

17 February 2014

## **AFME Submission on Single Resolution Mechanism Trilogue Negotiations**

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The Association for Financial Markets in Europe (AFME) strongly supports the establishment of a banking union in Europe. We believe that this project can greatly improve the functioning of the financial system and the Single Market, ensuring financial stability and enhancing integration, to the benefit of the European economy.

The Bank Recovery and Resolution Directive (BRRD) represents important progress in ensuring that shareholders and creditors bear the losses of failing institutions and therefore breaking the sovereign-bank link. Now that trilogues on the Single Resolution Mechanism (SRM) regulation are under way, it is essential that momentum is maintained to ensure that political agreement on an integrated, consistent and effective resolution system, to work alongside and in connection with the SSM and the BRRD, is reached before the end of the Parliament's mandate. We appreciate the legal complexity of the issues and the commitment expressed by all parties towards reaching agreement.

AFME would like to express its views on a number of important issues under discussion in the SRM trilogue negotiations in the hope that this will represent a constructive contribution to current discussions. These comments relate to the scope and effectiveness of the SRM, the degree of consistency between the SSM and SRM frameworks, the Single Resolution Fund (SRF), and the need for alignment between the SRM and BRRD provisions.

### **Effectively integrated Banking Union**

AFME has been strongly supportive of outcomes of the SSM and SRM discussions that represent a high level of true integration. It has been our great concern that we avoid simply adding new (and potentially overlapping or conflicting) layers of institutional decision-making that could lead to re-fragmentation, potentially exacerbating crises.

We believe that whether or not these objectives are achieved depends on the outcomes of the SRM legislative process. Integrated supervision requires integrated resolution. In this respect any misalignment could create instability risks in the form of misaligned incentives. The negative implications of such a situation include the potential pressure

for forms of re-nationalisation and re-fragmentation of supervisory activities or for regulatory forbearance.

### Scope

AFME and its Members strongly believe that supervision and resolution should be exercised by the same level of authority to ensure coherence, consistency and effectiveness. As we emphasised in our previous note on SRM developments<sup>1</sup>, it is important that the SRM should be able to apply to all banks in Member States which participate in the SSM and all banks should in principle pay into the SRF, albeit in a proportionate way. Furthermore it is essential that any bank which may pose a systemic risk be resolvable by the central resolution authority and that any call on the SRF will be subject to a decision by the SRB.

While it is positive to see that both the Parliament and the Council current positions go in the right direction to ensure that all banks within participating Member States are within the scope of the SRM, we urge negotiators to reach an agreement on the SRM scope on the basis of the above principles.

### Resolution planning

In addition to the decision to resolve an institution, resolution planning and resolvability assessments are key components of the resolution system.

It is very important that not only resolution actions, but also resolution planning, including the preparatory phase, assessments of resolvability and setting of MREL are centralised to ensure consistency and effectiveness in resolution action, by agreeing ex-ante the right approach for each bank.

### Effectiveness

The SRM should, if designed correctly, provide a more efficient, predictable and effective resolution regime for the banking union, with more certainty regarding resolution planning and the approach to resolution. It also should assist in reversing recent trends towards single market fragmentation and ring-fencing.

Importantly, the SRM should also increase the consistency and coordination of resolution for cross-border groups within participating Member States, as well as assist cross-border cooperation with resolution authorities outside of the banking union. This should reduce costs of funding, improve capital efficiency and ensure a level playing

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<sup>1</sup> AFME comments on SRM developments, 5 December 2013, <http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=10063>

field within the banking union and the wider single market, thus supporting economic recovery.

To achieve the abovementioned objectives, it is essential that the SRM decision-making process is sufficiently streamlined to ensure that decisions are made centrally, quickly and effectively. It is also important that the process of taking resolution decisions is not delayed by political dynamics. It is essential, particularly in relation to the decision to resolve an institution, that the decision can be made very quickly to enable the resolution to be conducted over a weekend.

In light of this, the Single Resolution Board (SRB), particularly in its executive session, should play a central role in preparing and taking decisions concerning resolution. While we acknowledge the existence of legal concerns behind the Council approach, we fear that the process proposed under the General Approach might not enable a sufficiently quick decision to be made in circumstances that are likely to require urgent action.

