to grant intra group waivers from prudential requirements
  - potential exemptions from consolidated supervision
  - a variety of consolidated methods available even tough
    - *EBA* Guidelines for common procedures and methodologies for the supervisory review and evaluation process, completed in 2014, supported by the monitoring and promotion of best practices in the colleges of supervisors established for cross border banking groups.

Different rules could undermine consolidated supervision

The **problem is not solved** by the CRD IV rule requiring, **for cross-border banking groups** with the parent undertaking established in one Member State and at least one subsidiary in another Member State:

- **a college of supervisors to reach a joint decision** on the capital and liquidity adequacy of supervised institution (Article 115 of Directive 2013/36/EU);

- Because of the **complex nature of joint decisions** that requires the "dialogue" between relevant competent authorities to reach an "agreement" (i.e. "compromise") within very strict time limits (art. 113 CRD IV and Commission Implementing Regulation (EU) No 710/2014):
  - The **risk assessment of subsidiaries** is performed by the relevant competent authorities
  - The **consolidating supervisor "revise"** the draft capital joint decision and the draft liquidity joint decision (the risk assessment performed by the competent authorities)

Different rules could undermine consolidated supervision

To solve this problems within the SSM

Important steps were made by the ECB initiative to issue a Regulation and guidelines on the exercise of Options and Discretions available in Union Law (Reg. (EU) 14 March 2016 2016/445 and the Guideline) to not affect the smooth functioning of the SSM for which the ECB is responsible **but** considering**:**

- the limited scope of the regulation and Guidelines: only options and discretions available to competent authorities (and not those explicitly granted to national legislation according Art. 4, par. 3 Reg. (EU) 1024/2013)
- The lack of a clear definition of “banking group”

There remain difficulties and possible inconsistencies in the application of the rules on consolidated supervision even within the SSM

The scope of the consolidated supervision in the CRD IV and CRR

- The scope of the consolidated supervision is based on the definitions of "parent company" and "subsidiary" (art. 18 CRR), as determined by the directives on the financial consolidated accounts (Directive 83/349/EEC, to be replaced by the Directive 2013/34/EU) (a "*group means a parent undertaking and all its subsidiary*")

- The accounting Directive refers to a situation of "control" and "dominant influence": i.e. the parent company has the right to exercise, or effectively exercises, a dominant influence over another undertaking

- When these circumstances occur the parent company shall draw up consolidated accounts

The scope of the consolidated supervision in the CRD IV and CRR

- Are the cases of “control” and “dominant influence”, as established by accounting directives adequate to implement consolidated supervisory measures? My answer is **no**

  - if the supervisory authorities do not have powers to address the consolidated measures at the highest level of consolidation (to the company at the top of the group, even if at the top there is a holding and not an “institution” (i.e. according to CRR a “credit institution” or an “investment companies”), but it’s a financial holding company or a mixed financial holding company (hereinafter (M)FHC)

  - If the parent company (or the credit institution) has limits stemming from commercial law to effectively exercise a dominant influence over the subsidiaries

The problems highlighted above are exacerbated in case the parent company and the subsidiaries are based in different jurisdictions

The addressee of the consolidated supervisory measures

- Under the Regulation (EU) No 575/2013 and the Directive 2013/36/EU (CRD IV) **individual and consolidated prudential requirements on both individual and consolidated basis are to be applied to institutions** (credit institutions and investment firms) (Article 11 in combination with Article 18 CRR)
  - In case of **parent institutions**, on the basis of a full consolidation of all institutions and financial institutions that are their subsidiaries
  - in case of **an institution controlled by a parent (M)FHC** on the basis of a full consolidation of all the subsidiaries of the same parent financial holding company or parent mixed financial holding company
- One exception is the case of G-SII buffer and O-SII buffer which may also apply to (M)FHC (Article 131 CRD IV)

The addressee of the consolidated supervisory measures

- Considering that a credit institution, on which the prudential requirements on consolidated basis are imposed, might face difficulties to comply with such consolidated requirements as it has no corporate power over other institutions and financial institutions which fall within the scope of consolidation under Article 18 CRR,

  - is it appropriate that (M) FHC are also subjected to obligations to extent necessary for effective consolidated supervision of the group as whole?
    - **Yes** because corporate practice shows that lines of instruction/directions are from the top holding to the other undertakings in the group and the reverse (bottom-up) seems difficult if not naive.

The addressee of the consolidated supervisory measures

- Does the CRD IV and CRR provide a legal basis to apply consolidated requirements **also** to (M) FHC? In my opinion **the answer is yes because:**

  - Article 119 CDR IV Requires member States to "adopt any measures necessary, where appropriate, **to include (M)FHC in consolidated supervision**" (the ECB may directly use powers in respect of (M)FHC in transposition of Article 119 CRDIV)

  - But in case national legislations do not provide special rules including (M)FHC in the scope of consolidated supervision?

The addressee of the consolidated supervisory measures

- A broader reading of the legal system could be inferred by the following rules contained in CRD IV enlightening the **legislative intent** (see R. Smits, 2016, forthcoming):
  - "…Title VII chapter 3 (i.e. supervision on a consolidated basis) shall apply to (M)FHC which have their head offices in the Union" (Article 2(4))
  - "Member States shall ensure that the competent authorities monitor the activities of institutions, and where applicable of (M)FHC to assess compliance with the requirements of this directive and CRR" (Article 4(2) and (3))
  - "…**In order to be effective, supervision on a consolidated basis should therefore be applied to all banking groups, including those the parent undertakings of which are not credit institutions or investment firms**. Member States should provide competent authorities with the necessary legal instruments to enable them to exercise such provision (Recital 47)
  - "…competent authorities should ensure compliance with the principles and rules on remuneration for institutions on a consolidated basis, that is at the level of the group, parent undertakings and subsidiaries, including the branches…" (Recital 67)

The addressee of the consolidated supervisory measures

- A broader reading of the legal system could be inferred by the following rules contained in CRD IV enlightening the **legislative intent**:

- "Member States shall require that the members of the management body of a financial holding company or mixed financial holding company be **of sufficiently good repute and possess sufficient knowledge, skills and experience** as referred to in Article 91(1) to perform those duties…" (article 121(1)

- "In accordance with Chapter 1, Section IV of this Title, Member States shall ensure that administrative penalties or other administrative measures aiming to end observed breaches or the causes of such breaches **may be imposed on financial holding companies, mixed financial holding companies, and mixed-activity holding companies, or their effective managers, that breach laws**, regulations or administrative provisions transposing this Chapter" (Article 126)

Prudential rules recognizing banking groups

- A formal approach interpreting CRD IV and CRR addressing the supervision at consolidated level to credit institutions only and not to the group as a whole conflicts with obligations stemming from prudential rules explicitly **recognising banking groups**:

- EBA guidelines on Internal Governance: check and balances in a group structure:
  - The management body of an institution's parent company shall have overall responsibility for adequate internal governance across the group and for ensuring that there is a governance framework appropriate
  - the management body of a regulated subsidiary should ensure that its own internal decisions or practices are note detrimental to:
    - The sound and prudent management of the subsidiary;
    - The financial health of the subsidiary;
    - The legal interests of the subsidiary's stakeholders

Crisis management rules recognizing banking groups

The Banking on Recovery and Resolution Directive (Directive 2014/59/EU – BRRD):

- requires group recovery and resolution plans (member States shall ensure that Union **parent undertakings** draw up and submit to the consolidating supervisor a group recovery plan. Group recovery plans shall consist of a recovery plan for the group headed by the Union parent undertaking as a whole) (Article 7);

- provides for (M)FHC resolution (Article 1(1) (c) and (d))

- requires compliance with minimum own funds and eligible liabilities (MREL) requirements on a consolidated basis by the parent undertaking (Article 45(8)-(9)), even if the Directive allows for a multiple-point-of-entry or a single-point-of-entry resolution.

The powers of the ECB *vis-à-vis* the holding financial (or mixed financial) parent company

- In addition to supervision of individual credit institutions, the ECB's tasks should include supervision at the consolidated level, supplementary supervision, supervision of financial holding companies and supervision of mixed financial holding companies, excluding the supervision of insurance undertakings (recital 26, SSM Reg.)

- In order to ensure that supervisory rules and decisions are applied by credit institutions, financial holding companies and mixed financial holding companies, effective, proportionate and dissuasive penalties should be imposed in case of a breach (recital 36)

The powers of the ECB *vis-à-vis* the holding financial (or mixed financial) parent company

- Accordingly to the principle expressed in the recitals, the SSM Regulation clearly states that the ECB:
  - In relation to the supervisory tasks conferred on it by the Regulation shall have the responsibilities for the supervision of the (M)FHC which are established in participating Member States (Article 6(4)
  - May require to (M)FHC to provide all information that is necessary in order to carry out the tasks conferred on it (article 11)
  - Shall have the powers to require (M)FHC in participating Member States to take the necessary measures at an early stage to address relevant problems in specific circumstances (Article 16)
  - may impose administrative pecuniary penalties to (M)FHC where intentionally or negligently, (M)FHC breaches a requirement under relevant directly applicable acts of Union law in relation to which administrative pecuniary penalties shall be made available to competent authorities under the relevant Union law (Article 18)
  - conduct all necessary on-site inspections at the business premises of (M)FHC (Article 12 in conjunction with Article 10(1))

The powers of the ECB *vis-à-vis* the holding financial (or mixed financial) parent company

Consistently with the approach of the SSM Regulation conferring specific powers on the ECB over (M)FHC, the Framework Regulation clearly states that:

- **a supervised entity** means not only a credit institution but also a (M)FHC (Article 2(20))

The notion of “supervised group”

SSM Framework Regulation contains a definition of “supervised group”:

- ‘**group**’ means a group of undertakings of which at least one is a credit institution and which consists of a parent undertaking and its subsidiaries, or undertakings linked to each other by a relationship within the meaning of Article 22 of Directive 2013/34/EU of the European Parliament and of the Council (2), including any sub-group thereof (Article 2(5))

- ‘**supervised group**’ means any of the following (Article 2(21)):

a) a group whose parent undertaking is a credit institution **or financial holding company** that has its head office in a participating Member State;

b) a group whose parent undertaking is a **mixed financial holding company** that has its head office in a participating Member State, provided that the coordinator of the financial conglomerate….is an authority competent for the supervision of credit institutions and is also the coordinator in its function as supervisor of credit institutions;

c) supervised entities each having their head office in the same participating Member State provided that **they are permanently affiliated to a central body which supervises them under the conditions laid down in Article 10 of Regulation (EU) No 575/2013** and which is established in the same participating Member State;

The notion of “significant group”

The ECB may addresses decisions to a “supervised group”

- ‘**ECB supervisory decision**’ means a legal act adopted by the ECB in the exercise of the tasks and powers conferred on it by the SSM Regulation, which…. is addressed to one or more supervised entities or supervised groups…. (Article 2(26) of the SSM Framework Regulation)

Any credit institutions and other “supervised entities” within a “significant supervised group” is “significant”

If one or more supervised entities are part of a supervised group, the criteria for determining significance shall be determined at the highest level of consolidation

Each of the supervised entities forming part of a supervised group shall be deemed to be a significant supervised entity in any of the following circumstances:

a) if the supervised group at its highest level of consolidation…fulfils the size criterion, the economic importance criterion, or the cross-border activities criterion;

b) if one of the supervised entities forming part of the supervised group fulfils the direct public financial assistance criterion;

c) if one of the supervised entities forming part of the supervised group is one of the three most significant credit institutions in a participating Member State.

The consolidated supervision of cooperatives groups

- The CRR contains a clear definition of cooperative groups, as part of the norm regarding the waiver the application of prudential requirements for **credit institutions permanently affiliated to a central body** (Article 10)

- The **chore characteristics** of this group are:
- the commitments of the central body and affiliated institutions are joint and several liabilities or the commitments of its affiliated institutions are entirely guaranteed by the central body;
- the solvency and liquidity of the central body and of all the affiliated institutions are monitored as a whole on the basis of consolidated accounts of these institutions;
- the management of the central body is empowered to issue instructions to the management of the affiliated institutions.

The consolidated supervision of cooperatives groups

Art. 10 of CRR as a model for cooperative groups? **Yes** because of:

