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## Briefing note

### Single Resolution Mechanism: summary and level 2 issues

28 April 2014

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This note provides a high level summary of the key elements of the regulation establishing the Single Resolution Mechanism (“SRM”) based upon the “preliminary version” of the text as approved by the Parliament on 15 April 2014<sup>1</sup> which we note is prior to completion of the jurist linguist process.<sup>2</sup>

We also include a table of level 2 items in the appendix. Please note that this note does not cover the terms of the related Intergovernmental Agreement (the “IGA”) as this is still under negotiation.

#### Scope

The SRM applies to all credit institutions established in participating Member States (i.e. those Member States participating in the Banking Union). It also applies to parent undertakings and investment firms established in participating Member States which are subject to consolidated supervision by the ECB.<sup>3</sup>

The Single Resolution Board (the “Board”) is responsible for resolution planning and taking resolution decisions for entities which are directly supervised by the ECB and for cross-border groups (i.e. those with entities established in more than one participating Member State). However in practice draft plans are likely to be prepared by national authorities subject to instructions and approval by the Board.

However, for other entities, national resolution authorities (“NRAs”) are responsible for:<sup>4</sup>

- a) resolution planning and resolvability assessments;
- b) adopting early intervention measures;
- c) applying simplified obligations and waivers;
- d) setting the level of MREL (subject to guidelines and instructions from the Board<sup>5</sup>);
- e) adopting resolution decisions provided that there is no use of the Single Bank Resolution Fund (the “Fund”); and
- f) writing down capital instruments.

If the resolution decision involves the use of the Fund, the Board would have to adopt it. The Board also has an oversight role to ensure that the decisions taken by NRAs comply with the SRM and has the power to exercise directly the powers under the SRM.<sup>6</sup> However, this is likely to provide significant flexibility for NRAs in relation to smaller banks which don’t operate in more than one participating Member State which could include subsidiaries of large banks headquartered outside the Banking Union.

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<sup>1</sup> [www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+20140415+SIT-01+DOC+WORD+V0//EN&language=EN](http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+20140415+SIT-01+DOC+WORD+V0//EN&language=EN)

<sup>2</sup> This note is intended to provide a high level summary only and should not be relied upon.

<sup>3</sup> Article 2

<sup>4</sup> Member States have the option of asking the Board to cover all entities in their territory if they wish.

<sup>5</sup> Article 10(1b)

<sup>6</sup> Article 6a

## Implementation

The SRM regulation enters force on the 20<sup>th</sup> day following its publication in the Official Journal, which we expect in July. Certain articles apply from the date of entry into force.<sup>7</sup> These include establishing the Board and cooperation obligations.

The powers of the Board to collect information and cooperate with NRAs “for the elaboration of resolution planning” apply from 1 January 2015.

However the remainder of the SRM, including the resolution powers of the Board and the establishment of the Fund, applies from the later of (i) 1 January 2016; and (ii) the date upon which the conditions under the IGA for the transfer of contributions to the Fund are met.<sup>8</sup>

The Board can therefore be set up once the regulation comes into force and will gain certain powers in relation to resolution planning from 1 January 2015 but will not gain full decision-making powers until 1 January 2016 at the earliest, depending upon when the IGA comes into effect. It is not clear precisely what is meant by the “elaboration of resolution planning” and therefore what the role of the Board will be from 1 January 2015. Further clarity is also required as to how these provisions interrelate with the Bank Recovery and Resolution Directive (“BRRD”).

## The Board

The Board will be established as an EU agency with separate legal personality and accountable to the Parliament, the Council and the Commission. It will be composed of:

- a) a Chair;
- b) four further full-time members; and
- c) a member appointed by each participating Member State representing the NRA.

The ECB, the Commission and the EBA are also able to participate as non-voting observers.

The executive session of the Board is composed of the Chair and the four full-time members. It also includes the representatives of the participating Member State(s) where the relevant entity or entities which are subject to the decision are situated. The executive session takes most of the executive decisions save where expressly conferred on the plenary session.<sup>9</sup> Decisions in executive session are to be taken by simple majority.<sup>10</sup>

All members participate in plenary sessions with each member having one vote. The matters set out in Article 46(1) are to be adopted in the plenary session. These include:

- decisions on the use of the Fund above €5bn (or €10bn for liquidity support) if a meeting is requested within 3 hours of the draft scheme;
- providing “guidance which the executive session shall follow” on further use of the Fund once the net accumulated use of the Fund reaches €5bn over the last 12 months; and
- setting ex post contributions to the Fund.