### **Single Resolution Fund**

AFME and its Members have consistently made the case that a significant ex-ante funded resolution fund is an unnecessary component of an effective resolution framework. Not only does bail-in render the need for any such additional funding unlikely in the extreme, the existence of such a fund in itself has the potential to undermine commitment to shareholders and creditors bearing the losses of failing banks.

However, having established resolution funds under the BRRD, it is important, firstly, that an integrated approach be adopted in the context of the SRM that is consistent with the objectives of that mechanism and, secondly, that there is appropriate consistency and continuity between what has been established under the BRRD and what is put in place under the SRM. Any such fund should mirror the minimum funding levels, purposes and uses of national resolution funds under the BRRD. The SRF must also be subject to the same constraints on its use as those agreed on the use of national resolution funds under the BRRD.

AFME has a number of concerns in this regard. Firstly, it is essential, as established under the BRRD and re-articulated in the agreements to-date on the SRM that sufficient time is provided to build-up the fund. Given the very large amounts involved as well as the many challenges currently facing the industry, it is essential that the ten year period envisaged for building-up of funds (SRF or national) is in no way abridged. Ten years is the absolute minimum that can be envisaged for this purpose. There can be no question of the timeline for build-up of the SRF diverging from that provided for under the BRRD.

Secondly, and as an important matter of principle, in no circumstances should legacy losses be required to be absorbed by the SRF. No bank should be subject to resolution

involving SRF funding until it has undergone an ECB-led asset quality review exercise and any deficiencies identified have been addressed.

While we understand legal concerns from some Member States, we believe that the transitional arrangements could be more optimally designed to make better progress towards the new integrated approach under Banking Union. It is noted for example that under the proposed operation of the SRF, where the funds already paid into the fund are insufficient to meet the needs of a particular bank failure, the remainder is required to be paid by the individual countries where the bank is based (and subsequently recouped from the industry) until after year 10 of the fund's existence. After year 10 however all of the compartments of the individual countries shall be merged and there is no longer a requirement for individual countries to advance funds in the event of a shortfall. AFME considers that as an intermediate step, automatic borrowing between national compartments should take place once 50% of the fund's target level is reached. Such borrowing should be automatically granted unless it would result in a Member State not having sufficient funds to finance any foreseeable resolution in the near future. As stated above this would of course have no implications for the build-up period of the final fund.

The approach to calculating industry contributions is different under the SRM, taking all participating jurisdictions together for calculation purposes. This reflects the integrated nature of banking union, which AFME supports. (However, it should be noted that important differences remain amongst AFME Members as to the appropriateness of the formula used generally for calculating firms' contributions to resolution funds across the EU.) At the same time, AFME and its members believe that, whatever the formula, individual banks should not be penalised as a result of banking union. In particular no bank should be required to contribute more to the SRF build-up than they would otherwise have been required to contribute. This is important to avoid any penalising effects from joining Banking Union, to preserve single market consistency, and a level-playing field within the banking union, as well as across the Single Market as a whole. To the extent that this would result in a small reduction in the percentage amount raised this will be compensated for by the very large absolute amount and the economies of scale arising from the establishment of banking union.

Finally, in no case should the SRF be deployed in the resolution of a bank which has not yet undergone an ECB-led asset quality review exercise and any deficiencies identified have been addressed.

### **Consistency between the SRM and the BRRD**

It is imperative that maximum levels of appropriate consistency and alignment between the BRRD and the SRM is ensured. This is essential to avoid divergences between participating and non-participating Member States and to ensure a level-playing field across the EU.

The BRRD establishes the recovery and resolution “toolkit” of powers and tools which apply to the EU as a whole. The SRM regulation should be consistent with this and be limited in its scope to how the toolkit established by the BRRD should be *applied* in participating Member States. In a number of instances the Council and Parliament SRM texts significantly deviate from the BRRD and this must be addressed in the trilogues to ensure consistency, clarity and to avoid an unlevel playing field between participating and non-participating Member States. Overall consistency could be ensured by simply providing that the SRB applies the relevant provisions set out in the BRRD in place of the relevant national resolution authorities of participating Member States.

We attach as an annex a short paper which identifies a number of areas of inconsistency between the current SRM texts and the BRRD text. This paper also suggests relevant amendments to address the inconsistencies.

