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Rosalind Z. Wiggins  
*Yale School of Management*

Michael Wedow  
*European Central Bank*

Andrew Metrick  
*Yale School of Management*

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European Banking Union B: The Single Resolution Mechanism

Rosalind Z. Wiggins
Michael Wedow
Andrew Metrick

Yale Program on Financial Stability Case Study 2014-5A-V1
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Abstract

The options available to European governments to respond to a multinational bank in financial trouble have been severely limited since each country has its own unique laws and authority applicable to banks operating within its borders. The Bank Recovery & Resolution Directive (BRRD), which was adopted in 2013 and scheduled to go into effect January 2015, harmonizes rules across EU countries for how to restructure and resolve failing banks. However, the directive would maintain the existing system of individual national resolution authorities and resolution funds. To better secure the Eurozone banks and to compliment the Single Supervisory Mechanism, which was enacted in April 2014, the European Parliament approved the Single Resolution Mechanism (SRM). The SRM establishes a Single Resolution Board and a single Resolution Fund that will handle bank failures in all EU countries participating in the SSM. This case reviews the changes in Eurozone bank resolution resulting from the BRRD and the SRM.

1 This case study is one of four by the Yale Program on Financial Stability (YPFS) considering the European Banking Union, other cases are:
   • European Banking Union A: The Single Supervisory Mechanism
   • European Banking Union C: Cross-Border Resolution—Fortis Group
   • European Banking Union D: Cross-Border Resolution—Dexia Group
Cases are available from the Journal of Financial Crises.

2 Director, The Global Financial Crisis Project and Senior Editor, Yale Program on Financial Stability.

3 Principal Expert, European Central Bank, Directorate Financial Stability, Financial Services Policy Division. This co-author’s contribution represents his personal opinions and does not necessarily reflect the views of the European Central Bank or its staff.

4 Janet L. Yellen Professor of Finance and Management, and YPFS Program Director, Yale School of Management.
1. Introduction

On April 15, 2014, the European Parliament, responding to the challenges posed by the deterioration of numerous banks during the global financial crisis of 2007-09 and the sovereign debt crisis, which began in late 2009, adopted the Single Resolution Mechanism (SRM) providing for a super-national resolution of banks in participating member states.

Since the founding of the EU, many European banks have taken advantage of the EU single market and the common euro currency, used in 18 of the 28 EU member states, to expand their operations beyond their home countries. However, in 2008, bank supervision was still undertaken at the national level, leading to a hodgepodge of varying rules across the EU. Additionally, the options available to European governments to respond to a multinational bank in financial trouble remained limited by these laws and the relationship between governments and the banks located within their borders. The risks posed by these limitations were illustrated by the collapse of the Belgian-Dutch bank Fortis Group N.V./SA in 2008 and the difficulties surrounding Franco-Belgian bank Dexia Group, SA, which was first bailed out in 2008 and then taken into receivership in 2011.5

As a result, beginning in 2011, the EU adopted several reforms to bank regulation and then, determining that additional structural reforms were required to protect the euro, established a common banking union for all the member states, the European Banking Union.6

On November 3, 2013, the Single Supervisory Mechanism (SSM) was enacted, providing that as of November 4, 2014, the European Central Bank (ECB) would become the supervising authority for all 6,000 banks in the Eurozone (though the National Supervising Authorities [NSAs] continued to play a significant role). In light of the SSM, it became even clearer that it would be inconsistent to have the supervision of Eurozone banks be centralized at the European level while resolution of such banks remained decentralized at the national level, lest a situation arise where an SSM-supervised bank was to be resolved by its various NSAs.

To respond to this dilemma, in April 2014 the European Parliament adopted regulations establishing the SRM to govern resolution of all banks subject to the SSM (i.e., banks located in the Eurozone and in any member state opting into the SSM). The SRM established a Single Resolution Board (SR Board) to oversee resolutions and a Single Resolution Fund (SR Fund) to finance such resolutions. As with the SSM, however, the national resolution authorities (NRAs) would continue to play a major role under the SRM.