The general position is that a simple majority is required in the plenary session. However, on votes in relation to use of the Fund above €5bn, a simple majority representing at least “30% of contributions” to the Fund (presumably this refers to the majority including participating Member States where institutions contribute at least 30% of contributions to the Fund) is required and certain other decisions including ex-post contributions

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<sup>7</sup> Article 88(4). Certain powers to adopt delegated and implementing acts also apply from 1 November 2014.

<sup>8</sup> Article 88(6)

<sup>9</sup> Article 50

<sup>10</sup> Article 51

require a 2/3 majority representing at least “50% of contributions” during the 8 year transitional period and 30% of contributions thereafter.<sup>11</sup>

### **Resolution trigger**

The determination of whether an institution is failing or likely to fail will be made by the ECB after consulting the Board. However, the Board can make the determination if it notifies the ECB and the ECB fails to make a determination within 3 days.<sup>12</sup> The Board determines whether the other conditions for resolution are met.

### **Adoption of a resolution scheme**

When the conditions for resolution are satisfied, the Board is required to adopt a resolution scheme which determines the application of the resolution tools (including any discretionary exceptions from bail-in) and use of the Fund.

The scheme is generally set by the Board in its executive session. However, if the use of the Fund exceeds €5bn (or €10bn for liquidity support) then a plenary meeting can be called to vote on this within 3 hours of the draft scheme being proposed.<sup>13</sup>

The Board submits its scheme to the Commission. The Commission then has 24 hours to either endorse or object to the scheme. Within 12 hours of receipt it may propose to the Council:

- a) to object to the scheme on the ground that it does not meet the public interest criteria; or
- b) to approve or object to a material modification of the amount of the Fund provided for in the scheme.

The Commission may also object to the proposed scheme within the 24 hour period in respect of issues other than those under the remit of the Council. While the drafting is not entirely clear, the intent appears to be that if the Commission decides that the public interest criteria might not be met or that a material change should be made to the amount of the Fund to be used, these decisions must be put to the Council, but all other changes are within the remit of the Commission’s approval or rejection of the Board’s proposal.

Where the scheme is referred to the Council, the Council shall act by simple majority.

If no objection is raised within the 24 hour period following transmission of the scheme to the Commission, it will enter force. If the Council approves a modification under (b) above or the Commission has objected on other grounds, the Board is required to modify the scheme accordingly within 8 hours. If the Council objects on public interest grounds, the entity is required to be wound up under national law instead.

While this process remains unwieldy and has the potential to make resolution less effective, it is improved from the proposed mechanism under Council’s General Approach, with a reduced scope of the role of the Council and the plenary session of the Board.

### **Implementation of a resolution scheme**

Once a resolution scheme enters force, NRAs are required to take “all necessary measures” to implement it using their powers under national law transposing the BRRD.<sup>14</sup> This is clearer than in previous drafts and provides a simpler framework whereby the BRRD provisions are used by NRAs, but it gives rise to some questions around what happens if participating Member States transpose the BRRD in different ways.

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<sup>11</sup> Article 48

<sup>12</sup> Article 16

<sup>13</sup> Article 48

<sup>14</sup> Article 16(8). See also article 20 and 21 to 26.

One open issue is how detailed the resolution scheme will be and therefore the extent to which more detailed decisions will be centralised or left to NRAs. Article 6(5) also provides that where the Board takes a decision that is addressed to a NRA, the NRA has the right to specify further the measures to be taken. However, the Board has the power to issue further instructions relating to execution of the resolution scheme.<sup>15</sup>

In the event that the NRA does not comply with a decision by the Board or has applied it in a way that poses a threat to the resolution objectives or the efficient implementation of the resolution scheme, the Board has the power to direct an entity under resolution to transfer assets or liabilities to another person and/or require the conversion of any debt instruments which contain contractual conversion provisions and/or to take any other “necessary action”.<sup>16</sup>

## Funding

The SRM establishes the Fund which will replace national resolution funds for participating Member States. Contributions are to be raised by national authorities and transferred to the Fund pursuant to the IGA. The IGA will also include provisions on the use of the Fund. This note does not cover the terms of the IGA as this is still under negotiation.

