ASSONIME RESPONSE TO
DG INTERNAL MARKET AND SERVICES WORKING DOCUMENT ON
TECHNICAL DETAILS OF A POSSIBLE EU FRAMEWORK FOR BANK
RECOVERY AND RESOLUTION

INTRODUCTION


A number of important initiatives in this direction have already been adopted by the European Commission, including a communication on Bank Resolution Fund (May 2010), a proposal of review of the Deposit Guarantee Schemes Directive (July 2010) and a communication on crisis management which preceded and largely inspired this working document (October 2010).

While containing many useful ideas and suggestions, the approach outlined in the document is far too complex. In particular as we are going to argue, the harmonization of national bank insolvency rules or the creation of a single European Resolution Authority are not necessary and would entail endless negotiations possibly leading nowhere. An agreement on these issues would, in all likelihood, be impossible to reach. These steps seem us to be unnecessary and redundant.

In our opinion, a coherent and comprehensive approach should be based as such as possible on existing powers and institutional arrangements. Any changes should be adopted only as strictly required.
The bank crises resolution system should be based on 4 pillars: 1

i) all countries should have in place administrative powers to deal with bank crises resolution. All national legislatures should have a set of common principles and administrative powers for early corrective action and resolution of a bank crisis, as it has been recommended by the Basel Supervisors, but does not require full harmonisation of national laws. Crisis prevention, resolution and liquidation would all be part of a unified resolution procedure managed for each bank or banking group in every country by the supervisory authority with adequate powers. When capital continues to fall despite early mandated action, national supervisors should have the powers to impose reorganization measures, 2 using special administrative tools such as acquisition by or assisted sale to a private sector purchaser, partial transfer of assets, deposits and liabilities and other special tools to preserve banks’ systemic functions. 3

ii) European banking groups should be resolved with a consolidated group-level approach and it should be avoided that each jurisdiction takes its own steps regarding the commencement and the management of a crisis resolution procedure. All banking groups would be supervised and, in case of need, subjected to mandatory resolution procedures on a consolidated basis, under the law of the parent company. Subsidiaries chartered in separate jurisdictions, but unable to survive a crisis of the parent company on their own, would also fall under the same authority.

In this spirit, a further modification of the Winding Up Directive should extend the ‘universal’ principle of resolution of cross-border banking groups not only to branches, but also to subsidiaries that, besides not enjoying managerial autonomy, cannot effectively stand alone in case of default. Full universality across both branches and subsidiaries would better reflect the reality of integrated businesses; it would correspond to the already established principle of consolidated group supervision; it is essential in order to create an integrated system of deposit guarantee and mandated action for reorganisation and winding up.

The key principle is that separate resolution of subsidiaries would only be allowed to the extent that they would be really independent of the parent company, would be unaffected by the group’s liquidation and would not cause danger to the group’s survival in case the subsidiary were wound up. In this way, economic function and legal form could be reconciled; the incentives to maintain and operate a complex structure without functional justification would be greatly reduced.

1 The system proposed is described in CEPS-Assonime Report “Overcoming too big to fail - A Regulatory Framework to Limit Moral Hazard and Free Riding in the Financial Sector”, authored by Jacopo Carmassi, Elisabetta Luchetti and Stefano Micossi. Based on the principles espoused above, the Report proceeds to develop a full regulatory architecture for the European Union.

2 Ref. to question 28.

3 Ref. to question 31.
In order to make group resolution possible, all European banking groups would be required to prepare and regularly update a document detailing the full consolidated structure of legal entities that depend on the parent company for their survival, and a clear description of operational – as distinct from legal – responsibilities and decision-making, notably regarding functions centralised with the parent company. The document should also include contingency plans describing possible recovery and winding up arrangements, also updated on an ongoing basis, taking account of key factors such as size, interconnectedness, complexity and dependencies.

In preparing their plans, banks would be free to decide the structure and organisation of their business, notably regarding the decision to set up branches or subsidiaries in the foreign jurisdictions where they operate. However, separate resolution of subsidiaries, eschewing consolidation in the parent group, would only be allowed to the extent that they would be demonstrably fully independent of the parent company, would be unaffected by its liquidation and would not endanger its survival in case the subsidiary were wound up.

iii) Resolution of banking groups in crisis would be managed by strengthened Colleges of supervisors, under the leadership of the parent company supervisor and a regime of full exchange of information amongst all interested national supervisors. The Colleges of supervisors would report to the EBA, which would sanction all proposals by the Colleges with its own decisions. These decisions would include the initiation of mandated action and all subsequent steps, and the mediation of disputes between national supervisors. It is necessary to establish a system of early mandated action by bank supervisors ensuring that, as capital falls below certain thresholds, the bank or banking group will be promptly and adequately recapitalized. Should the bank fail to do so and capital continue to fall, then supervisors would be empowered to step in and impose all necessary reorganisation, including disposing of assets, selling or closing lines of business, changing management, ceding the entire bank to a stronger entity.