Pursuant to the SRM, the SR Board was to implement in the Eurozone the Bank Recovery and Resolution Directive (BRRD)—adopted by the European Parliament in April 2014—which

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6 The European Banking Union encompasses (1) Single Supervisory Mechanism (SSM), (2) Single Rulebook, (3) Deposit Guarantee Scheme, and (4) Single Resolution Mechanism and Common Resolution Fund (European Commission Memo 12/656).
established uniform rules for how failing banks throughout the entire EU were to be restructured and resolved. The BRRD made a significantly enhanced variety of resolution tools uniformly available across the EU, and shifted the costs of funding resolutions from the national governments and taxpayers to the bank shareholders and the banks themselves. These changes were intended to break the cycle of debilitation between banks and their sovereign governments that saw the financial stability of several countries seriously weakened during the crises.

This case will provide participants with an understanding of the SRM and enable them to examine the purposes of the BRRD and SRM, and to consider whether the structure of the SRM fulfills its stated purposes. The rest of this module is organized as follows. Section 2 describes the harmonized EU resolution regime of which the SRM is a part. Section 3 describes the components of the SRM. Section 4 addresses the SR Board. Section 5 explains the resolution tools available. Section 6 describes how the resolution process is initiated, and lastly, Section 7 discusses the SR Fund.

Questions

1. How “singular” is the SRM?
2. Why is the SRM needed in addition to the BRRD?
3. What are the strengths and weaknesses of the SRM?
4. How likely is the multistep resolution approval process to be effective in the midst of a real-time crisis?
5. Is the projected size and schedule for funding the SR Fund optimal for its purpose?
6. How will bank failures be handled during the transition period before the SR Fund is fully funded?
7. Will the SRM help to break the negative feedback loop between sovereign debt and banking debt of EU member states, and if so, how?

2. The Harmonized EU Resolution Regime

The harmonized EU resolution regime has been achieved through the congruence of three EU initiatives: (1) the BRRD, which set out a new framework for bank recovery and resolutions for EU banks and was applicable to all banks in all member states, (2) the SRM, which implemented the BRRD in the Eurozone and, (3) the Single Resolution Fund, which

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7 The NRAs of individual member states not in the Eurozone and thus not subject to the SRM would continue to be responsible for implementing the new rules, and the funding of such resolutions would remain at the national level.
shifted the cost of resolving failing banks from the taxpayers onto the shareholders and the banks themselves.

The BRRD required each member state to establish a National Resolution Authority (NRA), which could be done by granting these powers to an existing supervisory authority, and a national resolution fund (The BRRD was also incorporated into the Single Rule Book, which is the compendium of the harmonized banking rules applicable to all EU member states). The NRAs were responsible for the functions and the tasks relating to the resolution under the BRRD in those member states not subject to the SRM. Bank resolutions not subject to the SRM and overseen by an NRA were to be funded by the respective national resolution fund.

**The European Banking Union**

As the financial crisis evolved into the sovereign debt crisis, it became clear that additional actions were needed to place the Eurozone’s banking sector on a sounder footing and restore confidence in the euro. In June 2012, a proposal was floated to create a Banking Union to ensure common implementation of the new banking standards in the Eurozone. As illustrated in Figure 1, the three^{8} pillars of the Banking Union are (1) the Single Supervisory Mechanism, providing for the centralized supervision of banks in the Eurozone by the ECB, (2) the Single Resolution Mechanism, providing for centralized resolution of banks in the Eurozone and a Common Resolution Fund, and (3) Harmonized Deposit Guarantee Schemes, providing greater support for Eurozone depositors (See European Commission (2012) for further discussion of the Banking Union).

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^{8} The Single Rulebook has, at times, also been referred to as a pillar of the EU banking reform.
3. The SRM and its Components

Within the SRM, the BRRD applies to the participating member states. Furthermore, the SRM is closely aligned with the SSM in that it creates a regulatory continuum. In the case that an entity or group supervised in a uniform manner under the SSM starts to deteriorate, the SRM ensures that it would also be resolved on a centralized basis.\(^9\)

The SRM established a new European agency, the SR Board, to be the authority responsible for implementing and enforcing the terms of the BRRD with respect to all entities that fall under the SSM (SRM Regulation, Article 2). As illustrated by Figure 2, the SR Board is at the center of the SRM system, which also includes NRAs that will continue to play a role in resolving certain banks. Effective operation requires close cooperation with the ECB and the National Supervising Authorities. The SR Board is also charged with establishing and administering the SR Fund (Ibid., Article 64).