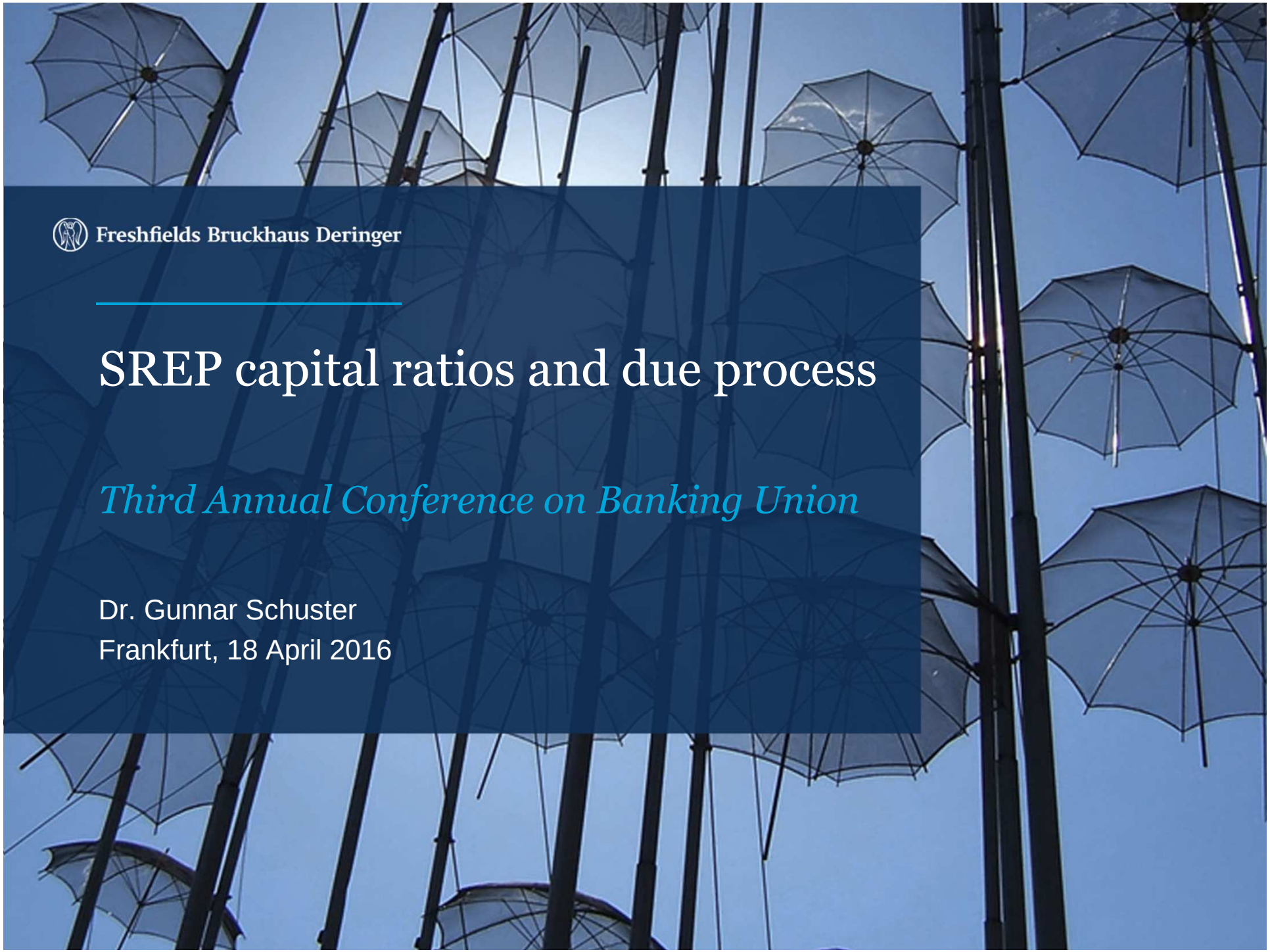
- Article 11 CRR, providing that where Article 10 is applied, **the central body shall comply with the prudential requirements on the basis of the consolidated situation of the whole** as constituted by the central body together with its affiliated institutions;
- the definition of “supervised group” contained in article 2(21) (c) of SSM Framework Regulation. The scope of this norm includes only those groups consisting of:
  - a parent company and its subsidiaries **or**
  - the supervised entities that are permanently affiliated to a central body under the condition laid down in Article 10 CRR

Conclusions

- The consolidated supervision can be undermined by the lack of:
  - **deeply harmonized rules** on supervision
  - **common rules on groups in the company law legislation**

- These problems can be partway overcome in the SSM because its legal framework contains a **definition of "supervised groups"** and confers on the **ECB considerable powers *vis a vis* parent companies at the top of the group**, even if they are not credit institutions

- the rules contained in the SSM legal framework can form the basis for building an articulated and **organic system of rules to govern banking groups in Europe?**



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SREP capital ratios and due process

Third Annual Conference on Banking Union

Dr. Gunnar Schuster

Frankfurt, 18 April 2016

I. SREP Framework

Basel Committee Core Principles

Directive 2013/36/EU (CRD IV)

- Art. 107 (3) and 73, 76-87, 97 et seq., 104, 128-142 CRD IV

Regulation (EU) No. 1024/2013 (SSM Regulation)

- Art. 4 (1) (f), 16 (1) (c), (2) SSM Regulation

EBA Guidelines

- EBA Guidelines 2014/13 on common procedures and methodologies for the supervisory review and evaluation process (SREP)
- EBA Guidelines 2015/08 on technical aspects of the management of interest rate risk arising from non trading activities
- 2016 EU Wide Stress Test, Methodological Note
- Draft EBA Guidelines on stresstesting and supervisory stresstesting (EBA/CP/2015/28)
- Draft EBA Guidelines on ICAAP and ILAAP information (EBA/CP/2015/26)
- Draft Guidelines on CVA risks under SREP (EBA/CP/2015/21)

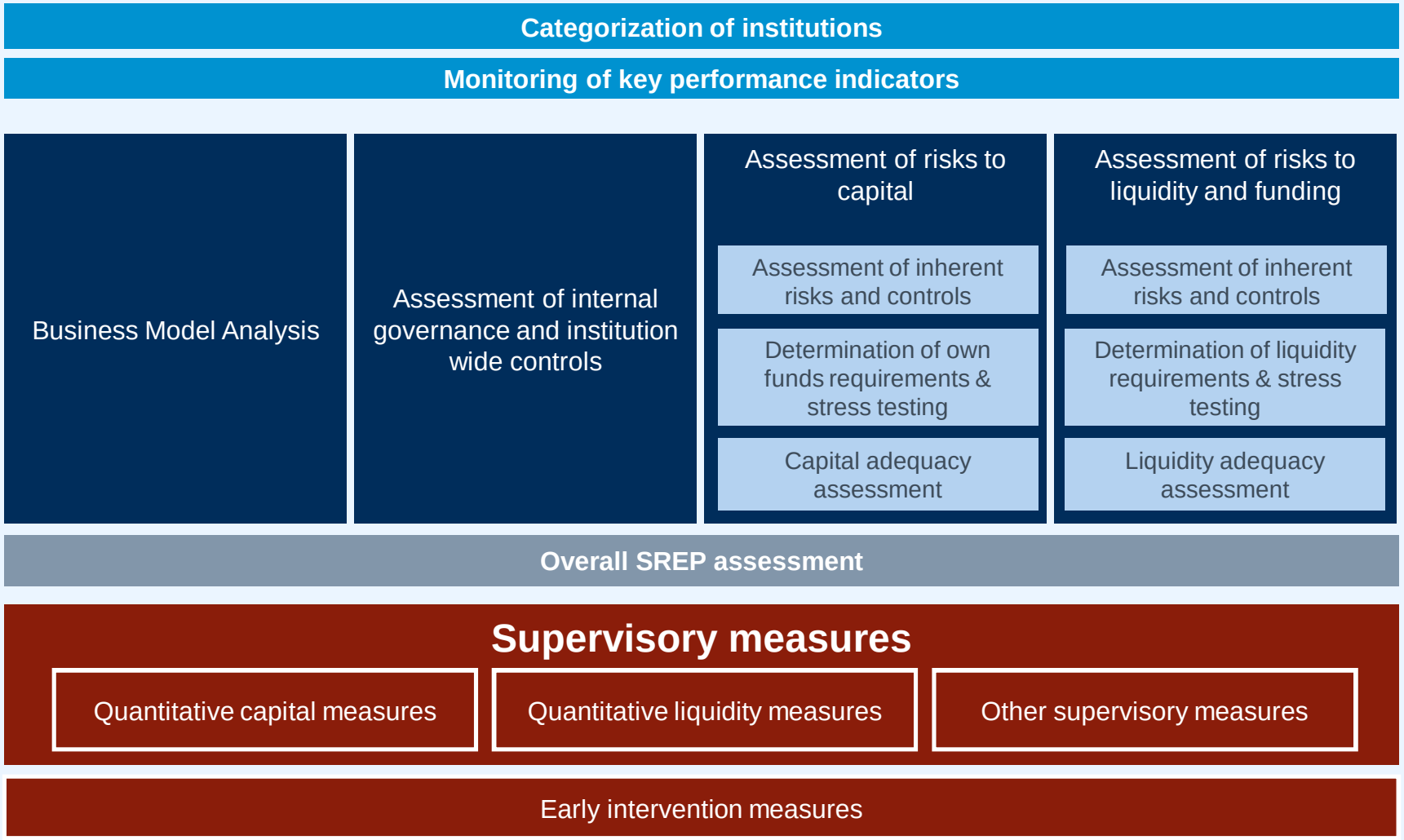
EBA Single Rulebook Q&A

ECB Guidance

- SSM SREP Methodology Booklet
- ECB Supervisory expectations on ICAAP and ILAAP

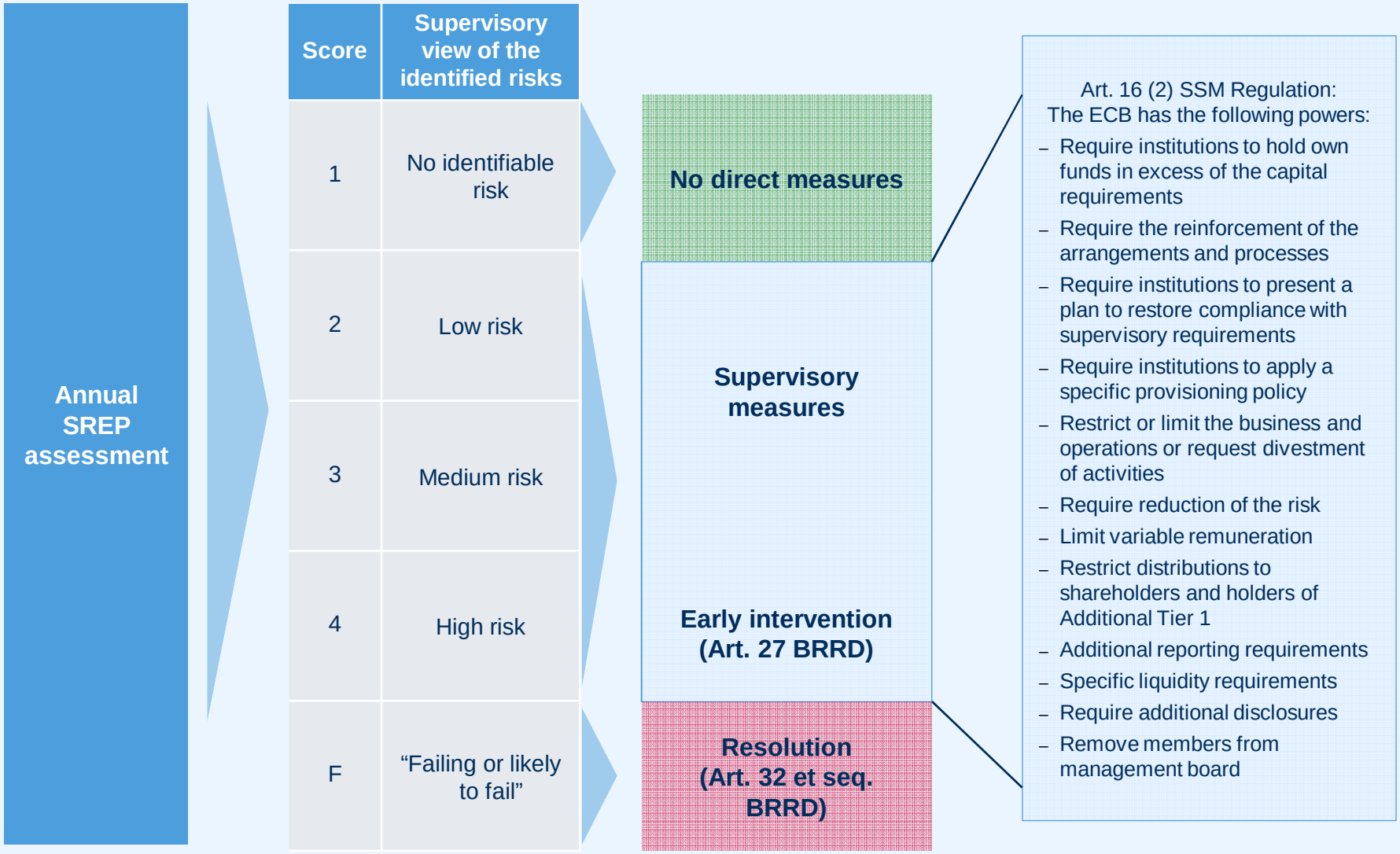
II. SREP Overview

The SREP framework

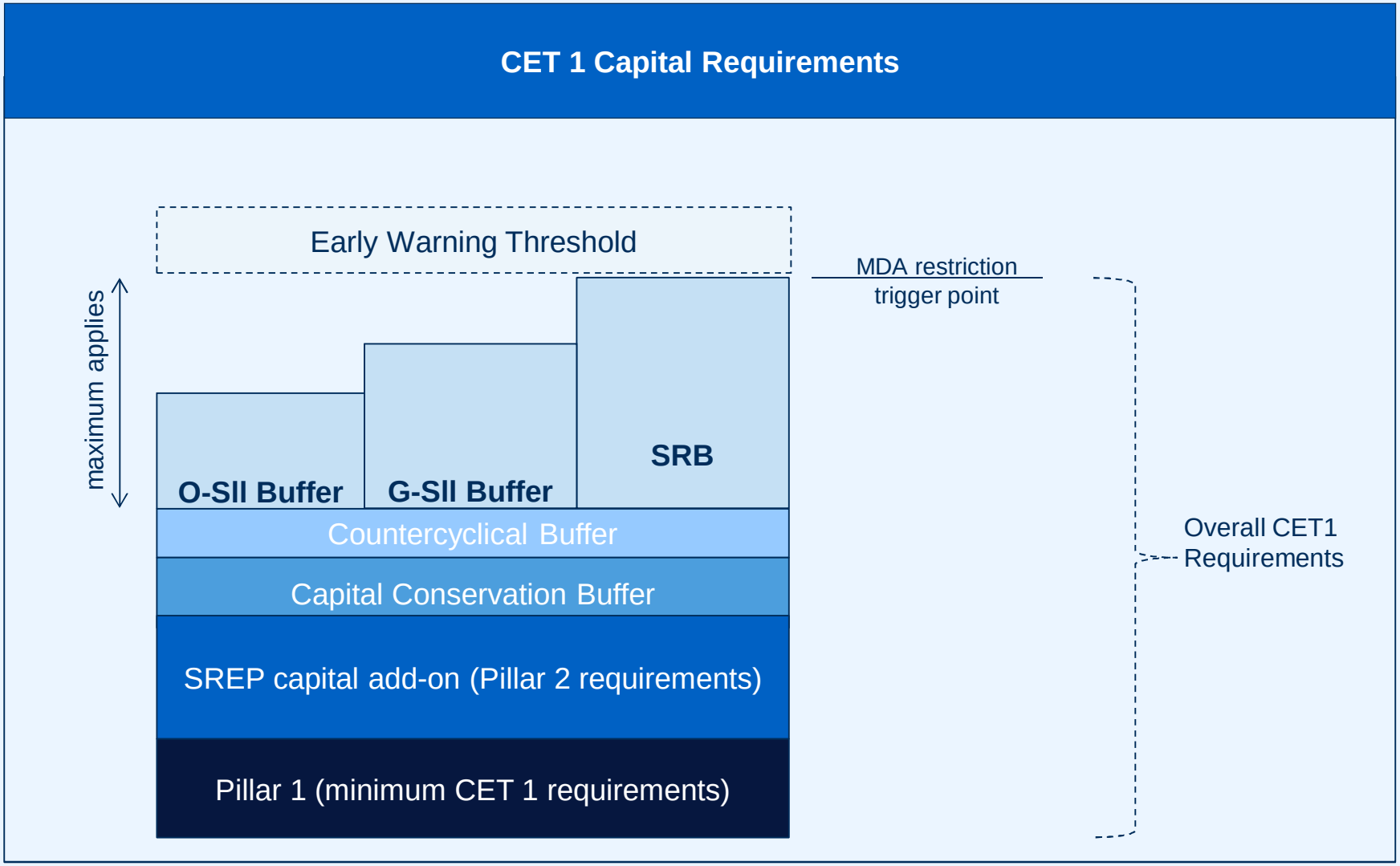


Source: SREP Guidelines Page 13

III. Overall SREP assessment and supervisory measures



IV. SREP capital requirements



Source: ECB – SSM SREP Methodology
(*The chart was amended by FBD*)