The target level of the Fund is set at 1% of covered deposits of all credit institutions authorised in all participating Member States.<sup>17</sup> The target level is to be reached within 8 years from 1 January 2016 or when the Fund comes into effect, which is contingent on the IGA.

Ex ante contributions of each institution to the Fund are to be calculated pro-rata to the amount of its liabilities (excluding own funds) less covered deposits with respect to the aggregate liabilities (excluding own funds) less covered deposits of all the institutions authorised in all participating Member States.

The contribution is to include a flat contribution on the above basis and a risk-adjusted contribution based on the criteria set out in the BRRD and applying the relevant delegated acts under the BRRD.<sup>18</sup> However, the Council, acting on a proposal by the Commission shall adopt implementing acts to “determine implementation of the contributions assessment” under the SRM. It’s not particularly clear what the scope of the ITS will be.

Up to 30% of contributions can be met through irrevocable payment commitments backed by collateral.

A requirement was inserted for the Board to enter into a facility “including where possible public financial arrangements” but this stopped short of the Parliament’s call for a public backstop.<sup>19</sup>

Use of the Fund is generally aligned with the use of resolution funds under the BRRD. The SRM provides for the Commission to assess whether use of the Fund is appropriate replicating the state aid rules.<sup>20</sup> This was necessary due to doubt as to whether use of the Fund would technically constitute state aid. However, this is subject to the power of the Council to act unanimously to overrule the Commission’s decision.<sup>21</sup>

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<sup>15</sup> Article 25(2)

<sup>16</sup> Article 26(2)

<sup>17</sup> Article 65

<sup>18</sup> Article 66

<sup>19</sup> Article 69a

<sup>20</sup> Article 16a

<sup>21</sup> Article 16a(10)

## Relationship with the BRRD

The Council, the Commission and the Board are expressly subject to RTS and ITS and any guidelines and recommendations issued by the EBA. The Board is also subject to any binding mediation decisions under Article 19 of the EBA Regulation.<sup>22</sup>

However, the SRM notably diverges from the BRRD in a number of respects, for example:

- a) It adds a cap on the level of the minimum requirement for eligible liabilities (“MREL”) by reference to the amount sufficient to ensure that losses could be absorbed and the group recapitalised which was not included in the BRRD.<sup>23</sup> As previously discussed, this is one of several criteria to be considered when assessing MREL under the BRRD<sup>24</sup>, but is changed to a cap under the SRM. Neither text elaborates on the level of losses that should be assumed in this provision.
- b) Article 44(8) of the BRRD which permits use of resolution funds where losses of 20% of RWAs have been imposed is not replicated under the SRM.
- c) The target level of the Fund is to be reached within 8 years rather than 10 for national resolution funds under the BRRD, although the latter is 10 years from 1 January 2015, commencing at least a year earlier than the Fund.
- d) The basis for assessing contributions to the Fund is different from the basis for contributions to national resolution funds under the BRRD. In particular the assessment base is by reference to the liabilities of all institutions in participating Member States rather than the relevant national Member State and there is a separate flat contribution and a risk adjusted contribution to the Fund as opposed to all contributions being subject to a risk adjustment under the BRRD.

It is also unclear how the government stabilisation tools under the BRRD apply within the SRM context.

## Cross-border cooperation

The SRM provides for the Board to represent NRAs for the purposes of consultation and cooperation with non-participating Member States under the relevant BRRD provisions.<sup>25</sup>

The Board is required to enter into memoranda of understanding with the resolution authorities and competent authorities of non-participating Member States. It is also required to conclude non-binding cooperation agreements in line with the EBA framework cooperation agreements under the BRRD.

The Board also assesses the recognition and enforcement of third country resolution proceedings in participating Member States and issues a recommendation to NRAs. NRAs are not bound to follow the recommendation but if they do not do so they are required to explain why they “cannot” implement the recommendation.<sup>26</sup>

The SRM therefore should reduce the cross-border issues both within the Banking Union and with non-participating Member States and third countries.