Within this framework, AFME takes the view that the EBA should maintain an important role and relevant powers in the area of European cross-border resolution in the framework of the Single Market for financial services as a whole. This should include mandatory mediation as well as developing technical standards and guidelines under the BRRD which apply to all Member States. Again the SRM should apply the relevant BRRD provisions, including technical standards and guidelines and be subject to the EBA’s powers under the BRRD.

### **Cross-border resolution**

The SRM provides an opportunity to strengthen cross-border cooperation both within the SRM and with other Member States and third countries. A consistent and centralised approach to cross-border recognition and cooperation within the SRM is also necessary to avoid divergences within the banking union. Decision-making on cross-border aspects of resolution should accordingly also be centralised under the SRM.

The SRB should be empowered to take decisions to recognise and support third country resolution proceedings throughout participating Member States under Article 85 of the BRRD and should take part in global Crisis Management Groups and have a key role in the design of institution-specific cross-border cooperation agreements. This is essential to ensure that the body responsible for taking resolution decisions in the SRM is the same body which takes part in cross-border discussions and decides whether to recognise and enforce third country resolution proceedings on behalf of participating Member States. It will, also ensure that there is no confusion either amongst Member States or between the EU and third country authorities as to how and by whom urgent decisions will be made in the event of a bank failure.

## Conclusion

To conclude, AFME and its members urge decision-makers to maintain political momentum around the SRM negotiations and to ensure that final decisions on both the SRM and any inter-governmental agreement (IGA) on the SRF are fully consistent and aligned with each other as regards provisions, organisational elements and timing of entry into force. The processes of adoption of any IGA should not be detrimental to the swift entry into force of the SRM.

## Annex

### Inconsistencies between the SRM and BRRD texts

It is important that the SRM provisions are consistent with those agreed in the BRRD. The BRRD establishes the recovery and resolution “toolkit” of powers and tools which apply to the EU as a whole. The SRM regulation should be consistent with this and be limited in its scope to how the toolkit established by the BRRD should be *applied* within participating Member States. In a number of instances the Council and Parliament SRM texts significantly deviate from the BRRD and this must be addressed in the trilogues to ensure consistency, clarity and to avoid an unlevel playing field between participating and non-participating Member States.

Consistency could be ensured in many cases by simply providing that the resolution Board applies the relevant provisions set out in the BRRD in place of the relevant national resolution authorities of participating Member States. This principle is already reflected to some extent in Article 5(1) and the Parliament text’s proposed Article 5(-1) but it is not followed in other sections of the draft regulation.

Instead of replicating the provisions establishing resolution tools, contents of resolution plans, how resolvability assessments should be conducted, how MREL should be assessed etc, the SRM regulation should only set out how such powers should be *exercised* within participating Member States. For example, rather than replicating the MREL provisions in Article 10 of the SRM regulation, it should simply require the Board to determine MREL for entities within the scope of the SRM in accordance with the provisions of Article 39 of the BRRD, with the Board making that determination in place of the relevant national authorities. The Board would make its determination through the decision-making process set out in the SRM, but the remainder of Article 10 could be deleted. This approach is taken in Article 29(1a) of the General Approach in relation to national resolution authorities: we propose that a similar approach be taken in relation to the tasks conferred on the Board. This approach would significantly clarify the text and ensure consistency with the BRRD.

Currently there is significant duplication and overlap, often with slightly different wording which could cause confusion, uncertainty and potentially a divergent approach. The SRM texts currently cross-refer to the BRRD text in some areas. However in many others they duplicate some BRRD provisions but also leave others out, which creates considerable uncertainty. Rather than duplicate BRRD

provisions, the relevant provisions of the BRRD should be cross-referenced. The Parliament text reflects greater cross-reference to the BRRD which we support, although this text also requires clarification in a number of areas.

Beyond these general suggestions, we identify in the table below some specific examples of inconsistency between each of the Parliament and Council texts and the agreed BRRD text. We also include additional suggestions to improve consistency between the two texts.