V. Statement of reasons requirement (1)

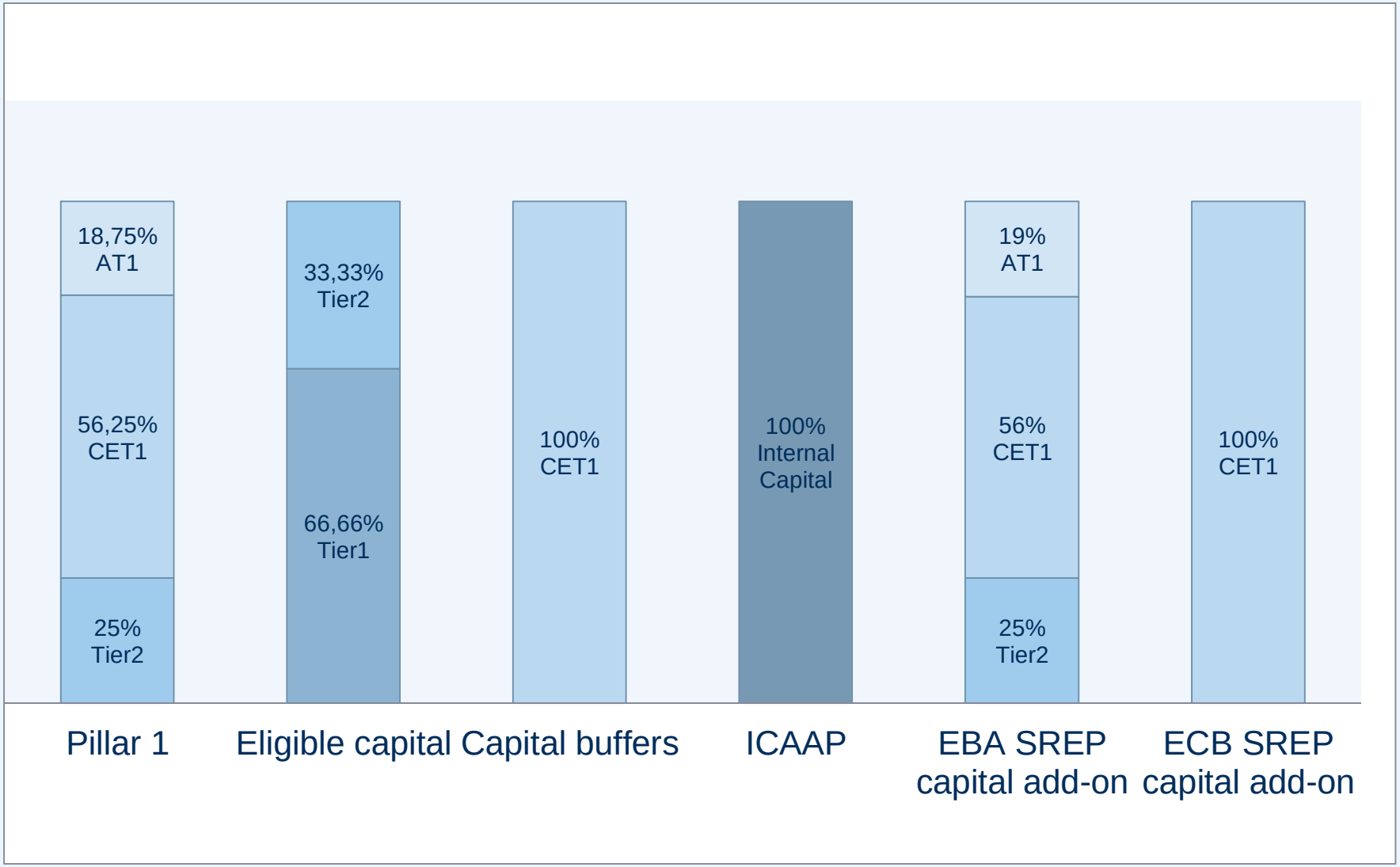
- Provided for in:
  - Art. 296 (2) TFEU
  - Art. 22 (2) SSM Regulation
  - Art. 33 SSM Framework Regulation
- Object and purpose
  - to enable person concerned to ascertain reasons for the measure and to assess whether it is erroneous and may be challenged before court
  - to enable courts to exercise their power of review
- Initial experience with the statement of reasons provided in ECB decisions

V. Statement of reasons requirement (2)

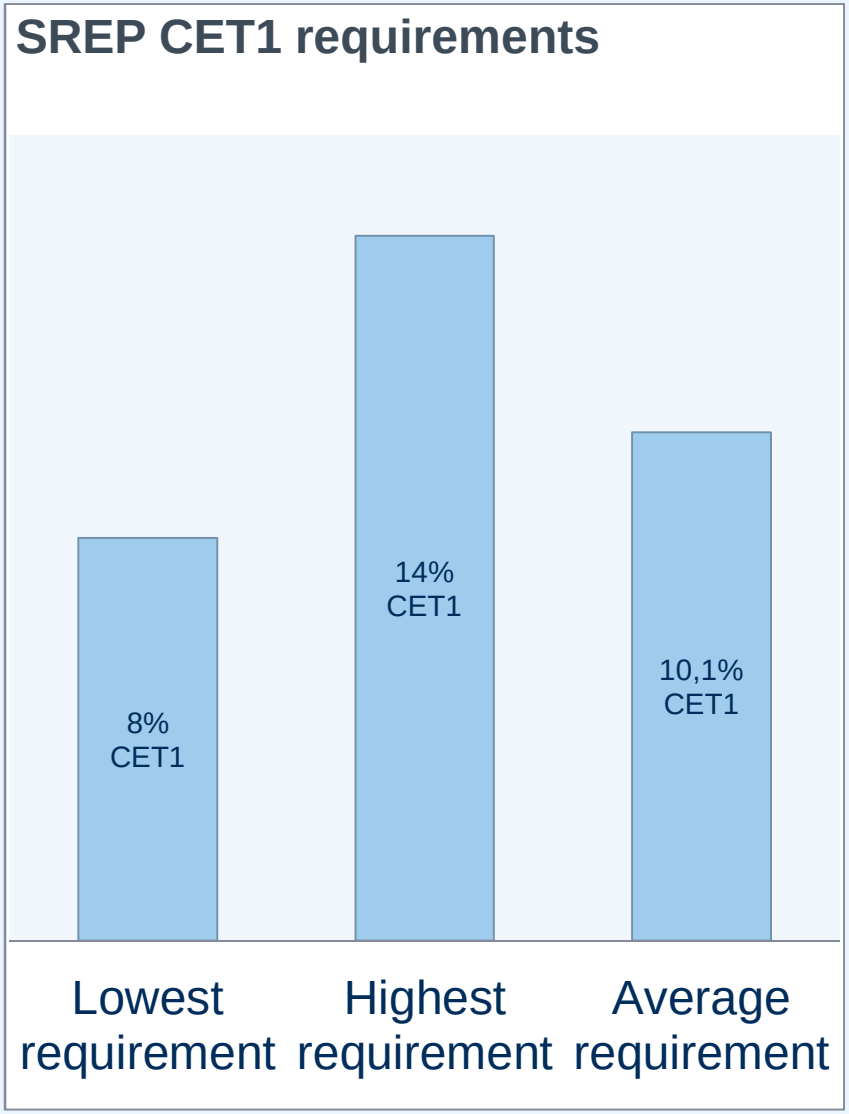
FBD interpretation of ECB's SREP decisions:

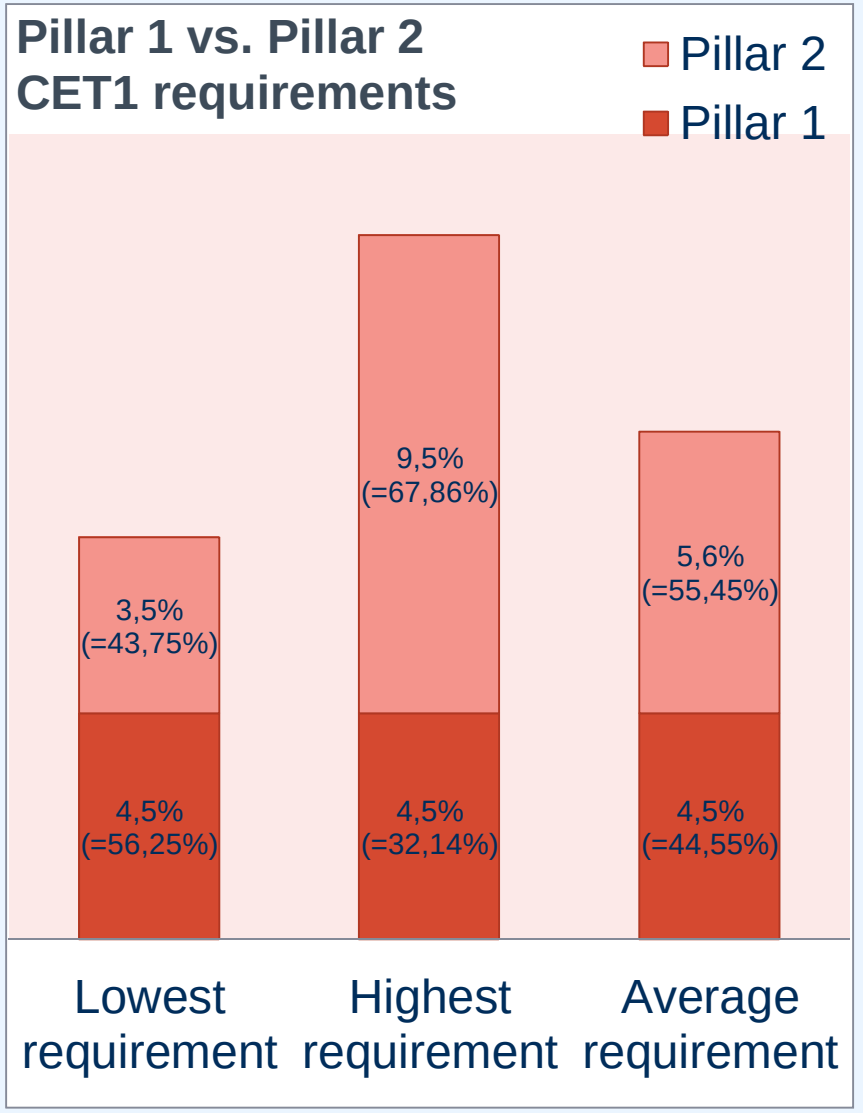
If **no findings** were made by the ECB in regard of an item…	If findings were made with regard to a particular item, but the **ECB regards the findings as less severe**…	If **findings** were made that are **regarded as severe**…
…the ECB simply states that the bank's arrangements "are broadly adequate (etc.)". We have not seen any confirmation of the type that they "are (fully) adequate(etc.)" Therefore, the simple statement that the bank's arrangements "are broadly adequate (etc.)" can be read as confirming that, in the ECB's view, the bank is compliant and meets the expectations of the ECB in regard to the particular item.	…the wording of the conclusion is the following: "are broadly adequate (etc.) […] However, […list of less significant deficiencies]". This wording can be interpreted as a statement made by the ECB that the bank is, in principle, acting in line with the applicable law. However, the ECB expects that the bank takes remediation measures with regard to the deficiencies.	…the ECB states that "[…] are not adequate (etc.) […list of significant deficiencies]". This wording is used by the ECB if it regards the findings as critical for a particular item.