Placing the EBA at the centre of the system is especially important, since only in this way all national supervisors and private interested parties would be guaranteed of fair treatment, and thus be ready to accept the delegation of resolution powers to another jurisdiction. Mandated action would also give them the guarantee that supervisory forbearance would not be used to favour national interests in the parent company’s jurisdictions to the detriment of other stakeholders.4

The key mechanism to convince host countries to delegate is assigning to the European Banking Authority a sanctioning power. It is crucial to stress that such a mechanism would not lead to a change of supervisor, national supervisors would retain their prerogatives. Instead, the new framework should envisage a coordination of national supervisors, under EBA’s umbrella. The EBA should set the regulatory and

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4 Ref. to question 53b and 55.
supervisory standards, on the basis of powers granted to it by Regulation 1093/2010, art. 10 and art. 15.

iv) Should reorganization not work, then liquidation would commence. A bridge bank would take over deposits and other “sound” banking activities, thus ensuring their continuity. All other assets and liabilities, together with the price received for the transfer of assets to the bridge bank, would remain in the “residual” bank, which would be stripped of its banking licence. An administrator for the liquidation of the residual bank would be appointed to determine its value and satisfy creditors according to the legal order of priorities, based on the law of the parent company and other jurisdictions involved.

The primary purpose of the liquidation would be to preserve and optimise the residual bank assets for the satisfaction of creditors, and residual claims by shareholders. Accordingly, the liquidation discipline should include rules for: a suspension of all the claims against the bank (‘moratorium’); the sale of the assets in an orderly and cost-effective manner; the distribution of the income to the various classes of creditors in an equitable and transparent manner, in respect of their priority; the immediate enforceability of close-out netting and collateral arrangements relating to financial transactions. Local courts will remain charged with claims of local creditors and will resolve them on the basis of the local jurisdiction.

In order to implement these principles, it is necessary to amend the Winding Up Directive to include the procedures for the creation of the bridge bank and hence the start of liquidation, the criteria and safeguards for the transfer of assets and claims to the bridge bank, the immediate withdrawal of the banking licence for the residual bank, and the duties of the administrator in charge of the liquidation. The administrator should be appointed by the EBA based on a proposal by the College of supervisors.
QUESTIONS

Institutional Scope

1a. What category of investment firms (if any) should be subject to the preparatory and preventative measures tools and the resolution tools and power?

The scope of application of the new European crisis resolution framework should include: 1) depository banks and 2) banking groups which have among their controlled entities one or more banks issuing deposits.

Other financial intermediaries, including investment banks, do not pose the same risk to financial stability, because they do not issue deposits and their liabilities are not redeemable on demand at par. They are not exposed to the risk of customer runs since their liabilities are market priced like their assets. When financial intermediaries that raise money from capital markets by issuing securities make wrong investment decisions, their investors will lose their money, with no further repercussions for the financial system at large. Since they have capital, they can also leverage it, thus increasing the riskiness of their operations; but as long as there is no external guarantee on the value of their liabilities, investors will monitor their risk exposure and will decide whether or not to maintain their investment.

Authorities

3a. Do you agree that the choice of the authority or authorities responsible for resolution in each Member State should be left to national discretion? Is this sufficient to ensure adequate coordination in case of cross border crisis?

The national supervisory authority should exercise resolution powers, and European banking groups should be resolved with a consolidated group-level approach through college of supervisors under the coordination of the EBA. It should be avoided that each jurisdiction takes its own steps regarding the commencement and the management of a crisis resolution procedure (see above pillar (ii)). As to ensure adequate coordination in case of cross border crisis, the powers of Colleges of supervisors should be expanded, amending art. 131a of the Capital Requirements Directive (2006/48/EC), as to include the task to elaborate common proposals on early intervention and reorganization of the banking group: agreed measures should be proposed to EBA, which would sanction them with its own decisions, including such specific sanctioning power in the tasks of EBA (amending art. 8 of EBA Regulation, on tasks and powers of EBA, and art. 21 on the role of EBA in Colleges of supervisors). EBA would also mediate disputes between national supervisors, on the basis of the binding mediating powers assigned to it by art. 10 of EBA Regulation 1093/2010.
3b. Is the functional separation between supervisory and resolution functions within the same authority sufficient to address any risks of regulatory forbearance?

3c. Is it desirable (for example, to increase the checks and balances in the system) to require that the various decisions and functions involved in resolution – the determination that the trigger conditions for resolution are met; decisions on what resolution tools should be applied; and the functional application of the resolution tools and conduct of the resolution process – are allocated to separate authorities?

A separation between supervisory and resolution authority is not needed. In order to concentrate within supervisors early intervention and resolution powers without creating room for supervisory forbearance, a set of procedural arrangements is needed that will strongly discourage supervisory forbearance, and indeed make it unlikely. In particular, mandated action would give the guarantee that supervisory forbearance would not be used to favour national interests in the parent company’s jurisdictions to the detriment of other stakeholders.