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\(^9\) See the European Commission proposal to establish the SRM, which includes the legislative history and further discusses this point (SRM Regulation Proposal).
Entities Covered by the SRM

The SRM applies to:

- Credit institutions established in a participating member state
- Parent undertakings, including financial holding companies and mixed financial holding companies, established in a participating member state, if they are subject to consolidated supervision by the ECB
- Investment firms and financial institutions established in a participating member state, if they are subject to consolidated supervision by the ECB

Specifically, the SR Board is responsible for the resolution of:

- The 120 systemically important bank groups, deemed “significant” under the SSM
- Approximately 200 cross-border banks that operate in more than one member state
- Any resolution involving use of the SR Fund

Similar to terms of the SSM, the NRAs are responsible for resolution of other banks subject to the SRM. However, at any time, the SR Board can assume direct responsibility for any such entity. A member state can also opt to have the SR Board exercise direct responsibility over all of its banks by submitting to supervision under the SSM. Framers of the SRM intended that all banks in the EU be subject to the terms of the BRRD and all resolution authorities have the same resolution tools, thereby resulting in a harmonized and unified system of bank resolution. Having resolution decisions regarding banks in the Eurozone decided by the SR Board, which can effectively address systemic and cross-border issues, also furthers this objective. The required resolution funds are intended to shift the burden of bailing out banks from the taxpayers to the banks’ shareholders and to the banks themselves.
As with the SRM, non-European banks are not governed by the SRM, although their branches located in the EU continue to be governed by their applicable NRA, which applies the harmonized rules under the BRRD and has the tools specified therein available to it.

Provisions of the SRM relating to the preparation of resolution plans, the collection of information, and national cooperation became effective as of January 1, 2015. The remaining provisions, including those relating to early intervention, resolution planning, and resolution actions, become effective January 1, 2016.

4. The Single Resolution Board and Decision Making

The SRM established a new EU agency located in Brussels, the SR Board, which is responsible for implementing the SRM. The board is comprised of:

- A chair
- Four independent, full-time members who shall act in the interest of the EU as a whole (permanent members)
- Two permanent observing members, one appointed by each of the ECB and the Commission (collectively the observing members)
- A member appointed by each member state subject to the SRM representing its NRA

The SR Board operates in two types of sessions, executive and plenary. As discussed below and shown in Figure 3, each member including the chair has one vote (excluding observing members).

**Executive Sessions**

Generally executive sessions are composed of the chair, permanent members, and observing members, with decisions being made by a simple majority of members entitled to vote. When deliberating on the resolution of a bank or group, however, the executive session also includes the SR Board members appointed by the member states that are directly involved in such resolution (i.e., where the group-level country and any subsidiary or entity covered by consolidated supervision is established). If the participating members are not able to reach a consensus agreement by the deadline set by the chair, the chair and the permanent members decide by a simple majority (SRM Regulation, Article 53 and 55).

**Plenary Sessions**

All SR Board members participate in plenary sessions, which are held at least two times a year. When deciding issues of a general nature, such as the annual work plan or budget, or rules of procedure, action is by simple majority vote. The chair casts the deciding vote in case of a tie.
Whenever a resolution scheme requires more than €5 billion (€10 billion in liquidity support) from the SR Fund, any member of the plenary may request (within strict deadlines) that the plenary session decide the matter instead of the executive session. In such cases, a simple majority vote that represents at least 30% of SR Fund contributions is required.