VI. Quality of the capital required as SREP capital add-on



VII. Amount of SREP capital add-on



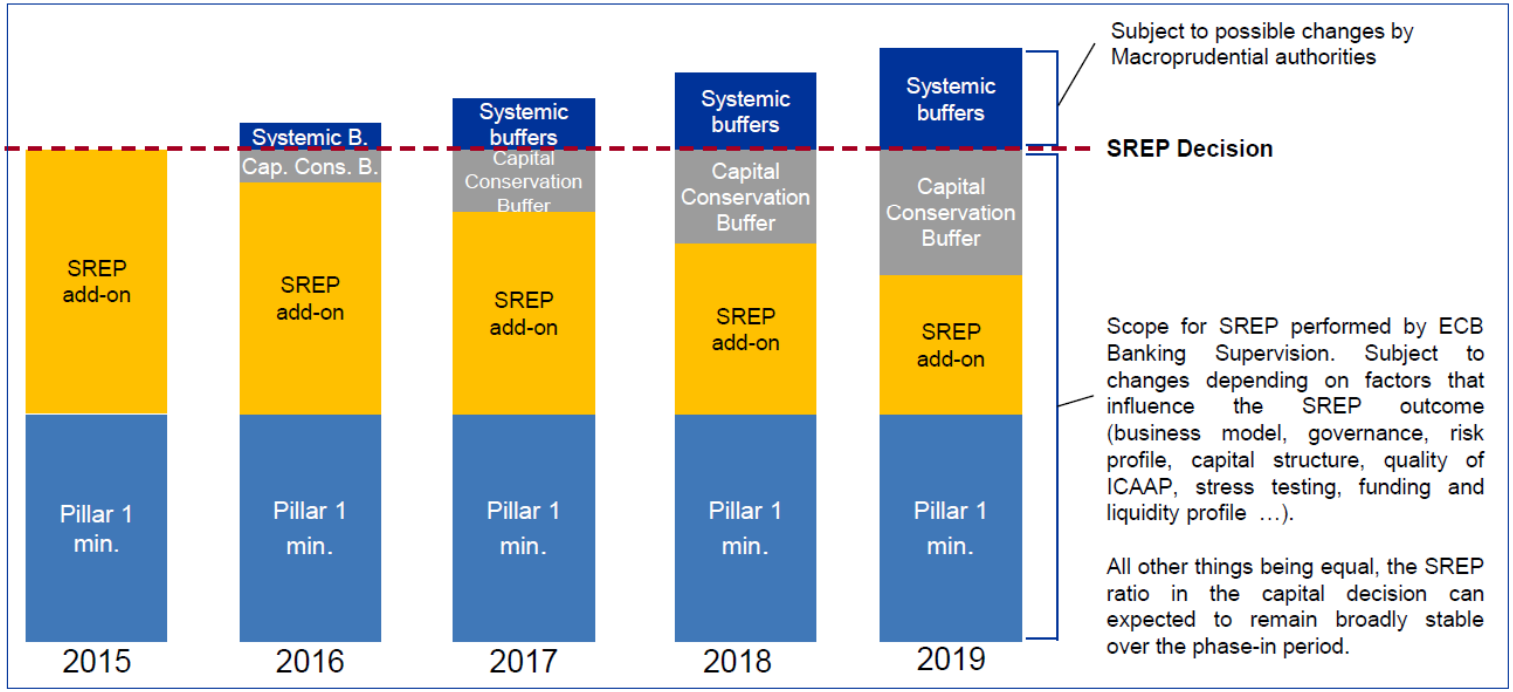


VIII. Capital buffers and SREP capital add-on

4.3. SREP - Capital Planning

ECB-PUBLIC

All things being equal, the Pillar 2 requirements set out in the SREP 2015 decisions also provide an indication for the future; especially the capital conservation buffer will phase-in by 2019 with the Pillar 2 net requirement reducing in equal fashion.



Excludes Countercyclical Buffer and reduces the three different systemic buffers to one for simplicity

Source: ECB – SSM SREP Methodology

IX. Consideration of systemic risk buffers

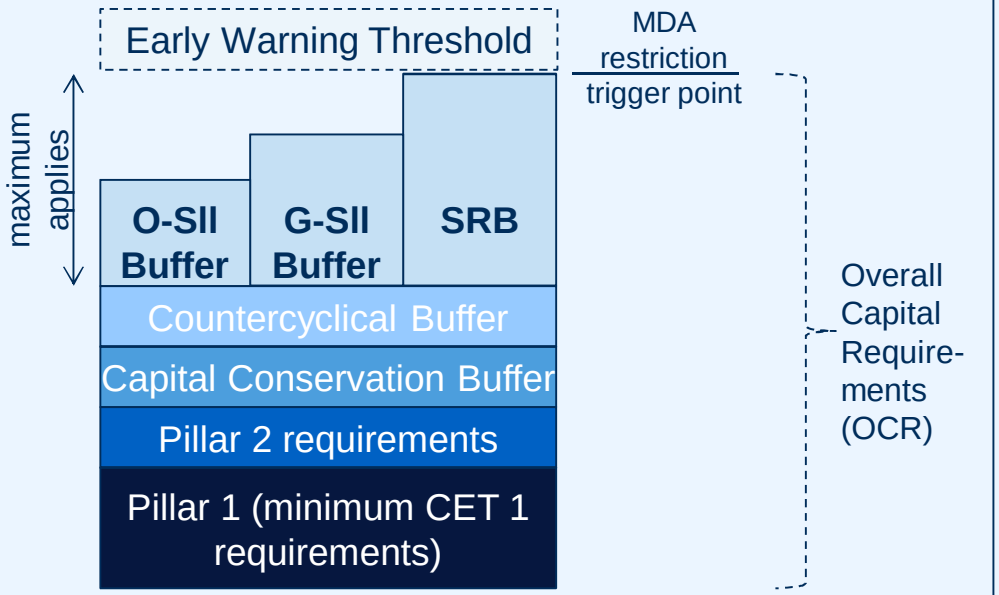
With respect to the SREP capital requirements the ECB's most recent Annual Report mentions that *"[a]n additional 20 basis points of capital requirements are the effect of the phase-in of the systemic buffers. These buffers are motivated by a key lesson of the crisis that is reflected in EU legislation: the need to contain the system-wide externalities that emanate, in particular, from global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs) and that affect the entire financial system and eventually the euro area's real economy. In order to contain these effects and in accordance with the relevant EBA Guideline,* ***systemic buffers*** *(whether for G-SIBs or D-SIBs, or the* ***systemic risk buffer****) are added to the Pillar 2 requirements. These systemic buffers will continue to be phased in as expected until 2019."*

Page 32, 33 of the ECB Annual Report 2015

X. SREP capital add-on and capital distribution

SREP decision – Capital measures

CET 1 Capital Requirements



Focus on MDA* (in line with EBA Opinion of 18 December 2015)

- Stacking order: Pillar 1, Net Pillar 2, buffers
- In 2015 Pillar 2 requirements and (phase-in) buffers in CET 1
- CET1 capital to be taken into account for the MDA calculation is limited to the amount not used to meet the Pillar 1 and Pillar 2 CET 1 requirements

** Maximum Distributable Amount:*
Breaches of the combined buffer requirement (CBR) - defined as the sum of the applicable buffers - lead to mandatory restrictions on distributions (e.g. dividends, coupon payments on AT1 capital instruments, discretionary bonuses). A bank which fails to meet its CBR will be automatically prohibited from distributing more than the so called Maximum Distributable Amount (MDA). The MDA is the bank's distributable profit multiplied by a factor ranging between 0.6 and 0 depending on how much CET1 capital is missing to meet the CBR.

Source: ECB – SSM SREP Methodology

XI. Disclosed SREP capital requirements

SSM banks (balance sheet > EUR 300bn)

Country	Institution	Capital requirements including SREP capital	Source
France	BNP Paribas	**10%** in 2016 including 0,5% G-SIB buffer	Annual Report 2015
	BPCE	**9,75%** in 2016 including 0,25% G-SIB buffer	Annual Report 2015
	Crédit Agricole	**9,75%** in 2016 including 0,25% G-SIB buffer	Annual Report 2015
	Société Générale	**9,75%** in 2016 including 0,25% G-SIB buffer	Pillar 3 Report 2015
Germany	Deutsche Bank	**10,25%** in 2015 and **10,75%** in 2016 including G-SIB buffer	Annual Report 2015
	DZ Bank	**8%** in 2015 and **9,5%** in 2016	Annual Report 2016
Italy	Intesa Sanpaolo	**9%** in 2015 and **9,5%** in 2016	Annual Report 2015
	UniCredit	**10%** in 2016 including 0.25% G-SIB buffer	Annual Report 2015
Spain	BBVA	**9,5%** in 2015 and **9,75%** in 2016 including 0,25% G-SIB buffer	Annual Report 2015
	Banco Santander	**9,5%** in 2015 and **9,75%** in 2016 including 0,25% G-SIB buffer	Annual Report 2015
	Caixa	**9,25%** in 2015 and **9,3125%** in 2016 including SI buffer	Statutory Documentation 2015
The Netherlands	ABN AMRO	**10,25%** in 2016 including 0,75% systemic risk buffer (***SRB***). The SRB has been set separately for Dutch systemic banks by the Dutch Central Bank.	Annual Report 2015
	ING	**9,5%** in 2015 and **10,25%** in 2016 including 0,75% SRB	Annual Report 2015

Questions?

Our Speaker

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Practice
Corporate

About
A financial services lawyer specialising in banking, investment services and insurance regulation with close contacts to the German and European financial regulators.

Skills and experience
Gunnar advises banks, investment firms, insurers and reinsurers, all types of funds and other market participants on all areas of financial services and markets regulation. He was co-head of our Financial Institutions Group from 2006-2012 and acts as relationship partner to some of the firm's largest financial institution clients.

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Thank you for your attention!

Financial Integration in Europe –

EDIS and the finalisation of the Banking Union

Dr Andreas Dombret
Member of the Executive Board
of the Deutsche Bundesbank

Panel Discussion on the SSM

EBERHARD KARLS
UNIVERSITÄT
TÜBINGEN

Cross-border coordination of bank resolution – All problems resolved?

Frankfurt, 18 April 2016

Jens-Hinrich Binder

Overview

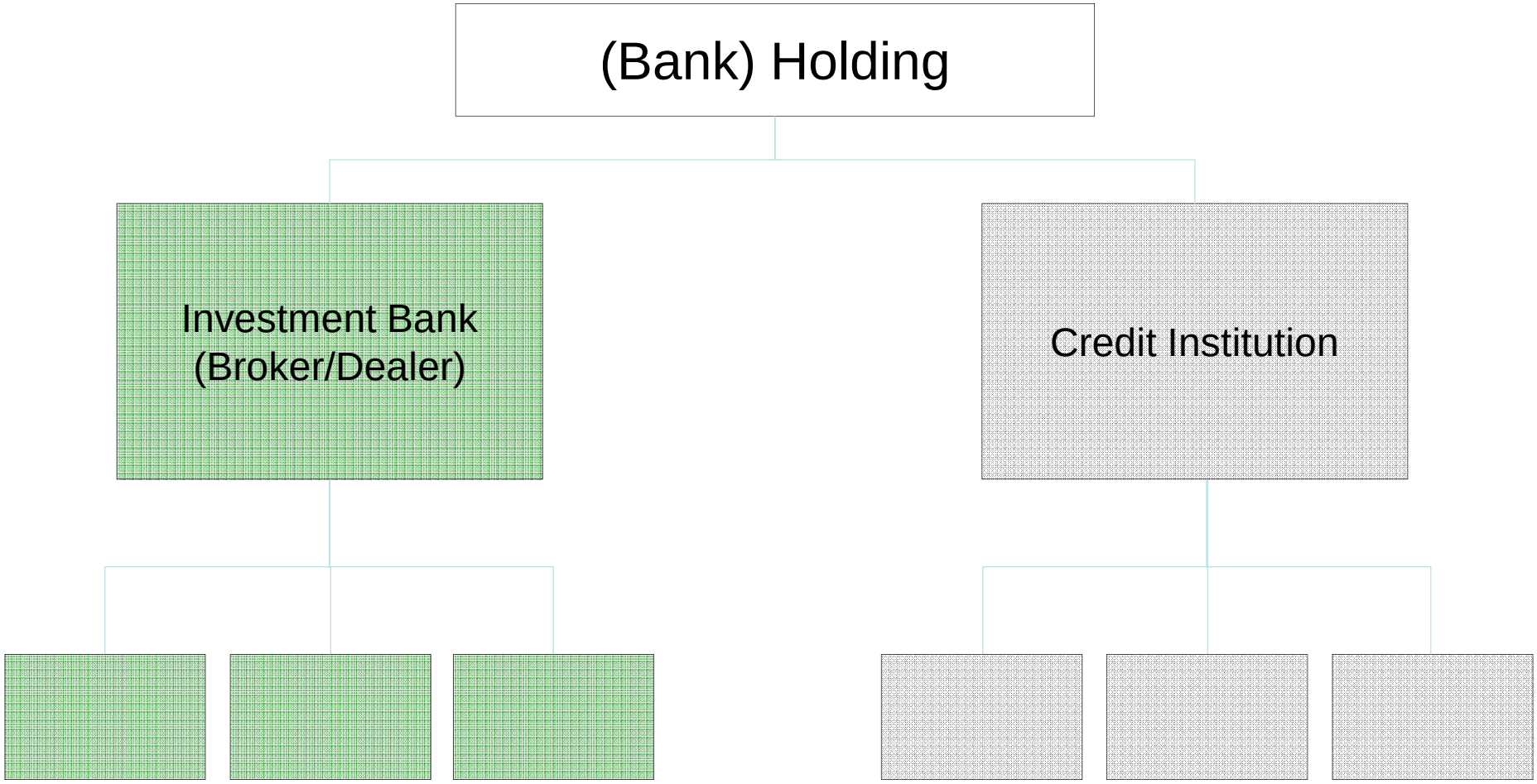
I. Introduction: The broader picture and the regulatory environment