Recovery Planning

7a. Is it necessary to require both entity-specific and group preparatory recovery plans in the case of a banking group? How to best ensure the consistency of recovery plans within a group?

Recovery and resolution plans should be prepared both by depository banks and, at the group level, by banking groups with depository subsidiaries. The plans should be made available to supervisors and the EBA, but not to the broad public.

7d. Should the EBA play a mediation role in the case of disagreement between competent authorities regarding the assessment of group preparatory recovery plans?

The EBA should resolve disputes between national competent authorities on the assessment of group recovery plans on the basis of the binding mediating powers assigned to it by art. 10 of EBA Regulation 1093/2010.

Resolution Plans

21b. Would the requirements for resolution plans suggested above will adequately prepare resolution authorities to handle a crisis situation effectively? Are additional elements needed to ensure that resolution plans will provide adequate preparation for action by the resolution authorities in circumstances of both individual and wider systemic failure?
Following the above proposed system (see particularly pillar (ii) and (iii)) all European banking groups should be required to prepare, provide to their supervisors and regularly update a document detailing: i) claims on the bank and their order of priority, ii) the full consolidated structure of legal entities that depend on the parent company for their survival (and may therefore produce liabilities for the parent company), and iii) a clear description of operational – as distinct from legal – responsibilities and decision-making, notably regarding functions centralised with the parent company. This document may also comprise ‘segregation’ arrangements to preserve certain functions of systemic relevance even during resolution: for clearing and settlement of certain transactions, netting out of certain counterparties, suspension of covenants on certain operations.

The document should also include contingency plans describing possible recovery and winding up arrangements, also updated on an ongoing basis, taking account of key factors such as size, interconnectedness, complexity and dependencies. Reorganisation and winding up arrangements should be conceived as a menu of options covering such things as: all the claims on the bank and their order of priority; possible segregation arrangements of certain functions to be maintained in case of resolution; ex-ante commitments to conversion of contingent capital into common equity; powers of management to bring in new investors quickly with no need of shareholders’ approval; indication of which assets or divisions or subsidiaries might be sold to third parties in case of distress; group-wide contingency funding plan; the management strategy to de-risk the bank business in a short time and to deal with the failure of their largest counterparties.

**Conditions for resolution**

28. *Which of the options proposed, either alone or in combination, is an appropriate trigger to allow authorities to apply resolution tools or exercise resolution powers? In particular, are they sufficiently transparent, and practicable for the authorities to apply? Would they allow intervention at the appropriate stage?*

When capital continues to fall despite early mandated action, national supervisors should have the powers to impose reorganization measures. According to our view the proposed option 3 is an appropriate trigger.

31. *Are the tools suggested in section 2 and elaborated in the following sections sufficiently comprehensive to allow resolution authorities to deal effectively with failing banks in the range of foreseeable circumstances? Are there any others that we should consider?*

The tools proposed seem to be sufficiently comprehensive: special administrative tools such as acquisition by or assisted sale to a private sector purchaser,
bridge bank, partial transfer of assets, deposits and liabilities and other special tools to
preserve banks’ systemic functions are fundamental for the new resolution system.5

**Group Resolution**

52. *Do you agree that the group level resolution authority should decide on the composition of the resolution colleges?*

Colleges of supervisors should be composed by the parent company supervisor (i.e. the home country authority) and all host country authorities of both branches and subsidiaries, coherently with the consolidated universal principle that we propose for early intervention and resolution (see pillar (ii)). Placing the College of Supervisors and the EBA at the centre of the system is especially important, since only in this way all national supervisors and private interested parties would be guaranteed of fair treatment, and thus be ready to accept the delegation of resolution powers to another jurisdiction. Mandated action would also give them the guarantee that supervisory forbearance would not be used to favour national interests in the parent company’s jurisdictions to the detriment of other stakeholders.

**Financing Arrangements**

59a. *Should the basis for the calculation of contributions be fully harmonised or left to the discretion of Member States?*

59b. *Are eligible liabilities an appropriate basis for calculating contributions from individual institutions, or a more risk adjusted basis be preferable? The latter might take account of elements such as: a) the probability that the institution would enter into resolution, b) its eligible liabilities, c) its systemic importance for the markets in question, etc. However, would that add too much complexity?*

Banking groups should pay a risk-based fee to national deposit guarantee schemes and resolution funds. Deposit guarantee schemes should be used exclusively to protect retail depositors; resolution funds should not be used for providing financial assistance to a faltering bank and its shareholders and creditors, e.g. through recapitalization, debt guarantee or purchase of toxic assets, but to facilitate effective implementation of the special reorganization tools without imposing burden on taxpayers.

Rome, 17 February 2011

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