**Figure 3: Single Resolution Board Decision Making**

<table>
<thead>
<tr>
<th>Type of Session</th>
<th>Composition</th>
<th>Voting</th>
<th>Duties</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Executive A</strong></td>
<td>Chair, permanent members, observing members.</td>
<td>All except observing members have one vote.</td>
<td>Matters not involving the resolution of a bank.</td>
</tr>
<tr>
<td><strong>Executive B—Resolution of entity or group located in a single member state</strong></td>
<td>Chair, permanent members, observing members and representatives from the member states where the entity or group is located.</td>
<td>All except observing members have one vote. Chair and permanent members can decide by simple majority vote if decision deadline is not met by larger group.</td>
<td>Prepare all decisions considering resolution procedure and adopt those decisions.</td>
</tr>
<tr>
<td><strong>Executive C—Resolution of a cross-border group (an entity or group located in more than one member state)</strong></td>
<td>Chair, permanent members, observing members and representatives from the member states where the entity or group is located.</td>
<td>All except observing members have one vote. Chair and permanent members can decide by simple majority vote if decision deadline is not met by larger group.</td>
<td>Prepare all decisions considering resolution procedure and adopt those decisions.</td>
</tr>
<tr>
<td><strong>Plenary Session</strong></td>
<td>Chair, permanent members and representatives from all member states participating in the SSM/SRM.</td>
<td>All except observing members have one vote, and a simple majority is decisive, except that when a decision is regarding use of the SR Fund, a simple majority vote that represents at least 30% of SR Fund contributions is required.</td>
<td>Meets at least twice a year. Handles issues of general nature: annual work program, budget, rules of procedure. Upon specific request from any plenary member (within strict deadlines), decides on resolution schemes that require use of the SR Fund in excess of €5 billion (or €10 billion in liquidity support). Decides issues re: the raising of ex post (future) contributions from banks, voluntary borrowing between financing arrangements, alternative financing means, and mutualization of national financing arrangements.</td>
</tr>
</tbody>
</table>

*Source: SRM Regulation.*
5. The Resolution Toolkit

The SRM vests in the SR Board authority to implement certain terms of the BRRD in the Eurozone and requires a close integration with the ECB under the SSM. The BRRD is intended to ensure that resolution authorities have a common set of useful tools available to resolve any bank that fails, particularly in the case of cross-border bank failures. Implementation by the SRM ensures that cross-border and systemic banks are resolved in a manner that takes into consideration their unique characteristics and potentially broad impacts.

The tools available under the BRRD are divided into three categories: resolution planning, early intervention powers, and resolution.

Resolution Planning

The SRM requires the SR Board to draft resolution plans and to adopt all decisions relating to resolution for the entities and groups that are under direct ECB supervision (pursuant to the SSM) and all cross-border groups. Each resolution plan must describe how the SR Board or NRA would resolve the entity in the event of financial deterioration (including systemic instability scenarios) by applying the resolution tools and utilizing the SR Fund.

Plans must be drafted at the entity and group level. The plans are to be drawn up in consultation with the bank’s supervisor and the NRA in the member state in which the bank is located. EU-based subsidiaries of non-EU entities are also required to have a plan. See Appendix A for details of what elements are to be included in the resolution plan.

If the SR Board identifies an impediment to resolution, the board has the authority to request the entity to change its legal or operational structures to ensure that it can be resolved with the available tools in a manner that does not compromise critical functions, threaten financial stability, or involve costs to the taxpayer (See SRM Regulation, Articles 8, 10 for more on resolution planning.).

The Early Intervention Powers

Under the BRRD, when a bank’s financial condition deteriorates so that it fails to meet, or is likely to fail to meet, its regulatory capital requirements, supervisory authorities (the ECB or NSA, as applicable) may exercise certain early intervention powers. These powers include requiring the bank to:

- Undertake any of the steps set out in its recovery plan (required under the SSM)
- Draw up an action program and a timetable for its implementation
- Hold a shareholders’ meeting to adopt emergency steps
- Draw up a plan for restructuring its debt with its creditors

The supervisor may also appoint a special manager to restore the financial condition of the bank. The supervisor has sole responsibility with regard to early intervention measures.
However, the ECB or other supervisory authority must notify the SR Board when it exercises any early intervention power against a bank. Upon receiving such notice, the board shall notify the European Commission and may begin to make preliminary plans for the bank’s resolution. The ECB or the relevant NSA shall provide the SR Board with all of the information necessary in order to update the bank’s resolution plan and prepare for the possible resolution of the institution and for valuation of its assets and liabilities.

**Resolution Powers and Tools**

In the event that the financial condition of an entity or group is deteriorating, and corrective intervening actions do not arrest the decline, resolution may be initiated pursuant to the SRM (See Initiating the Resolution Process below.). Resolution authorities have the power to take over a bank that is failing, to take over decision-making authority from the bank’s shareholders and managers, to transfer assets and liabilities, and to amend, close out, and terminate contracts. Resolution authorities have a number of specific tools at their disposal.

**Sale of part of the business.** Resolution authorities would be able to sell all or parts of the failing bank. The sale would have to be on commercial terms, but the consent of shareholders would not be required.