II. Coordination, cooperation and recognition: Key challenges for cross-border bank resolution

III. Cross-border bank resolution in Europe: Where do we stand?

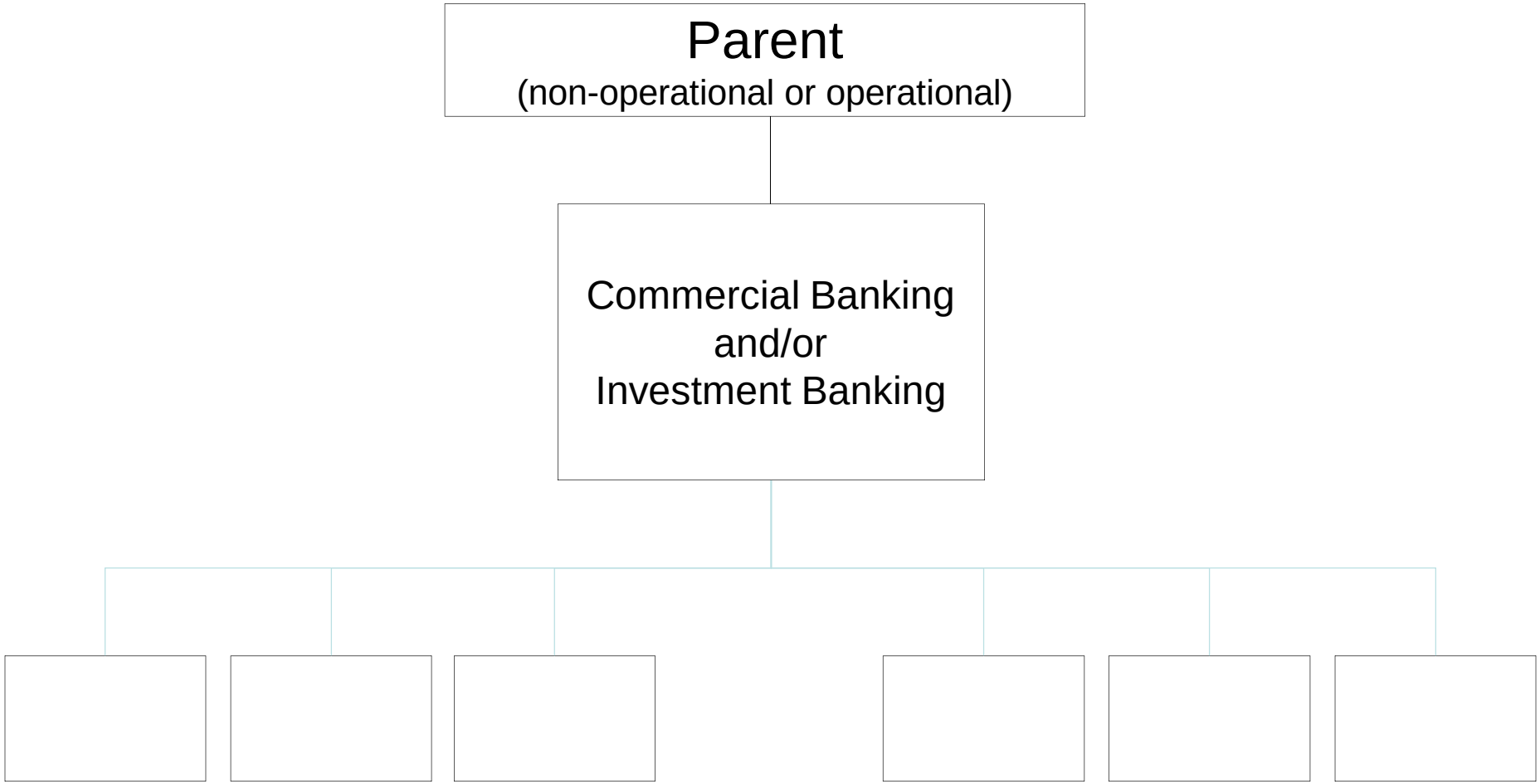
IV. Conclusions

Different Group Models and Resolution



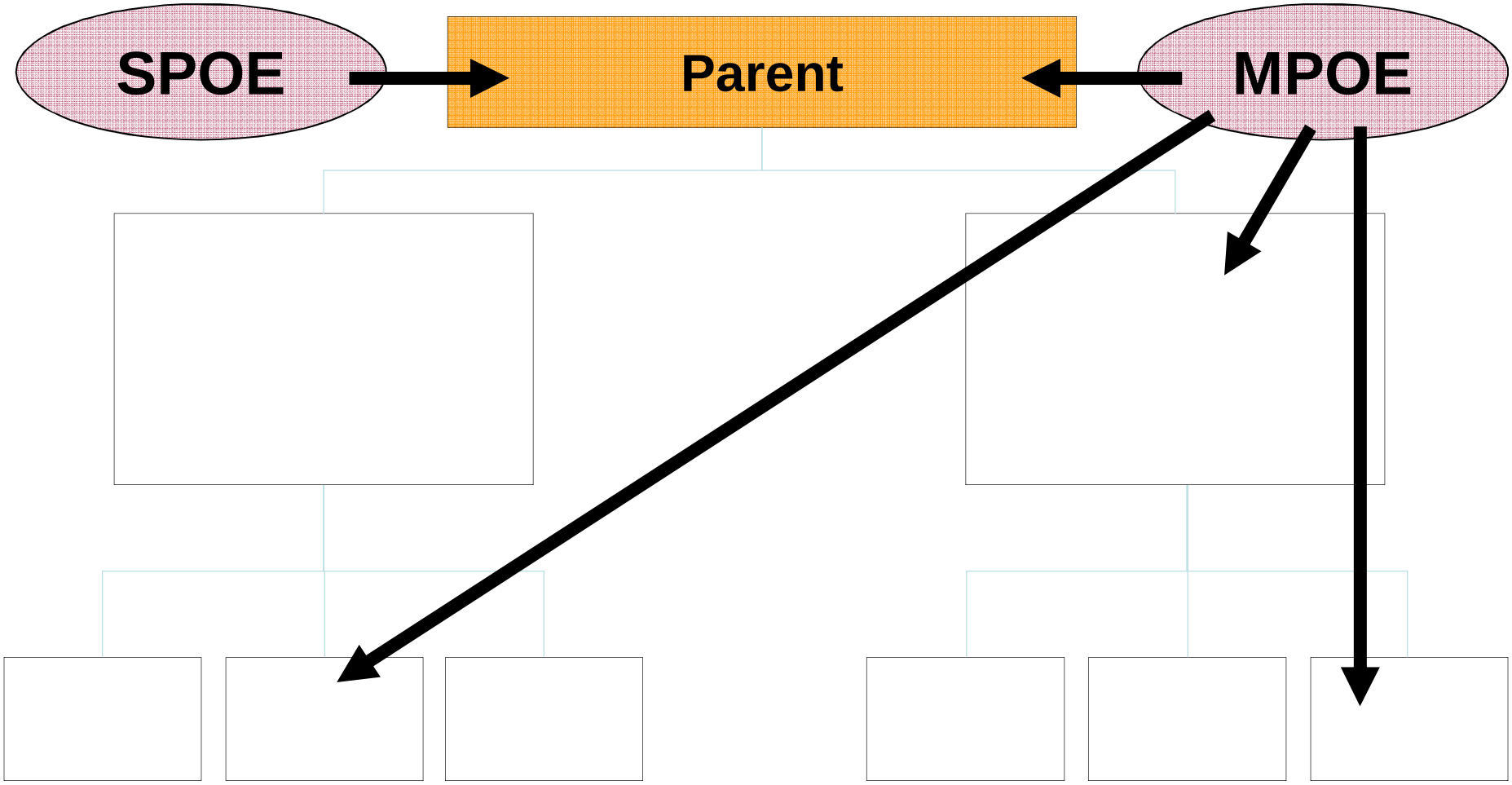
Sources: Liikanen-Report, 2012, Annex 5; IIF, Making Resolution Robust, 2012

Different Group Models and Resolution (cont'd)



Sources: Liikanen-Report, 2012, Annex 5; IIF, Making Resolution Robust, 2012

The Problem(s) of Bail-in in Group Structures



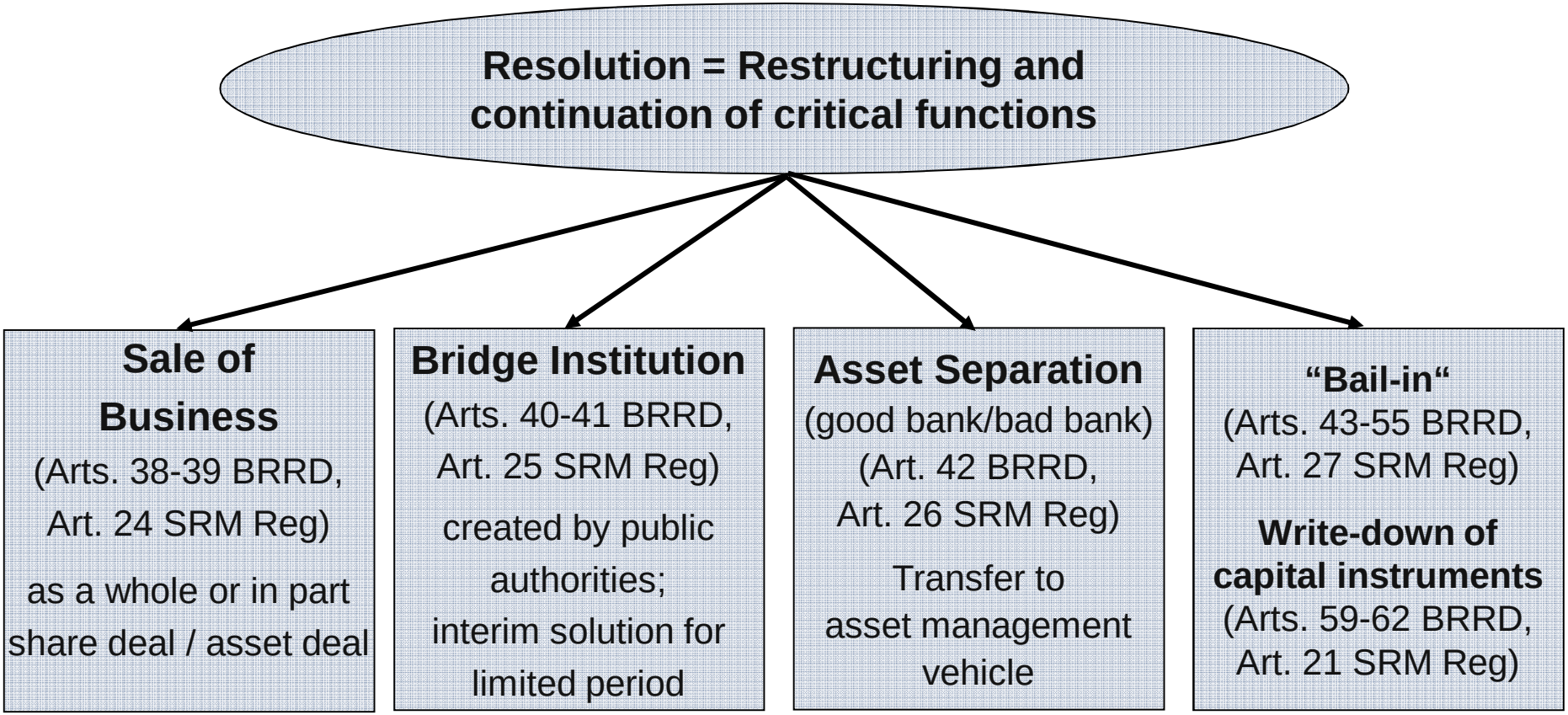
The Regulatory Environment

- **EU Prudential Supervision**
  - Home Country Control
  - “European Passport”
  - Titles III and IV of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV)
  - in place since 1989, developed in line with international standards (Basel Concordat)

The Regulatory Environment (cont'd)

- **EU framework for bank resolution**
  - Directive 2001/24/EC on the reorganisation and winding-up of credit institutions: conflicts-of-laws provisions allocating resolution powers with regard to
    - "reorganisation measures" (Art. 3(1) and (2))
    - "winding-up proceedings" (Art. 9(1) and Art. 10)
  - Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (the "BRRD")

The BRRD and SRM Toolbox



if: - institution has failed or is likely to fail (at least, proximity of insolvency)
- no alternative measure, including bail-in, capable of preventing failure
- resolution action is required to protect public interest (systemic stability)

Coordination

- In bank resolution, coordination problems arise …
  - … wherever financial operations and activities range across borders
  - … even where relevant authorities and jurisdictions fail, or even refuse, to cooperate
    - ➢ coordination ≠ cooperation: note the difference!
  - … with regard to both timing and technical design of resolution action
- because actions taken by one resolution authority will inevitably have a bearing on resolution action elsewhere!

Cooperation

- E.g., BRRD, Recital 17:

  "Effective resolution … requires cooperation among competent authorities and resolution authorities within supervisory and resolution colleges at all (…) stages".

- The need for *ex ante* arrangements with regard to decision-making infrastructure
- But infrastructure is not enough – note residual national interests:
  - longer-term gains of cooperation vs.
  - short-term impact of insolvency implications on local constituents

Cooperation (cont'd)

- A prisoners' dilemma among resolution authorities (and governments) in cross-border cases
- If "isolationism" is to be overcome, a complex set of preconditions must be fulfilled:
  - decision-making infrastructure AND
  - credible *ex ante* commitment to submit to mutually agreed burden-sharing in the future …
  - … which requires predictability and reliability of economic outcomes of resolution for involved jurisdictions *ex ante*

Recognition

- A concept with a variety of meanings:
  - *respecting* the substance of foreign decisions and refraining from contradictory measures
  - giving *legal* and *de facto effect* to foreign measures, e.g. with regard to write-down of claims, execution of titles, etc.
- Not merely a conflicts-of-laws issue – recognition impossible without at least some degree of active cooperation by host authorities and/or courts

The BRRD Regime

- **Institutional arrangements** for cross-border cooperation
  - general principles requiring fair and effective cooperation (Art. 87 BRRD)
  - between EU Member States: creation of **resolution colleges** by group-level Resolution Authorities (Art. 88, 91 and 92 BRRD)
  - in relation to non-EU Third Countries:
    - creation of European resolution colleges in case of EU branches in more than 1 MS (Art. 89 BRRD)
    - negotiated arrangements (Arts. 93-98 BRRD)

The BRRD Regime – Conclusions

- Institutional and legal arrangements for enhanced cross-border cooperation
  - both between EU Member States and, in a more flexible way, in relation to non-EU Third Countries
  - based on FSB “Key Attributes for Effective Resolution Regimes for Financial Institutions“
- Is it sufficient? To be sure, a significant step ahead, but…
  - witness residual, potentially conflicting, vested interests of Member States!
  - predictability of economic outcomes contingent on further development of RRP, MREL, TLAC standards

Recognition and Enforcement

- **Established by Directive 2001/24/EC**, but restricted scope: applicable to defined procedures only
- **"Winding-up proceedings"** (defined in Art. 2, 9th indent):

  "**collective proceedings** opened and monitored by the administrative or judicial authorities of a Member State with the **aim of realising assets** under the supervision of those authorities (…)"

  ➔ automatic direct effect pursuant to Arts. 10, 11 Dir. 2001/24

Recognition and Enforcement (cont'd)

- **"Reorganisation measures"** (defined in Art. 2, 7th indent):

  "measures (…) intended **to preserve or restore the financial situation of a credit institution** and which could affect third parties' pre-existing rights"

  ➔ automatic direct effect pursuant to Art. 3 Dir. 2001/24

  ➔ does not cover hybrid resolution tools, but expanded by Art. 117 BRRD

Recognition and Enforcement (cont‘d)