Topic	Article(s) of SRM text(s)	Relevant article(s) of BRRD	Inconsistency/proposed amendments
General principles	6	29	The additional general principles under the SRM should be limited to principles relevant to balancing decision-making within the SRM and not cut across the general principles governing resolution set out in Article 29 of the BRRD. For example the Parliament’s proposed Article 6(1a) would introduce a new general principle which is not reflected in the BRRD.
Resolution planning	7	9-12	<p>Under the BRRD, a group resolution plan covers all EU entities, but the SRM would introduce a new “group” plan covering only those entities in participating Member States. This is due to the definition of group in the SRM only covering entities in participating Member States.</p> <p>The Board should simply take the place of the group national resolution authority for groups headquartered in participating Member States and the role of national host resolution authorities for subsidiaries in participating Member States and exercise the powers established by the BRRD.</p> <p>We support the Parliament’s proposed Article 7(2a) cross-referring to the BRRD. The General Approach fails to do this, for example Article 7(5) should cross-refer to Article 9(4) of the BRRD and incorporate the EBA RTS under Article 9(4a) of the BRRD.</p>
Resolvability	8	13, 13a	We support the Parliament’s proposed amendments to Articles 8(2) and 8(3) cross-



Topic	Article(s) of SRM text(s)	Relevant article(s) of BRRD	Inconsistency/proposed amendments
assessments			<p>referring to the BRRD. Under the General Approach, the wording in Article 8 is slightly different from the BRRD. For example Article 13(1) of the BRRD contains references to no central bank liquidity assistance which is not reflected in Article 8 of the General Approach text. This could be resolved by defining resolvability by cross-reference to the BRRD provisions, including the EBA RTS as provided in the Parliament text.</p> <p>It is also unclear how the SRM interacts with the requirement in Article 13a(1) of the BRRD for the assessment of group resolvability to be considered in resolution colleges.</p> <p>Again the Board should simply take the place of the group national resolution authority for groups headquartered in participating Member States and the role of national host resolution authorities for subsidiaries in participating Member States and exercise the powers in accordance with the BRRD.</p>
Addressing impediments to resolvability	8	14, 15	<p>Article 8a of the Parliament text introduces an obligation on the Board to prioritise certain institutions which is not required by the BRRD.</p> <p>Article 8(5) of both SRM texts differs from Article 14 of the BRRD in that it refers to “potential” substantive impediments rather than just actual substantive impediments. This should be aligned by deleting “potential”. The process for notification also differs: under the BRRD, impediments are notified to the institution, which proposes measures to remedy the impediments whereas under the SRM the Board report includes proposed measures. It is unclear how this would work for a group with subsidiaries in both participating and non-participating Member States.</p> <p>Article 8(8) of the SRM texts has slightly different wording from Article 14(3) of the BRRD, for example the latter refers to the measures proposed do not effectively “reduce or remove” impediments whereas Article 8(8) only refers to “remove”.</p>

Topic	Article(s) of SRM text(s)	Relevant article(s) of BRRD	Inconsistency/proposed amendments
			<p>The measures that can be taken set out in Article 8(9) should cross-refer to Article 14(4) of the BRRD as per the Parliament text. Under the General Approach, there are divergences in the drafting. It should also be clarified that the right of appeal provided in Article 14(6) and Article 14(7) of the BRRD also applies to decisions under the SRM.</p> <p>Again, the Board should simply take the place of the group national resolution authority for groups headquartered in participating Member States and the role of national host resolution authorities for subsidiaries in participating Member States and exercise the powers established by the BRRD.</p>
Simplified obligations	9	4	<p>The simplified obligations and waivers in Article 9 of the General Approach diverge from those agreed in Article 4 of the BRRD. These should be aligned, with the Board making the decision in place of relevant national resolution authorities in participating Member States but applying the BRRD provisions.</p>
MREL	10	39	<p>The MREL provisions in Article 10 should be aligned with the agreed Article 39 of the BRRD. The Parliament text seeks to do this, but under the General Approach, Article 10 significantly departs from Article 39, for example by introducing a cap in Article 10(2a).</p> <p>Again, the Board should simply take the place of the relevant national resolution authorities for entities in participating Member States and exercise the BRRD provisions.</p>
Resolution of holding companies	14	28	<p>Article 28 of the BRRD <i>empowers</i> resolution authorities to take resolution action in respect of financial institutions and parent undertakings when the conditions are met. However Article 14 of the General Approach <i>requires</i> them to take resolution action.</p>

Topic	Article(s) of SRM text(s)	Relevant article(s) of BRRD	Inconsistency/proposed amendments
Use of the Fund	71	92	Article 71(3) of both the Parliament and Council texts applies to all entities in Article 2, whereas the equivalent provision in Article 92(3) of the BRRD only applies to entities in (b), (c) or (d) of Article 1 of the BRRD.