

Credit institutions and investment firms: framework for recovery and resolution

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OPINION OF THE EUROPEAN CENTRAL BANK on a proposal for a directive establishing a framework for recovery and resolution of credit institutions and investment firms.

The ECB fully supports the development of a recovery and resolution framework and the removal of obstacles to effective crisis management at financial institutions. It is of the view that the directive should be adopted rapidly. At the same time, further steps will be required to create a single resolution mechanism, one of three banking union pillars.

Accordingly, the ECB calls on the Commission to urgently present a separate proposal for an independent European Resolution Mechanism, including aspects of a common European Resolution Fund. This Fund would, as a minimum, be financed by the financial institutions. Consistency among these three pillars is crucial to the success of a financial market union. The ECB makes a number of specific observations as regards the following issues:

Definition of resolution: the proposed directive defines resolution as the restructuring of an institution in order to ensure the continuity of its essential functions.

Conditions for resolution and assessment of the need for extraordinary financial public support: the ECB is of the view that the responsibilities for determining whether an institution is failing or likely to fail should be clearly allocated to the competent authority in the interest of prompt and efficient resolution action. The determination of the circumstances in which an institution is failing or likely to fail should be based only on an assessment of the prudential situation of an institution. Thus, a particular need for State aid (criteria proposed by the Commission) should not, in itself, establish an adequate objective criterion. Instead, the circumstances underlying the granting of State aid would be comprised in the assessment of the institutions prudential situation.

Involvement of central banks in recovery and resolution: the ECB insists on the following points:

- central banks have a responsibility for macro-prudential and financial stability, as well as expertise on financial markets and should be involved in the resolution process;
- Member States shall ensure that, where the central bank is not itself the resolution authority, the competent authority and the resolution authority engage in an adequate exchange of information with the central bank;
- the proposed provisions should not in any way affect the competence of central banks to decide independently and at their full discretion on the provision of central bank liquidity to solvent credit institutions, both in standard monetary policy operations as well as emergency liquidity assistance;
- the proposed directive requires each Member State to include in its resolution tool box the power to establish and operate a bridge institution and an asset management vehicle. Where a central bank acts as resolution authority, it should be clear, for the avoidance of doubt, that the central bank will in no event assume or finance any obligation of these entities;
- the ECB welcomes that the proposed directive provides that resolution costs should in principle be borne by shareholders and creditors and where these funds are not sufficient, by financing arrangements. However, the ECB stresses that, in line with the prohibition on monetary financing, central banks may not finance these financing arrangements.

Involvement of national designated authorities in assessment of recovery plans: to ensure that any relevant systemic concerns are taken into consideration in such reviews, including the overall impact of simultaneous implementation of recovery plans, which may lead to procyclical or herding behaviour, the ECB deems it necessary that the competent authorities make the assessments in consultation with the competent national designated authorities where they are separate entities.

Intra-group financial support: the ECB notes, however, that the implementation of these voluntary agreements in national legal systems raises complex legal issues. It considers that further reflections may be needed on whether additional provisions are warranted to ensure the legal certainty and enforceability of intra-group transactions that are approved and implemented according to these voluntary agreements.

The bail-in tool and write-down powers: the ECB supports the introduction of such a bail-in tool by the Member States from 1 January 2018 at the latest. It makes the following observations:

- the bail-in mechanism should be designed to be in line with internationally agreed key attributes for effective resolution, in particular a power for the resolution authority, under a resolution regime, to bail in a wide range of liabilities in accordance with the creditor hierarchy that would apply in a liquidation;
- resolution measures should be adopted in justified circumstances and accompanied with appropriate conditions to limit moral hazard
- bail-in powers, as a resolution tool, should be used predominantly for the resolution of institutions that have reached a point of unviability;
- the bail-in tool should be combined with a replacement of management and subsequent restructuring of the institution and its activities in a way that addresses the reasons for its failure;
- further work on bail-in, namely on the possibility of introducing a minimum requirement for a targeted level of designated bail-in instruments while still maintaining the overall scope of bail-in should be continued;
- the resolution authorities should have the power to write-down capital instruments before entering into resolution. With a view to the recapitalisation of institutions, the ECB recommends expressly clarifying this in the proposed directive, for the avoidance of doubt.

Financing of resolution and target size of the financing arrangements: the ECB therefore welcomes that the resolution tools and powers in the proposed directive enable authorities to put the burden of resolution financing on the shareholders and creditors. While acknowledging the benefit of additional resolution financing sources, the ECB is of the view that the ambitious proposal to set up a European system of financing arrangements will not solve important cross-border resolution issues, such as coordination and burden sharing.

The use of the deposit guarantee schemes in resolution financing (DGS): the ECB welcomes that the proposed directive gives priority to the

repayment of depositors covered by the DGS where a DGS is requested to use its available financial means to finance resolution as well as, at the same time, the usual function of repayments of insured depositors, and the available means are insufficient to satisfy all these requests. Against this background, the ECB advocates that legal certainty is ensured by clearly defining the role of the DGS in resolution financing, regardless of which resolution tool is chosen and how the measures are applied. From a financial stability perspective, the priority claim in respect of the covered deposits is also supported.

Further harmonisation of recovery and resolution rules: the ECB supports the development of a recovery and resolution framework also for non-bank financial institutions with systemic importance, for instance insurance companies and market infrastructures. This should be coordinated with international initiatives.