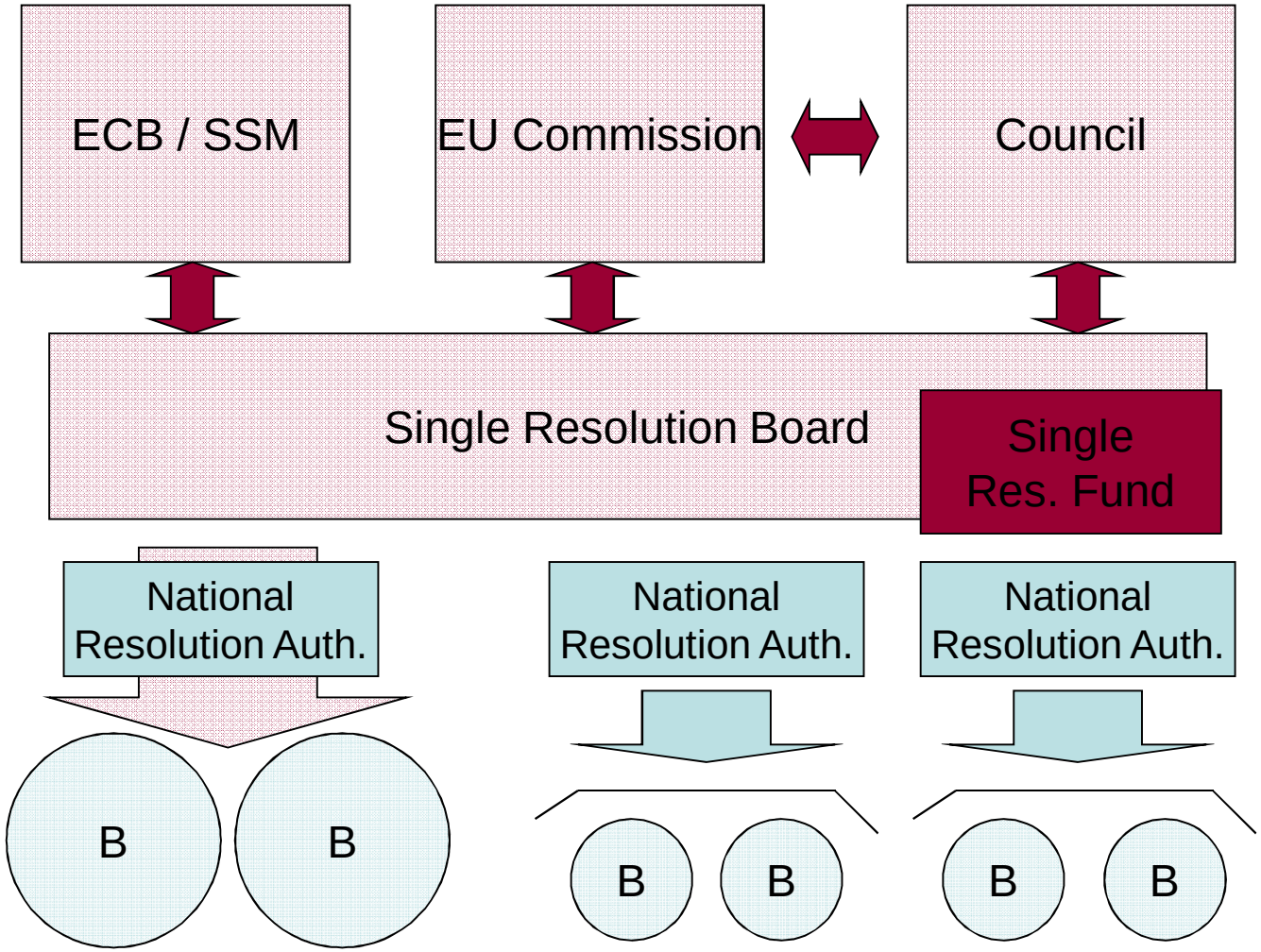
- All problems resolved, then?
  - in principle, yes:
    - comprehensive regime for mutual recognition and automatic direct effect
    - cf. ECJ, 24 Oct. 2013 – C-85/12 (LBI/Kepler): extends also to “national legislative acts that confer on reorganisation measures the legal effects of winding-up proceedings“ and to moratoria imposed in such circumstances
    - coupled with additional cooperation duties pursuant to Art. 66 BRRD

Recognition and Enforcement (cont'd)

- All problems resolved, then?
  - however:
    - residual powers for "host" jurisdictions to determine whether measure, *qua* BRRD measure, is eligible for mutual recognition
    - witness recent case law
      - High Ct of Munich in *BayernLB v. HETA*
      - UK High Court in *Goldman Sachs International v. Novo Banco S.A.* [2015] EWHC 2371, per Hamblen J.

The Single Resolution Mechanism

Resolution scheme adopted by SRM under **SRM Regulation (modelled after the BRRD)** and executed by national Res Auth



Resolution action taken by national Res Auth under **national laws transposing the BRRD** (with oversight rights for SRM)

Resolution Action within the SRM

Assessment of Conditions for Resolution
by SRB on own initiative or upon a communication from ECB (Art. 18(1) SRM Reg)
(in coordination with national Res Auth)

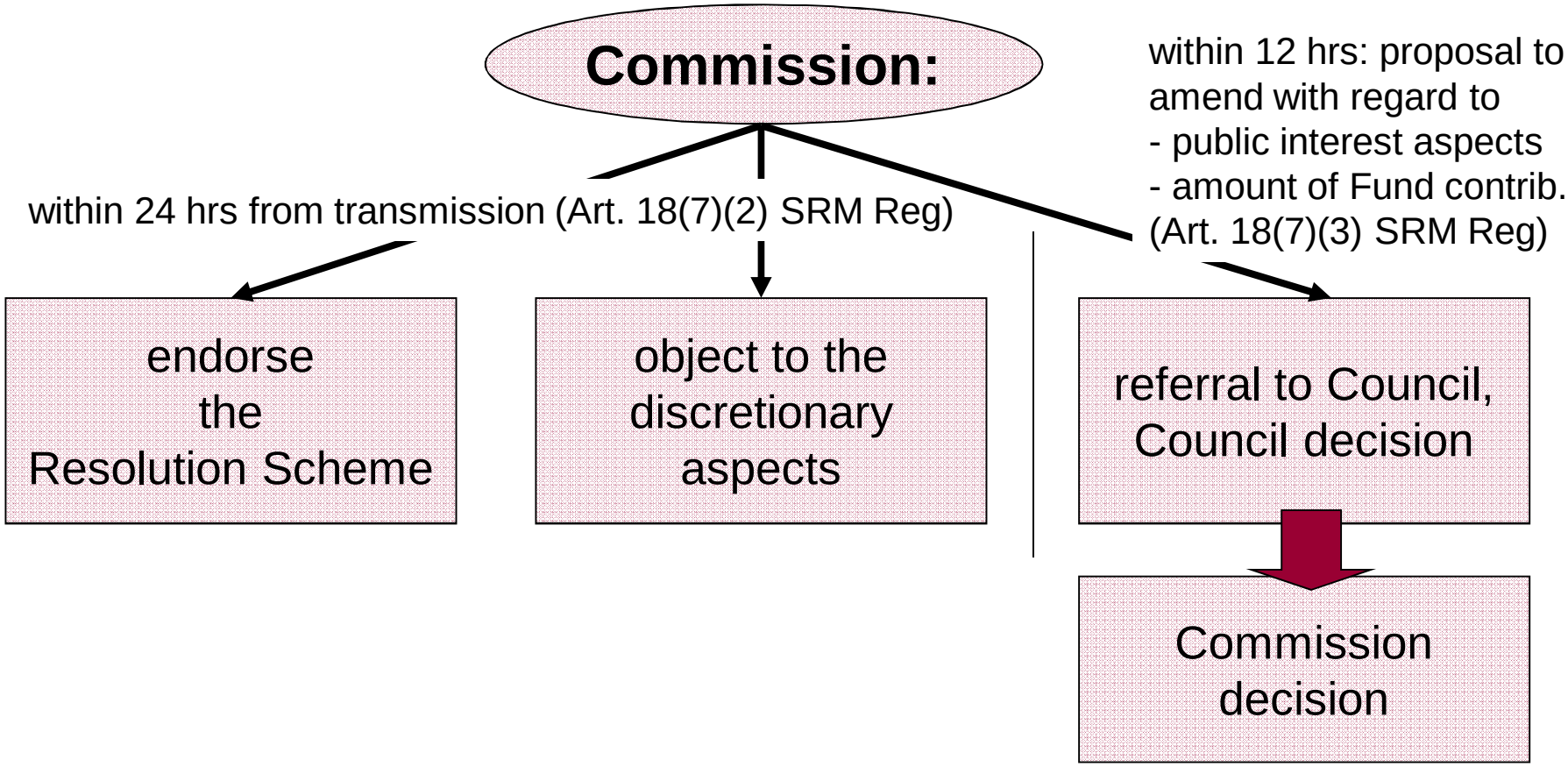
↓

Adoption of "Resolution Scheme"
to place institution under resolution and determine the application of resolution tools and the use of the Res Fund (Art. 18(1) and (6) and Art. 23 SRM Reg)

↓

Transmission of Res Scheme to Commission
(Art. 18(7)(1) SRM Reg)

III. Cross-border bank resolution in Europe: Where do we stand?



Cross-border Coordination within the SRM

- **The Resolution Scheme** (Arts. 18 and 23 SRM Reg)
  - **addressed** to national Res Authorities (Art. 18(9) SRM Reg)
  - **functions:**
    - to place relevant entity formally under resolution (Art. 18(6)(a) SRM Reg),
    - to determine the application of the resolution tools to the institution, in particular any exclusions from bail-in (Art. 18(6)(b) SRM Reg),
    - to determine the use of the Fund to support resolution action in accordance with Art. 76 (Art. 18(6)(c) SRM Reg)
  - **note:** need to reconcile with State Aid regime, Commission decision as to compliance required before entry into force (Art. 19 SRM Reg)

Cross-border Coordination within the SRM

- **The Resolution Scheme** (Arts. 18 and 23 SRM Reg)
  - to “establish the details of the resolution tools to be applied to the institution under resolution …, to be implemented by the national resolution authorities in accordance with the relevant provisions of [BRRD] as transposed into national law, and determine the specific amounts and purposes for which the Fund shall be used“ (Art. 23(1) SRM Reg),
  - to “outline the resolution actions that should be taken by the Board in relation to the Union parent undertaking or particular group entities established in participating MS“ (Art. 23(2) SRM Reg)
  - where appropriate, to provide for appointment of special manager by national Res Authorities (Art. 23(5) SRM Reg)

Cross-border Coordination within the SRM

- **The Resolution Scheme** (Arts. 18 and 23 SRM Reg)
  - **execution**
    - by national Res Authorities under national laws transposing the BRRD (Art. 29(1) and Art. 18(9) BRRD), or
    - where national Res Authorities do not comply, directly by the SRB (Art. 29(2) SRM Reg
    - note: duties for cooperation and information exchange within SRM (Arts. 30 and 31 SRM Reg) and with other MS and Third Countries (Art. 32 SRM Reg).

The Situation Within the Eurozone

- Centralised decision-making for resolution action for banks under ECB supervision and cross-border groups within Eurozone
- Possibly an important step towards better, fairer economic outcomes not compromised by national biases and vested interests
- But complex procedures and need to rely on NRA cooperation could turn out to be problematic

Are we where we ought to be?

Further reading: JH Binder, Cross-border coordination of bank resolution in the EU: All problems resolved?

Available at http://ssrn.com/abstract=2659158

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Banking Union and the Role of the European Commission in Resolution

Third Annual Banking Union Conference
University of Frankfurt

18 April, 2016

John Berrigan, DG FISMA

Outline of Presentation

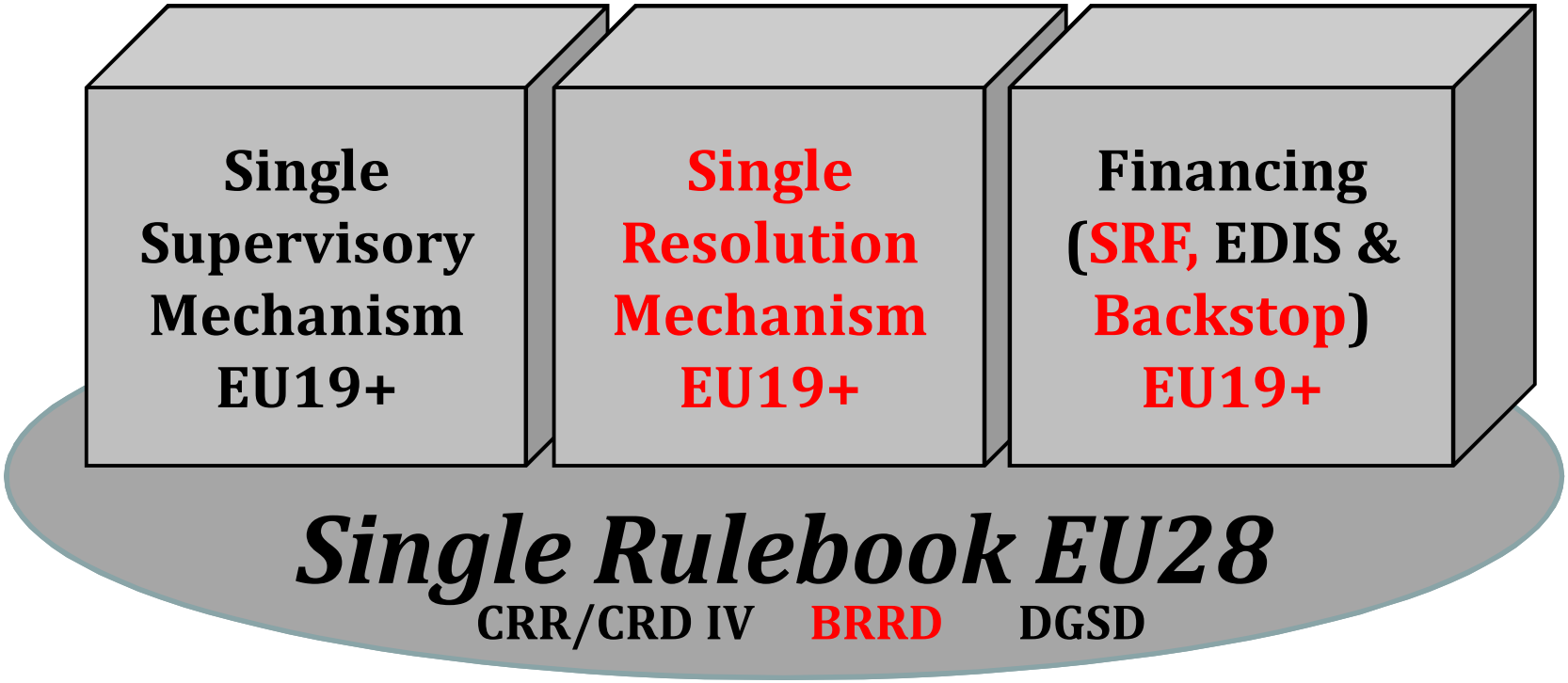
- Resolution in context of Banking Union
  - *Resolution and the rationale for BU*
  - *Resolution and the Commission blueprint for BU*
  - *What parts of the resolution framework exist in BU?*
  - *What parts are missing?*
  - *Do these gaps matter*?
- Commission roles in BU resolution framework
  - *Maintenance of EU legislative framework*
  - *Participation in resolution preparation within SRM*
  - *Participation in resolution decisions within SRM*
  - *Too much complexity?*
- Challenges in transition to steady-state framework
- Conclusions

Resolution in context of Banking Union

Resolution and rationale for BU

- BU primarily to address effects of the EMU crisis
  - *Reversing financial fragmentation…*
  - *… by weakening the bank-sovereign nexus…*
  - *… via centralised crisis prevention and management...*
  - *… and combined risk sharing/reduction.*
- Effective resolution (with bail-in) a key element of post-crisis response

Resolution and Commission blueprint for BU



Banking Union-what exists?