**Establishment of a bridge institution.** Resolution authorities could establish a publicly controlled entity and transfer instruments, assets, rights and liabilities of the failing bank to it in order to ensure continuity of critical functions and avoid significant adverse effects on financial stability until a sale of the business can be conducted. The value of liabilities transferred cannot exceed the value of assets and rights transferred or provided from other sources. The new entity would have to be licensed and comply with bank capital requirements and would operate as a commercial concern until market conditions enable it to be sold, in whole or parts, to a private sector purchaser.

**Asset separation tool.** Resolution authorities would be able to transfer impaired assets of the failing bank into an asset management vehicle where they can be wound down over time. It is intended that this tool only be used as a supplement to the others.

**The bail-in tool.** Resolution authorities would be able to write down or convert into equity the claims of a broad scope of creditors.\(^{10}\) Claims that are client-related and employee-related, are excluded from bail-in. Others claims may be excluded by the authorities, for example, if it is not possible to bail them in within a reasonable time. However, in order to prevent this flexibility from being used to shield creditors from losses, the SR Fund cannot

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\(^{10}\) “Under the BRRD, the order in which the creditors subject to the bail-in would be affected is: subordinated liabilities, unsecured and non-preferred liabilities, eligible deposits from natural persons and micro-, small- and medium-sized enterprises, and finally, the applicable deposit guarantee scheme (DGS). The DGS would step in and make the contribution for covered deposits (i.e., eligible deposits up to €100,000) if needed, given that covered deposits are excluded from bail-in” (ECB 2014, 45).
be used to cover for excluded liabilities until an amount of at least 8% of the total liabilities, including own funds, of a bank have been bailed in (ECB 2014, 45-6).

The bail-in provision is designed to shift the financial burden of resolving failing banks from the taxpayers to the banks’ shareholders and creditors (bail-in) and then to the banks themselves (the fund) (European Commission Memo 14/295). The tool permits the authorities to mimic a bankruptcy in that creditors’ claims may be reduced or they may have their claim converted to equity, thus reducing the total liabilities of the bank, and presumably the amount taxpayers would have to pay to support it.

6. Initiating the Resolution Process

If the preventive and early intervention measures fail to stem the deterioration of a bank, the resolution powers may be invoked by the SR Board or NRA, as applicable. A bank may only be put into resolution if the following conditions are met:

- The entity is failing or is likely to fail;
- Having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector measures or supervisory action, including early intervention measures, would prevent its failure within a reasonable timeframe; and
- A resolution action is necessary in the public interest.

Due to the extraordinary nature of a decision to resolve a bank, the SRM employs a decision-making process that is intended to be both thorough and quick. Under the SRM, the determination to initiate the resolution process lies initially with the ECB, which shall make an assessment of whether a bank is failing or is likely to fail after consulting with the SR Board. If the ECB assesses that the bank is failing or is likely to fail, it shall immediately communicate that assessment to the Commission and to the SR Board. As shown in Figure 4, for some smaller banks, which would not require tapping the SR Fund, the NRA rather than the ECB would be the initiating authority.
Figure 4: How the SRM Allocates Resolution Authority

<table>
<thead>
<tr>
<th>Type of Bank</th>
<th>Resolution Planning</th>
<th>Resolution</th>
<th>Responsible Entity</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Significant” bank supervised directly by ECB</td>
<td>SR Board</td>
<td>SR Board</td>
<td>SR Board, but NRA implements the resolution scheme under SR Board direction.</td>
</tr>
<tr>
<td>Cross-border bank/group</td>
<td>SR Board</td>
<td>SR Board</td>
<td>SR Board, but NRA implements the resolution scheme under SR Board direction.</td>
</tr>
<tr>
<td>All other banks/SR Fund to be used</td>
<td>NRA</td>
<td>SR Board</td>
<td>SR Board, but NRA implements the resolution scheme under SR Board direction.</td>
</tr>
<tr>
<td>All other banks/SR Fund not to be used</td>
<td>NRA</td>
<td>NRA</td>
<td>NRA</td>
</tr>
</tbody>
</table>

*Source: Project Editor Notes.*

Given its macroprudential oversight role, if the SR Board believes that a bank is failing or about to fail, it shall notify the ECB of its intention to make such a determination. If the ECB does not make such an assessment within three days of receiving notification from the SR Board, the board may make such an assessment in its executive session. The ECB shall immediately provide the SR Board with any relevant information that the board requests in order to inform its assessment.