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<sup>22</sup> Article 4

<sup>23</sup> Article 10(2b)

<sup>24</sup> See Article 45(6) of the BRRD.

<sup>25</sup> Article 30

<sup>26</sup> Article 31

## **Additional powers**

The Board has rights to information from the ECB, national competent authorities and national resolution authorities. It also has the power to require banks, their employees and third parties to whom they have outsourced functions or activities to provide information necessary to carry out its functions.<sup>27</sup>

The Board has the power to conduct investigations<sup>28</sup> and on-site inspections.<sup>29</sup> It also has the power to issue fines.<sup>30</sup>

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<sup>27</sup> Article 32

<sup>28</sup> Article 33

<sup>29</sup> Article 34

<sup>30</sup> Article 36

## Appendix

### SRM Level 2 items<sup>31</sup>

No.	Article	Topic	Type	Description/relevant text	Deadline
1.	16a(8)	Sanctions for failure to comply with state aid decision	Commission delegated acts	Delegated acts concerning detailed rules of procedure concerning: (a) the calculation of the interest rate to be applied in case of a recovery decision in accordance with paragraph 5 [of Article 16a], (b) the guarantees of the rights to good administration and the right of access to documents referred to in paragraph 5[of Article 16a].	None specified (power not an obligation).
2.	62(5)	Contributions to administrative expenses	Commission delegated acts	Delegated acts in order to: (a) determine the type of contributions and the matters for which contributions are due, the manner in which the amount of the contributions is calculated, the way in which they are to be paid; (b) specify registration, accounting, reporting and other rules referred to in Article 62(3) necessary to ensure that the contributions are fully and timely paid; and	None specified

<sup>31</sup> Based on the provisional version of the text approved by the Parliament on 15 April 2014, prior to the jurist linguist process.

No.	Article	Topic	Type	Description/relevant text	Deadline
				(c) determine the annual contributions necessary to cover the administrative expenditure of the Board before it becomes fully operational.	
3.	65(5)	Contributions to the Fund	Commission delegated acts	Delegated acts to specify the following: (a) criteria for the spreading out in time of the contributions to the Fund calculated under Article 65(2); (b) criteria for determining the number of years by which the initial period referred to in Article 65(1) can be extended under Article 65(3); and (c) criteria for establishing the annual contributions provided for in Article 65(4) (further contributions after the target level has been met).	None specified (power not an obligation). Power to adopt delegated acts applies from 1 November 2014
4.	66(3a)	Contributions to the Fund	Council implementing acts	The Council, acting on a proposal from the Commission, shall, within the framework of the delegated act referred to in Article 66(3), adopt implementing acts to determine the conditions of implementation of paragraphs 1, 1a, and 2 [of Article 66], and in particular in relation to: (a) the application of the methodology for the calculation of individual contributions; (b) the practical modalities of allocating institutions to the risk factors specified in the delegated act.	None specified. Power to adopt delegated acts applies from 1 November 2014

No.	Article	Topic	Type	Description/relevant text	Deadline
5.	67(3)	Exemption from ex post contributions	Commission delegated acts	Delegated acts to specify the circumstances and conditions under which an entity may be partially or entirely exempted from ex post contributions under paragraph 2 of Article 67.	None specified (power not an obligation). Power to adopt delegated acts applies from 1 November 2014
6.	70(4)	Administration of the Fund	Commission delegated acts	Delegated acts on the detailed rules for the administration of the Fund and general principles and criteria for its investment strategy.	None specified (power not an obligation).

## Reviews

No.	Article	Topic	Type	Description/relevant text	Deadline
1.	83(1)	General review	Commission review	The Commission shall publish a report on the application of this Regulation, with a special emphasis on monitoring the potential impact on the smooth functioning of the internal market. That report shall evaluate a number of issues set out in Article 83.	By 31 December 2018 and subsequently every three years thereafter
2.	83(2a)	General review	Commission review	When the review of the BRRD is undertaken, the Commission is invited to put forward, as appropriate, a corresponding review of the SRM regulation.	It isn't entirely clear which review of the BRRD this refers to but there is a general review of the BRRD to be completed by 1 June 2018.