
Initial Position Paper on the Commission's proposal for a Single Resolution Mechanism

25th September 2013

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

In this position paper AFME and its members wish to set out some initial views on a number of key aspects of a Single Resolution Mechanism (SRM) and more generally on the issue of recovery and resolution within banking union.

Since the launch of the banking union project, we have taken the view that a separation of the jurisdictional scope of supervisory and resolution arrangements within the SSM could give rise to significant inconsistencies that would create systemic weaknesses.

We thus strongly welcome the work that has been done to develop a single resolution mechanism to operate alongside the Single Supervisory Mechanism (SSM) within banking union, on the basis that supervision and resolution need to be exercised by the same level of authority. This is necessary to avoid tensions between the two levels which could undermine the effectiveness of both supervision and resolution and distort competition in the Single Market.

AFME and its members support the establishment of a resolution mechanism with centralised decision-making power throughout the banking union within a timeframe that supports a strongly integrated single supervision mechanism and avoids discontinuities between supervision and resolution. A single resolution mechanism represents a key corollary to the SSM, and should be fully supportive of the implementation of high-quality and effective supervision. To achieve this, the resolution mechanism should be coordinated with a fully integrated approach to supervision and its relationship with the supervisory arrangements (SSM/ECB) needs to be efficient and optimally structured.

It goes without saying, that the SRM should be established on the basis of high levels of legal certainty. Legal certainty is necessary to achieve the objectives of the BRRD in creating an effective recovery and resolution framework which will enable firms to be resolved with shareholders and creditors bearing losses and avoiding taxpayer bail-outs.

Potential benefits of a strong single resolution mechanism

AFME takes the view that a single resolution mechanism will provide a more efficient and effective resolution regime for the banking union, with more certainty regarding cross-border decision making and greater predictability on the approach to early intervention and resolution.

The resolution mechanism, together with the SSM, is essential to reverse recent trends towards single market fragmentation, ring-fencing and the potential for inefficient capital or loss absorbing capacity requirements in different jurisdictions due to a lack of trust amongst home and host authorities.

Importantly, the single resolution mechanism 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 field within the Banking Union and, indeed, the wider single market, thus supporting economic recovery.

In terms of scope, AFME supports proposals for the single resolution mechanism to cover all banks in the SSM – this is in line with the powers granted to the ECB to assume direct supervision of any bank in the SSM in case of problems. This also ensures consistency between SSM and SRM's structures and operating models.

The importance of centralised decision-making

AFME takes the view that centralised resolution decision-making can bring tangible benefits, provided that the process is designed to ensure that those benefits can be achieved in practice.

It is very important that resolution decisions can be made decisively and in a short space of time in order for resolution to be effective. Moreover, centralised resolution decision-making should reduce the prospects for uncoordinated, inconsistent or inefficient decision-making by participating Member States with respect to cross-border groups. This would assist efficient cross-border resolution within the SRM, removing home/host issues. It would also enhance consistency related to recovery and resolution planning and to decisions around resolvability assessments and the minimum requirements for eligible liabilities (MREL). On the latter, clarity will be needed between the SRM and the SSM/ECB on how the assessment of MREL will be conducted. The proposal would also benefit from clarification that the role of national resolution authorities of participating Member States would be limited to that set out in the legislation. While Article 5(1) appears to imply this, the wording should not leave any room for doubt on such a key issue.

Importantly, a supranational body taking resolution decisions is essential in breaking the sovereign bank nexus. If established effectively, this body should not be susceptible to national pressures, thus improving consistency in the application of resolution tools and confidence in the process.

From an operational perspective, centralised resolution decision-making should increase the efficiency of resolution, reducing costs and uncertainty as to the resolution strategy that

would be taken by enabling institutions and investors to deal with a single resolution authority across the banking union.

BRRD principles to underpin the SRM

AFME and its members believe that the SRM should apply the resolution powers and safeguards which are established under the BRRD and apply to the EU as a whole. The BRRD should thus underpin the SRM to ensure a level playing field throughout the EU, with the SRM acting in place of national resolution authorities within banking union. AFME has been heavily engaged in the BRRD negotiations and produced a recent paper setting out our positions ahead of the trilogues.

These include the following:

- We are opposed to the use of resolution funds to absorb losses in place of creditors, which creates moral hazard and undermines the key objectives of shareholders and creditors bearing losses and instilling market discipline;
- Greater flexibility is required in the proposed minimum requirement for eligible liabilities (MREL) so that it can be applied appropriately to different group resolution plans and it can support both SPE and MPE resolution strategies. Amendments are also required to the basis for assessing MREL;
- Greater clarity is required to apply the BRRD provisions to cross-border groups operating in third countries and strengthen cross-border cooperation.

Regarding resolution funding, we believe that any Single Resolution Fund should mirror the minimum funding levels, purposes and uses of national resolution funds under the BRRD. Cumulative effects should be avoided. Such fund should not be used to absorb creditors' losses in any circumstance, vitiating the need for a large ex ante fund. Moral hazard arising from the mutualisation of losses (other than to insured depositors) should be eliminated at all costs. We thus warn that the additional general purpose in Article 64(2) of the SRM proposal could lead to divergences in use. Ensuring that resolution funds, and therefore any Single Resolution Fund, cannot be used to absorb creditors' losses would also reduce concerns around mutualising the losses of creditors in other Member States and absorbing losses arising from "legacy assets". Such assets should be dealt with in advance of the SRM coming into effect. It would also reduce the potential for different approaches to creditor participation between banks within the SRM and those in non-participating Member States, supporting a level playing field within the Single Market.

While the SRM text tracks the BRRD in terms of ex ante resolution fund contributions being tailored to the risk profile of a given bank, the explanatory text suggests that deposit-funded banks would be risk- (and thus contribution-) free, which takes insufficient account of the asset-side risk of bank business models and therefore misrepresents the full systemic risk that an institution could pose.

There should also be transparency in relation to the funding, investment and use of the fund to increase its accountability.

We are supportive of the proposed obligations on the Resolution Board and national resolution authorities to cooperate in good faith and exchange information, provided that confidentiality is maintained. We also welcome proposals for the Resolution Board to enter into cross-border cooperation agreements with third countries. To further assist cross-border resolution, the Resolution Board should also 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 enter into institution-specific cross-border cooperation agreements on behalf of national resolution authorities of participating Member States.

In line with the above principles, and on the basis of our analysis of the Commission's SRM proposal, we would welcome clarifications on the proposed changes to the creditor hierarchy when applying the bail-in tool referred to in Article 15. The hierarchy of claims when applying the bail-in tool should reflect the creditor hierarchy in insolvency, as recognised in the BRRD. The hierarchy should be the same for all resolution tools. While undermining consistency, any divergences would also give rise to constraints due to the principle that no creditor shall be worse off than in liquidation

Finally, from a single market perspective, AFME takes the view that it is important that the EBA maintains its role and powers in resolution, including mediation, vis-a-vis the SRM and in the framework of the single market for financial services as a whole. The same should apply as regards the EBA's role in supervision vis-a-vis the SSM.