Following a finding by the ECB or the SR Board that point (a) has been met with respect to an entity, an assessment of the condition referred to in point (b) shall be made by the SR Board, in its executive session, or (where applicable) by the NRAs, in close cooperation with the ECB. The ECB may also inform the Board or the NRAs concerned that it considers the condition of point (b) to be met.

If the SR Board finds that the three conditions set forth above are met, it shall adopt a resolution scheme and immediately transmit the same to the Commission. The resolution scheme will become effective upon the earlier of: (i) it is approved by the Commission, or (ii) there are no objections from the Council or the Commission within 24 hours after its adoption by the SR Board. According to the ECB:

The Council becomes involved in the decision making only at the explicit request of the Commission. Within 12 hours of the transmission of the resolution scheme [from the SR Board], the Commission may propose to the Council to object to the resolution scheme. The grounds on which the Council may object to the resolution scheme are strictly limited to the existence of a public interest and to material modifications by the Commission of the amount of the use of the SR Fund as proposed by the SR Board. The Council should, within 24 hours from the transmission of the resolution scheme by the SR Board, either approve the scheme or object to the Commission’s proposal by a simple majority decision, without amending it. The Council or the Commissions
shall provide reasons for the exercise of their power of objection. The SR Board shall within eight hours modify the resolution scheme accordingly and instruct the national resolution authorities, which should take all necessary measures to implement the resolution scheme. This implies that a resolution decision can be made over a weekend, even when a scheme is modified by the Commission/Council.” (ECB 2014, 43)

See Appendix B for more detail regarding the resolution initiating process.

7. The Single Resolution Fund

The Bank Sovereign Loop

European banks have traditionally held significant amounts of their home countries’ sovereign debt. The sovereign debt crisis, however, focused attention on the possible negative consequences of this close relationship. As banks encountered troubles, their host country governments were forced into bailing them out to avoid collapse. As the sovereigns struggled to raise monies to support distressed banks, their credit ratings suffered, and foreign investors retreated. The governments then relied even more on their domestic banks—often the very banks that they were rescuing—to buy up their debt and fund their budget deficits, some of which were enormous, given that in some cases the banking sector that the government was trying to rescue exceeded the country’s GDP by several factors.

Given banks’ significant holdings of the debt of their home sovereign governments, however, the impairment of the government debt impacted the banks’ stability and, in many cases, created a need for additional government assistance. The weakened rating of the sovereign impacted its ability to raise funds, causing further downward pressure on its debt. These impacts then spilled over to the banks that held sovereign debt, pressuring them to mark to market and raise additional capital (See Figure 5)\(^{11}\).

Several member states, such as Belgium, Ireland, Cyprus, Portugal, Italy, Greece, and Spain experienced severe trauma to the sovereigns as they struggled to support their banking sectors. This tight correlation of sovereigns and their home banks has been criticized by many commentators, including Chairman of the European Banking Authority, Andrea Enria, who in 2011 termed this situation a “dangerous feedback loop” (Enria 2011).

\(^{11}\) One reason for this national concentration is that sovereign debt has been excluded from the risk weighting that applied to other assets for purposes of calculating bank capital requirements under Basel II and III. Thus, banks could take on unlimited amounts of sovereign debt without increasing capital to support it, which although not impacting their capital requirements, did impact their liquidity. As a result, many European banks held high amounts of sovereign debt. However, it should be noted that the capital requirements treated all EU sovereign debt the same, so concentrations in home country debt are not totally explained by this.
National Resolution Funds Required

The BRRD requires that each member state establish a national resolution fund to receive contributions from banks and financial institutions in their respective member state to provide for the cost of resolving an entity or group (A member state may also make other financing arrangements rather than establish a fund.). Along with the bail-in provisions of the BRRD, the resolution funds are a critical element in breaking the feedback loop between sovereigns and banks. It is designed to shift the financial burden of bailing out banks from the taxpayers to the banks’ shareholders and creditors (bail-in) and then to the banks themselves (the fund) (European Commission Memo 14/295).

Beginning in 2016, for Eurozone banks, the Single Resolution Fund will serve as a centralized fund for all banks located in SRM-participating member states. The SR Fund will be financed through bank contributions raised at the national level and transferred to the SR Board, to be pooled at the EU level (An intergovernmental agreement governs the transfer and progressive mutualization of those contributions into a single fund.). Contributions to the fund will be determined pursuant to the SRM Regulation and an Implementing Act specifying the calculation method. Contributions will be comprised of a flat part and a risk-adjusted part so that banks with riskier operational profiles will contribute greater amounts.