- BU partly in place…
  - *Single rulebooks (CRD/CRR, BRRD, DGSD)*
  - *Single Supervisory Mechanism (operational Nov 2014)*
  - *Single Resolution Mechanism (operational Jan 2016)*
  - *Single Resolution Fund (operational Jan 2016, accumulated and mutualised over 8 years)*
- … but some key elements missing

Banking Union-what is missing?

- BU still needs…
  - *Bridge-financing for SRF (agreed and being implemented by MS)*
  - *Common deposit insurance scheme (not agreed by MS)*
  - *Common fiscal backstop (agreed by MS before 2024)*
- … and Commission (5 Presidents' Report) seeks progress on all three

Do the BU gaps matter for resolution?

- BU already functioning well, despite recent start-up
- But, SSM and SRM to become progressively "single" in behaviour
- Single behaviour requires adequate alignment of incentives
- Incentive alignment requires pooling of costs as well as policies
- Bail-in may not be enough – need full SRF and fiscal backstop
- So, full potential of BU cannot be delivered without all elements

Commission roles in resolution

Maintenance of EU legislation - Level 1

- Level 1 legislative framework for BU almost complete
- SRMR immediately applicable in BU
- BRRD (for 28) transposed into national law in all MS in coming months; full transposition check underway
- IGA ratified by MS in BU
- So, basic rules in place – although still need for interpretation

Maintenance of EU legislation - Level 2

- Level 2 measures substantially in place
- Majority of measures already adopted by end-2015
- Remaining measures likely to be in place by April-May 2016
- Highly technical content and complex procedures

Commission role in resolution planning

- Commission participates in day-to-day functioning of SRM
  - *Resolution preparation and planning delegated to SRB*
  - *Observer in SRB Executive Board*
  - *Observer in SRB Plenary Board*
  - *Technical input on matters relating to Single Resolution Fund (e.g. contributions, bridge financing)*
  - *Technical work on fiscal backstop in the future*

Commission role in resolution decisions

- Commission has ultimate responsibility for resolution decisions under "Meroni jurisprudence"
- Potentially two Commission decisions (state aid and financial stability) - important to ensure functional separation
- Commission resolution decision based on SRB proposal and guided by:
  - *Public interest*
  - *Objectives of resolution*
  - *Integrity of Internal Market*
  - *Bank viability*
- In unlikely event of disagreement with SRB, Commission passes decision to the Council

Too much complexity?

- Concerns expressed about complexity of resolution decision-making within BU
- Strong arrangements for cooperation between SRB and Commission
- Enhanced procedure within Commission
- Specified for procedure for rapid decision-making between SRB, Commission and Council (if necessary)

Transition versus steady-state

- BU resolution framework constructed for steady state
- Some important challenges in transition phase
  - *Readiness versus competitiveness for banks (TLAC/MREL)*
  - *Resolution amid systemic vulnerability (legacy issues)*
  - *Credibility versus flexibility in implementing rules (Level 2)*
  - *Taxpayer protection vs loss concentration (bail-in and home bias)*

Conclusions

- Resolution a key aspect of underlying rationale for BU
- BU resolution framework remains incomplete
- Efficiency of resolution framework requires completion of BU – shared responsibility for both decisions and costs
- Commission involved in resolution via legislative framework, but also planning process and decision-making (until Treaty change)
- Important challenges for resolution framework in transition to steady state

Thank you for your attention

Presentation by John Berrigan,
European Commission
3 November 2015

Freshfields Bruckhaus Deringer

Bail-in, MREL, TLAC, EDIS – bank liabilities in a new world

Third Annual Conference on Banking Union

Dr. Alexander Glos

Frankfurt, 18 April 2016

Agenda

I. Bank liabilities in the old world
II. Bail-in
III. MREL
IV. TLAC
V. EDIS
VI. Bank liabilities in a new world

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I. Bank liabilities in the old world

I. Bank liabilities in the old world

In the old world, bank liabilities used to be safe.

- Bank insolvencies were rare.
- It was relatively easy to determine the ranking in insolvency.
- Senior debt could only suffer in bank insolvencies.
- Depositors were protected by statutory deposit protection and, at least in Germany, by (higher) voluntary deposit protection schemes.
- Banks had to fulfil regulatory capital ratios (solely) based on equity and hybrid capital / junior debt.

But this world is past.

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II. Bail-in

II. Bail-in (1)

Overview (1)

- Bail-in as the most important resolution tool under the Bank Recovery and Resolution Directive
- Reversal of the philosophy of dealing with struggling banks during the financial crisis:
  - Bail-in instead of bail-out / creditors vs. taxpayers
  - Taxpayers shall now only be liable in very exceptional circumstances, and in that case, a bail-in of at least 8% of the bank's liabilities is mandatory.
  - An 8% bail-in is also mandatory if the Single Resolution Fund shall be used.
- Threat of a possible bail-in shall also ensure market discipline
  - Counter-measure against moral hazard posed by "too big to fail"

II. Bail-in (2)

Overview (2)

- Bail-in is effected by conversion of a liability into equity (if the bank has a positive net asset value) or by write-down of the liability
- "No creditor worse off" principle applies
- Bail-in applies to own funds and eligible liabilities
  - What is a liability?
    - Only financial liabilities?
    - Contingent liabilities?
    - Potential liabilites?

II. Bail-in (3)

(Non-)Eligible Liabilities

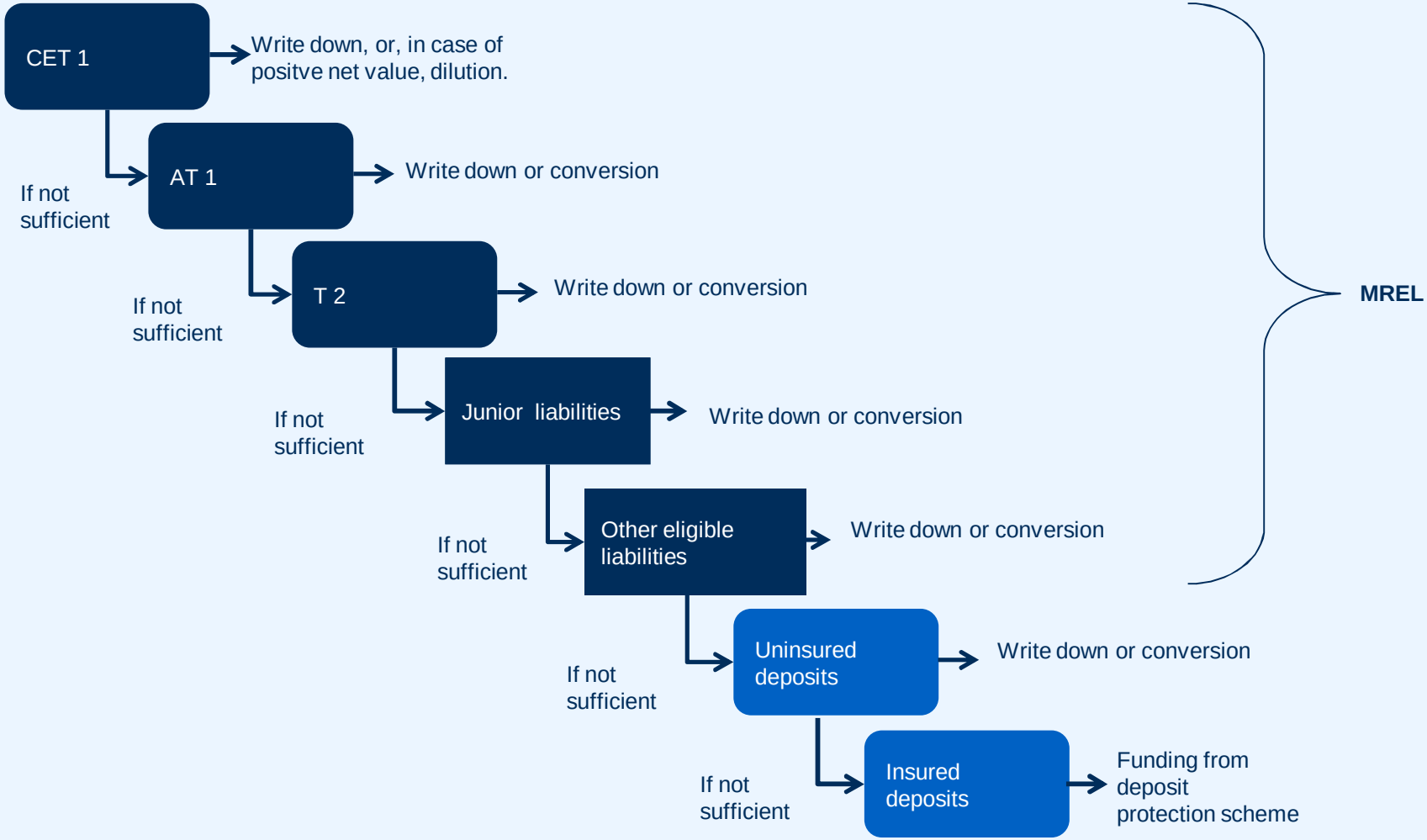
- All liabilities of an institution are eligible for bail-in with the exception of certain 'non bail-inable' liabilities, inter alia:
  - covered deposits (i.e. deposits up to EUR 100,000);
  - secured liabilities including covered bonds;
  - certain short term interbank liabilities;
  - liabilities to a suppliers of critical services.
- Discretion of resolution authorities to exclude further liabilities
- Specific rules for derivatives

II. Bail-in (4)

Liabilities under third country law

- Within the EU, the effects of a bail-in by the resolution authority of one member state are fully recognised in all member states
- There is no similar automatic recognition in third countries
- Banks are required to include a contractual bail-in clause into agreements which are governed by the law of a third country and which create (eligible) liabilities
- Burdensome administrative obligation for banks

II. Bail-in (5)



Source: Deutsche Bundesbank, June 2014

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III.MREL

III. MREL (1)

Minimum Requirements for Own Funds and Eligible Liabilities (MREL) are:

- a new quantitative (quasi) capital requirement;
- calculated as a percentage of the total liabilities and own funds (not risk weighted);
- set by the resolution authorities (in particular Single Resolution Board – SRB), not by the supervisory authorities;
- to be complied with both on solo basis as well as on a consolidated level.

III. MREL (2)

Criteria for instruments to qualify as eligible liabilities

- the instrument is issued and fully paid up;
- the liability is not owed to, secured by or guaranteed by the institution itself;
- the purchase of the instrument was not funded directly or indirectly by the institution;
- the liability has a remaining maturity of at least one year;
- the liability does not arise from a derivative;
- the liability does not arise from a deposit which benefits from preference in the national insolvency hierarchy.

III. MREL (3)

Criteria for the assessment of the required MREL ratio

- the need to ensure that the institution can be resolved by the application of the resolution tools in a way that meets the resolution objectives (**resolvability**);
- losses could be absorbed and the Common Equity Tier 1 ratio could be restored to comply with the conditions for authorisation and to sustain sufficient market confidence in entity (**loss absorption** and CET1 maintenance);
- the size, business model, funding model and risk profile of the institution (**individual assessment**);
- the extent to which the Deposit Guarantee Scheme could contribute to the financing of resolution (**external contributions**);
- the extent to which the failure of the institution would have adverse effects on financial stability (**financial stability**).

