How Single is the Single Resolution Mechanism?

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Introduction

- 1 January 2016: Single Resolution Mechanism (SRM) has become fully operational
- SRM charges the newly created Single Resolution Board (SRB) in Brussels with central decision making powers on bank resolution within the Eurozone
- Crucially, the new regime aims to provide a shift from public funded bailouts to bail-in
- Bank creditors are now supposed to finance a bank's losses, providing an alternative to unpopular public aid and (re)submitting banks to market discipline
- SRB operates in a highly politically sensitive setting
- The functionality and effectiveness of the new European resolution regime is as yet untested and, especially under politically stressed circumstances, uncertain
- Recently, mounting troubles in the Italian banking sector have provided a first stress test to the new resolution regime

Central question

- **Whether, and if so to what extent, Eurozone Members States retain discretion over bank resolution decisions?**

Three lines of inquiry

- **The degree of hamonization provided by the SRM**
- **Eurozone Member States' influence in the SRB's decision making (Governance of the SRM)**
- **The level of discretion for Eurozone Member States with respect to recapitalization of troubled banks, in particular: can they prevent bail-in?**

Degree of harmonization SRM

- Within Eurozone the SRM centralizes resolution decision-making at the level of the Banking Union -> SRB in charge instead of NRAs
- SRM provides for maximum harmonization, leaving no resolution tools or discretions to the Eurozone Member States
- SRM may apply the BRRD resolution tools, no more, no less
- SRM Regulation does not refer to the BRRD Goverment Financial Stabilisation Tools (GFST), so Eurozone MS no longer entitled to apply them!
- NB: The Explanatory Memorandum to the Dutch implementation legislation of BRRD and SRM Regulation acknowledged that while the powers of the Minister of Finance to nationalize banks will hardly be of practical meaning in the case of banks or banking groups, it stated that the resolution powers may still be exercised by the Minister of Finance as a matter of state emergency law!
- Degree of harmonization of SRM not uncontested

Governance of the SRM

- SRM's decision-making structure much-discussed during the negotiations

- Commission, EP, ECB, peripheral Memer states and France: favoured a supranational approach to resolution decisions, arguing that such regime is better equipped for effective and fast decision making

- Germany and other Northern European member States: involvement of national authorities in the decision making process, Germany even wanted to be the European Council, which can only act by unanimity, to be in charge of resolution decisions

Governance of the SRM

- **End result: Eurozone Member States do have a say in triggering resolution and in the adoption of a resolution plan, but more “supranational” than “intergovernmental”:**

  - Adoption of resolution plan in executive session of SRB, including representatives of all relevant NRAs -> NB: the NRA representatives have no voting rights in the absence of consensus!

  - Commission and Council have the power of endorsement / approval and objection with respect to the discretionary aspects of the conditions for adoption of a resolution scheme -> but both acting by simple majority!

Precautionary recapitalisation

- **Bank is NOT failing or likely to fail if, in order to remedy a serious disturbance in the economy of a Member State and to preserve financial stability, the extraordinary public financial support takes any of the following forms:**

  - State guarantee to back liquidity facilities provided by central banks in accordance with the central banks' conditions;
  - a State guarantee of newly issued liabilities; or
  - an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the entity

- **Provides some leeway for Eurozone Member States to provide public financial support without triggering the resolution scheme!**

- **In a recent explainer the ECB stated that precautionary recapitalisation entails an**

  "injection of own funds into a solvent bank by the state when this is necessary to remedy a serious disturbance in the economy of a Member State and preserve financial stability. It is an exceptional measure that is conditional on final approval under the European Union State aid framework. It does not trigger the resolution of the bank."

Precautionary recapitalisation

- European Commission, *Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication 2013')* (2013/C 216/01)

- The new State aid rules set out the principle that before any aid is granted all burden-sharing measures of a bank's shareholders and junior capital holders should be exhausted

- In other words: public recapitalization of a capital shortfall is only allowed after a bail-in on a bank's equity and junior and hybrid debt holders

- However there are exceptions: the Commission grants that no bail-in is required where implementing such measures would endanger financial stability or lead to disproportionate results

- Combining the exception on the requirement of a bail-in under precautionary recapitalisation with the exception on the application of bail-in to preserve financial stability under the State aid rules, opens a door for national governments to recapitalise a bank without having to apply a bail-in

Precautionary recapitalisation Monte di Paschi di Siena (MPS)

- ECB stress test -> capital shortfall -> MPS did not manage to raise enough private capital -> requested state aid from the Italian government
- The Italian government adopted on 23 December 2016 a decree allowing MPS to receive liquidity guarantees and a capital injection
- The aid would be received from a new EUR 20bn fund, created through public debt issuance, approved by the Italian parliament some days earlier for possible intervention in MPS and, if needed, other troubled institutions
- MPS's Tier 1 bonds, which are mostly held by professional investors, would be converted into shares at 75 percent of their nominal value
- Tier 2 bonds, which are mostly in the hands of retail investors, will be converted instead at 100 percent of their face value. To further insulate small savers from losses, MPS will offer to swap the shares they end up with as a result of the forced conversion with regular bonds and sell the same shares to the state instead
- To the extent retail investors suffered loss as a result of bail-in: compensation for mis-selling (vague promise)
- Rome wants to apply same recipe to Banca Popolare di Vicenza and Veneto Banca

Conclusions

- SRM provides for maximum harmonization, leaving no resolution tools or discretions to the Eurozone Member States, but not uncontested, see e.g. the Netherlands
- Eurozone Member States do have a say in decision-making, but more supranational than intergovernmental
- Precautionary recapitalization can be used to stay away from “supranational” SRB and to remain in the driver’s seat, but Commission must approve the plan in the context of the State Aid rules and must apply bail-in, unless the relevant national government convinces the Commission that this would endanger financial stability or lead to disproportionate results