The SR Fund is targeted to reach one percent of the combined covered deposits of the regulated banks, based on 2010 data—an estimated €55 billion target size—within an eight-year transition period starting from 2016.

Figure 5: Sovereign and Bank Debt Cycle

Source: European Banking Authority.
Transition Period Guidelines & Mutualization

During the transition period, the SR Board will allocate funds to separate compartments of the SR Fund corresponding to each member state (ECB 2014, 43). This will facilitate (in accordance with SRM guidelines) each member state financing a larger proportion of resolutions that occur within its borders during the early years of the fund. These guidelines also address concerns regarding mutualization (comingling) of the fund. According to the ECB:

[W]hen there is a need to draw on the [SR Fund] in the transition period, national compartments of the affected Member States will be used first, up to a predefined limit set for each year in the transition period. This limit will decrease during the transition period, starting at 100% in the first year; the limit will be 60% and 40% for the second and third year, respectively, and thereafter decrease by 6.67% annually for the subsequent years. As a second step, only if the first step was insufficient, all compartments will contribute up to predefined [mutualization] limit, also set for each year in the transition period... As a third step, if the previous steps were insufficient, the remaining resources in the national compartments of the affected Member States will be used. (Ibid, 44.)

If these three steps are still insufficient, future (ex post) contributions from the institutions in the affected member states will be used. If these are not immediately accessible, including for reasons relating to financial stability, the SR Board may exercise its power to contract for the SR Fund borrowings or other forms of support or to make temporary transfers between compartments (Ibid, 44.) The guidelines are set out in Appendix C.

Mutualization

The separate accounts will be subject to mutualization (i.e., comingling of the funds into one common fund) and will cease to exit at the end of the eight-year transition period. The rate of mutualization was a heavily debated topic; some member states with fairly strong banking sectors expressed concern that they would be required to subsidize weaker banking sectors in other member states.

It was finally decided that mutualization would occur gradually, and a stepped-in, front-loaded plan was agreed upon. Forty percent of the fund will be mutualized in the first year, 60% in the second year, and an additional 6.7% in each year thereafter. Full mutualization, 100%, will be reached in the eighth year (ECB 2014, 43-4) (See Figure 6 for chart showing the buildup and mutualization of the SR Fund.).
Figure 6: SR Fund Mutualization

Available Common Resources: % of total target

Source: European Commission.

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Appendix A: Information To Be Included In Recovery Plans

The recovery plan shall include the following information:

(1) A summary of the key elements of the plan, strategic analysis, and summary of overall recovery capacity;

(2) A summary of the material changes to the institution since the most recently filed recovery plan;

(3) A communication and disclosure plan outlining how the firm intends to manage any potentially negative market reactions;

(4) A range of capital and liquidity actions required to maintain operations of, and funding for, the institution's critical functions and business lines;

(5) An estimation of the timeframe for executing each material aspect of the plan;

(6) A detailed description of any material impediment to the effective and timely execution of the plan, including consideration of impact on the rest of the group, customers and counterparties;

(7) Identification of critical functions;

(8) A detailed description of the processes for determining the value and marketability of the core business lines, operations and assets of the institution;

(9) A detailed description of how recovery planning is integrated into the corporate governance structure of the institution as well as the policies and procedures governing the approval of the recovery plan and identification of the persons in the organization responsible for preparing and implementing the plan;

(10) Arrangements and measures to conserve or restore the institution's own funds;

(11) Arrangements and measures to ensure that the institution has adequate access to contingency funding sources, including potential liquidity sources, an assessment of available collateral and an assessment of the possibility to transfer liquidity across group entities and business lines, to ensure that it can carry on its operations and meet its obligations as they fall due;

(12) Arrangements and measures to reduce risk and leverage;

(13) Arrangements and measures to restructure liabilities;

(14) Arrangements and measures to restructure business lines;

(15) Arrangements and measures necessary to maintain continuous access to financial markets infrastructures;

(16) Arrangements and measures necessary to maintain the continuous functioning of the institution's operational processes, including infrastructure and IT services;

(17) Preparatory arrangements to facilitate the sale of assets or business lines in a timeframe appropriate for the restoration of financial soundness;

(18) Other management actions or strategies to restore financial soundness and the anticipated financial effect of those actions or strategies;

(19) Preparatory measures that the institution has taken or plans to take in order to facilitate the implementation of the recovery plan, including those necessary to enable the timely recapitalization of the institution.