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IV. TLAC

IV. TLAC (1)

Total Loss-Absorbing Capacity

- TLAC is the Financial Stability Board's (latest) response to "Too big to fail".
- An additional requirement for (systemically important) banks to hold capital/liabilities that can be used to absorb losses in a gone concern situation.
- Final principles published in November 2015
- Implementation by 2019

IV. TLAC (2)

	MREL	TLAC
Legal basis	Art. 45 BRRD/ Sec. 91 SAG	Unclear; BRRD/ SAG amendments; Level II-measures regarding BRRD and Sec. 25a KWG or Art. 16 (2) (a) or Art. 9 (1), 4 (1) (f) SSM Regulation
Objective	Creating sufficient liabilities which could be bailed in (BRRD RTS) and protection of specific creditors against bail-in (BRRD)	Creating sufficient loss-absorbing liabilities to avoid the need for a bail-out in case of a failure
Scope of application	Applicable to all credit institutions and investment firms	Applicable to G-SIBs
Ratio	Firm-specific Pillar 2 ratio	Same common External TLAC ratio for all G-SIBs plus “Pillar 2” firm-specific ratio
Denominator	Total liabilities and own funds; however, determination is also based on capital and leverage ratios	RWAs
Competent authority	Competent resolution authority	Competent supervisory authority

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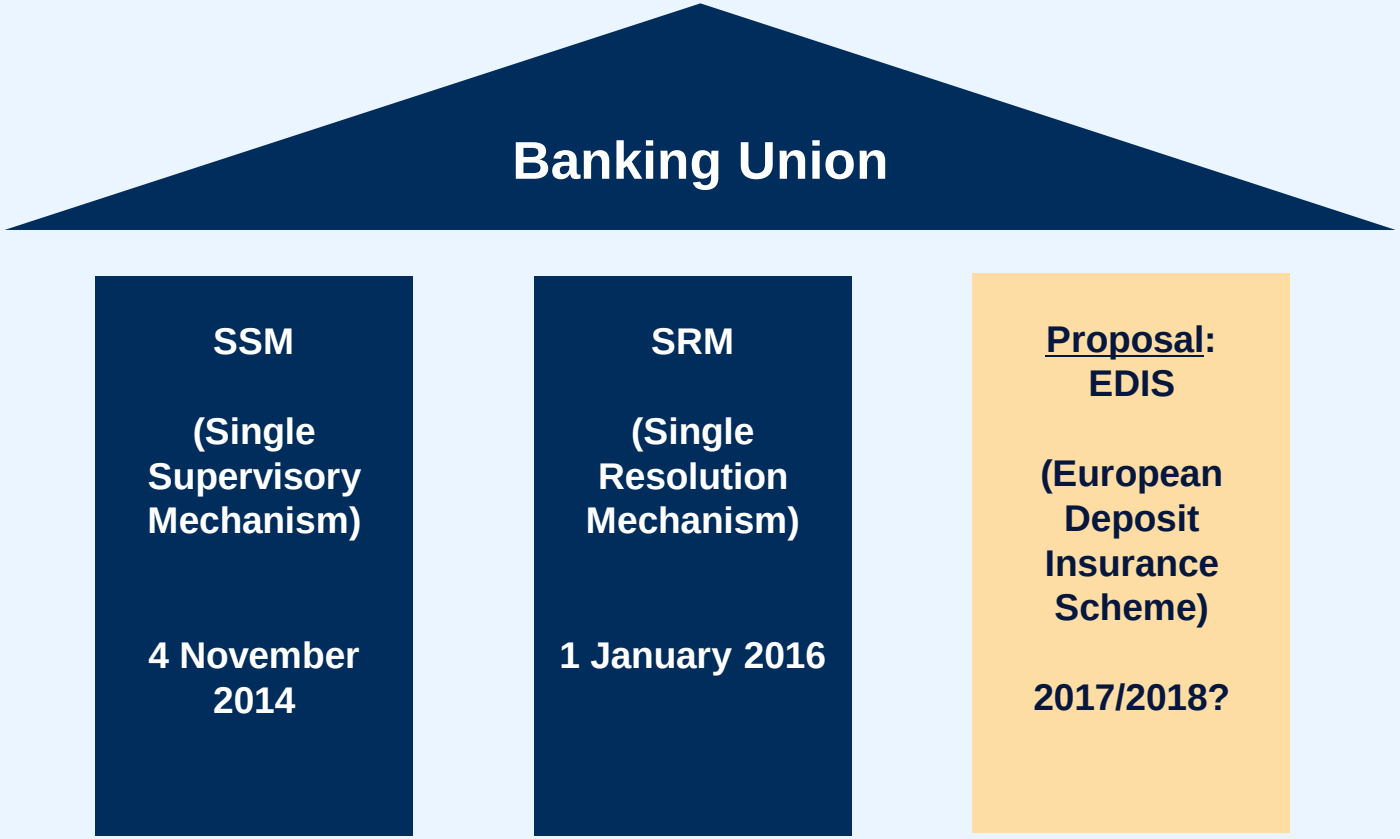
V. EDIS

V. EDIS (1)


Banking Union
SSM
(Single Supervisory Mechanism)
4 November 2014
SRM
(Single Resolution Mechanism)
1 January 2016
Proposal:
EDIS
(European Deposit Insurance Scheme)
2017/2018?

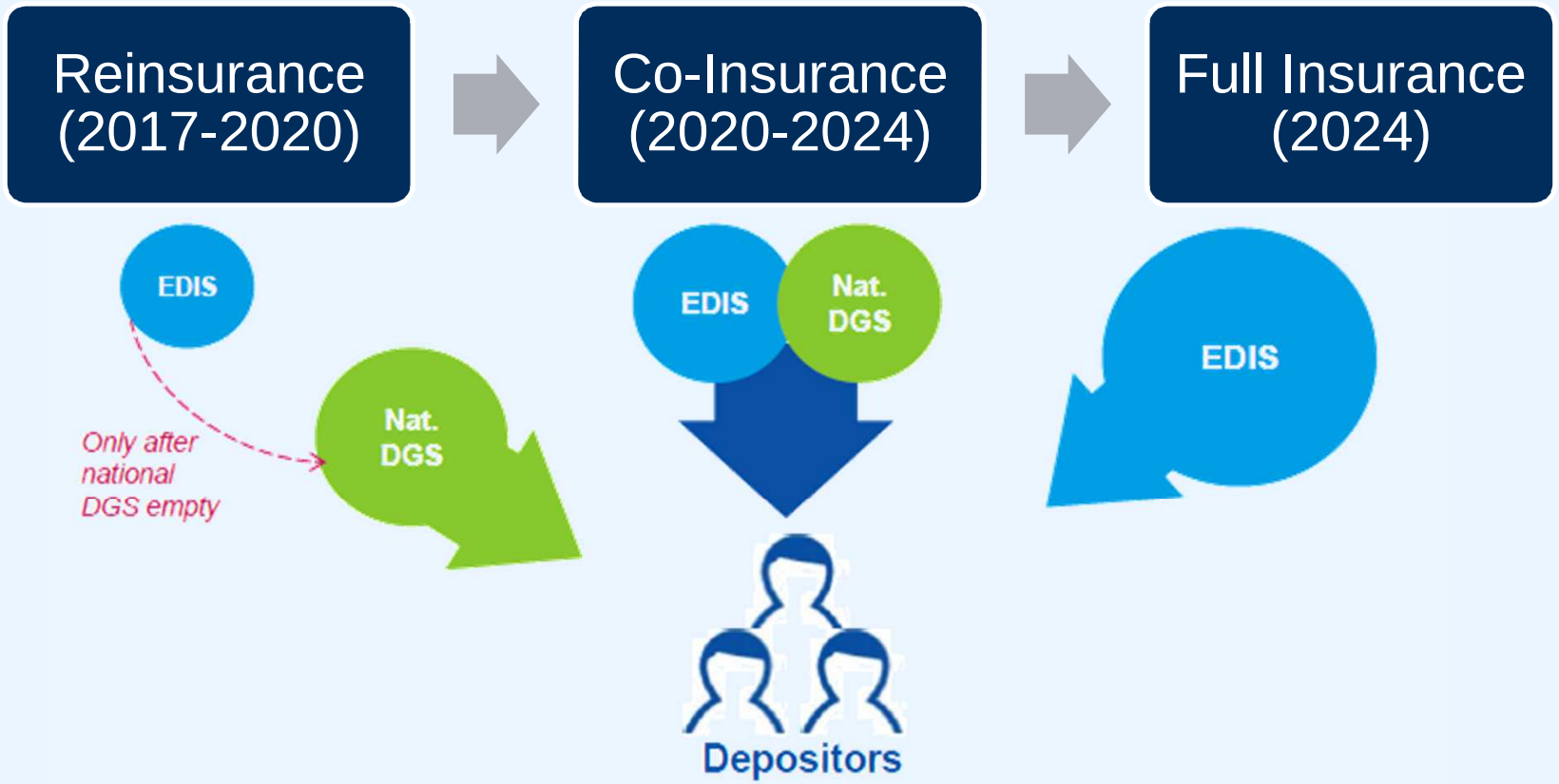
V. EDIS (2)

Overview

- Commission proposal for a **European Deposit Insurance Fund**
- The **SRB** to be the owner and administrator of the Fund and the leading authority in decisions around depositor compensation
- Similarly to SSM/SRM, EDIS to be a **network of the national Deposit-Guarantee Schemes** (DGS) – which shall continue to exist – **and SRB**
- No distinction between significant and less significant banks
- All DGS recognised in a member state of the Banking Union (statutory, contractual and institutional schemes)
- Deposits within the meaning of Directive 2014/49/EU and up to the **protection ceiling of EUR 100,000.00** per depositor

V. EDIS (3)

Implementation in three steps



Source: European Commission

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VI. Bank liabilities in a new world

VI. Bank liabilities in a new world

In the new world, bank liabilities are… complicated.

- Bank failures are less inconceivable
- Pre-insolvency failures are now possible – discretion of authorities to determine “fail or likely to fail”
- It is highly complicated to determine the risk of a bank(-related) liability:
  - Big banks (bail-in) vs. small banks (insolvency)
  - Highly differentiated ranking and complex rules for exclusion/excludability
  - Jurisdictional particularities even under the BRRD/SRM
  - Applicability of a bail-in to liabilities under third-country law
  - What is a liability?
- Banks have to fulfil regulatory capital ratios based on new instruments (and based on different denominators).
- European Deposit Protection may change views on safety of national deposit protection schemes.

Questions?

Our speaker

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Practice
Corporate

About
A financial services lawyer specialising in banking and investment services regulation, with close knowledge of the German and European financial regulators.

Skills and experience
Alexander advises banks and other financial institutions, and also unregulated entities, on all areas of financial services regulation. He specialises in banking and investment services regulation, as well as payment services and capital markets regulation. Alexander works with financial institutions and investors on M&A and loan portfolio transactions, as well as bank restructurings and other financial market stabilisation measures. His recent experience includes advising two banks with regard to the Comprehensive Assessment by the European Central Bank as well as one bank in relation to a proceeding with the Administrative Board of Review of the European Central Bank.

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Thank you for your attention!

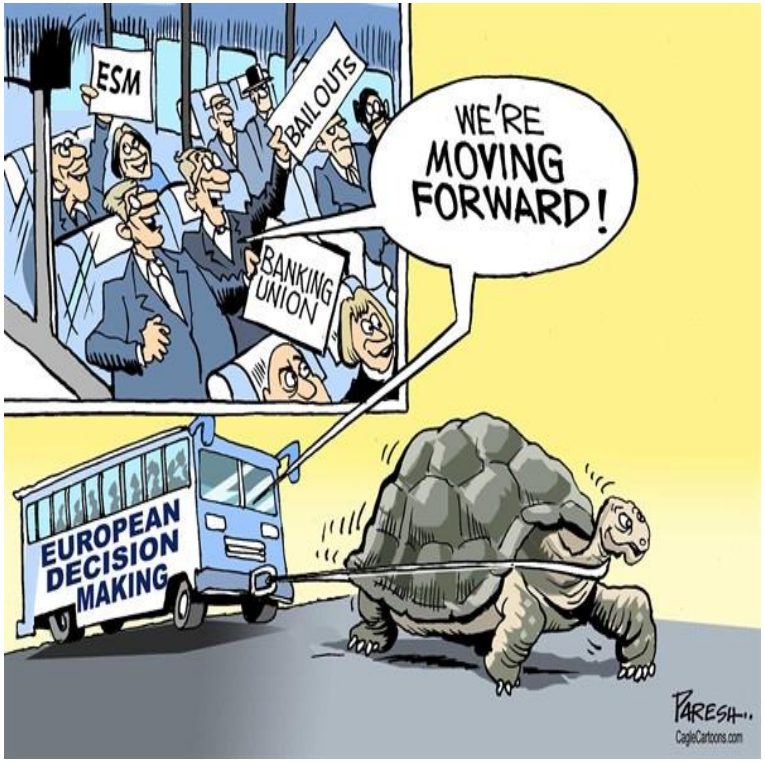
Panel Discussion on the SRM

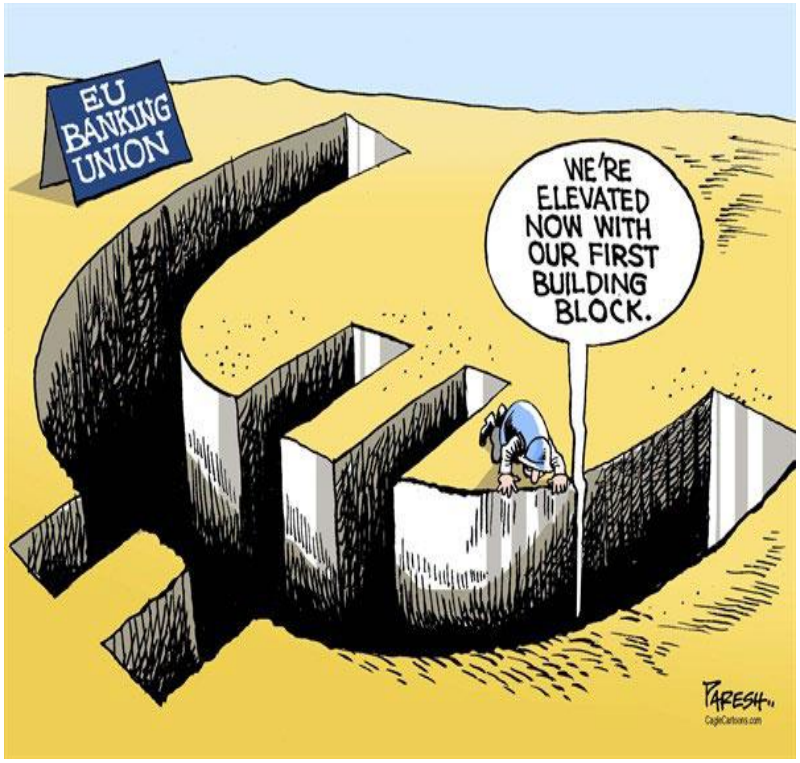
Banking Union Conference

ILF, Goethe University & Freshfields Bruckhaus Deringer
Frankfurt, 18 April 2016

Diederik van Wassenaer, Global Head of Regulatory and International Affairs

The common view on the Banking Union …





What is new for ING?

- Many requests for data and information
- Formalisation (rule-based) & centralisation of supervision
- One integrated supervisory approach
- On-site inspections

- On balance: a positive experience!

Experiences after 18 months

- ECB conclusions on risk profiles of banks not always clear
- Receiving feedback from the ECB takes time
- Efficiency in transferability of capital and liquidity remains major challenge
- Fragmentation and duplication caused by national regulation and supervision should be eliminated
- Single Rule Book to be further developed, application of options and discretions within the SSM to be reduced