Source: BRRD, Annex-Section A**.
Appendix B: Timetable for Initiating the Resolution Process

7. In practice what will each step involve?

**Step 1:** The ECB, after consultation with the Board, determines that the first condition for resolution is met and informs the Commission and the Board. The Executive Board [the SR Board] may make that determination if the ECB, within three days of having been informed by the Board about its intention to make that determination, does not make it.

**Step 2:** The Executive Board, in close cooperation with the ECB, determines that the second condition for resolution is met. The ECB may also inform the Board that the second condition for resolution is met.

**Step 3:** The Executive Board adopts a resolution scheme when it assesses that the three conditions for resolution are met, and, immediately after adoption, it transmits it to the Commission.

**Step 4A:** Within 24 hours after transmission, the Commission either endorses the resolution scheme, or objects to it, with regard to the discretionary aspects of the resolution scheme in the cases not covered in Step 4B. The Commission provides reasons for the exercise of its power of objection.

**Step 4B:** Within 12 hours after transmission, the Commission may propose to the Council: to object (within 12 hours) to the resolution scheme on the ground that it does not fulfill the third condition for resolution; or to approve or object (within 12 hours) to a material modification of the amount of Fund provided for in the resolution scheme. The Council provides reasons for the exercise of its power of objection. If the Council objects to the resolution scheme on the ground that it does not fulfill the third condition for resolution, the entity is orderly wound up in accordance with the applicable national law.

**Step 5A:** The resolution scheme may enter into force only if no objection has been expressed by the Council, or by the Commission, within 24 hours after transmission.

**Step 5B:** Within eight hours, the Board modifies the resolution scheme in accordance with the reasons expressed by the Commission, in its objection under Step 4A, or by the Council, in its approval of the modification proposed by the Commission under Step 4B.

*Source: European Commission, A Single Resolution Mechanism for the Banking Union—frequently asked questions, Memo 14/295, April 15, 2014.*
## Appendix C: SR Fund Approval Authority

<table>
<thead>
<tr>
<th>Type of Session</th>
<th>Composition</th>
<th>Voting</th>
<th>SR Fund Approval Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Executive A</strong> - Resolution of entity or group located in a single member state</td>
<td>Chair, permanent members, observing members, and representative from the member state in which the entity or group is located.</td>
<td>A simple majority is needed. Observing members do not vote.</td>
<td>Can approve use of SR Fund without limit, subject to plenary rights.</td>
</tr>
<tr>
<td><strong>Executive B</strong> - Resolution of a cross-border group, an entity or group located in more than one member state</td>
<td>Chair, permanent members, observing members, and representatives from the member states in which the group operates.</td>
<td>A simple majority is needed. Observing members do not vote.</td>
<td>Can approve use of SR Fund without limit, subject to plenary rights.</td>
</tr>
<tr>
<td><strong>Plenary Session A</strong> - Institutions where all components are located and governed by the SSM/SRM.</td>
<td>Chair, permanent members, observing members, and members of SR Board and representatives from all member states participating in the SRM.</td>
<td>Decisions involving use of SR Fund monies require a simple majority of SR Board members in the session representing at least 30% of contributions to the SR Fund. Observing members do not vote.</td>
<td>If use of SR Fund is anticipated to be in excess of €5 billion (or €10 billion in liquidity support), any member of the plenary can (within strict deadlines) request that the plenary consider the resolution rather than the executive session. Can approve use of SR Fund without limit.</td>
</tr>
</tbody>
</table>
| **Plenary Session B** - For Mixed Resolutions (those involving institutions governed by the SSM/SRM and also with components not governed by the SSM/SRM). | Chair, permanent members, observing members, and members of SR Board and representatives from all member states participating in the SRM. | • During the eight-year phase-in period, approval by a 2/3 majority of SR Board members representing at least 50% of contributions is required.  
• In the “steady state” period (once the SR Fund is fully mutualized), a 2/3 majority of board members representing 30% of contributions, will be required.  
• Observing members do not vote. | Can approve use of SR Fund without limit. |