Credit institutions and investment firms: framework for recovery and resolution

2012/0150(COD) - 15/05/2014 - Final act

PURPOSE: to harmonise the national rules for recovery and resolution of banks.

LEGISLATIVE ACT: Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

CONTENT: since the onset of the financial crisis in 2007-08, the absence of effective instruments for the resolution of banks has often led to the use of public funds to restore trust in even relatively small banking institutions, so as to prevent a domino effect of failing institutions from causing real damage to the economy.

The directive accordingly establishes a policy framework for managing bank failures in an orderly manner and to avoid such contagion, without resorting to taxpayers' money. It establishes a range of instruments to tackle potential bank crises at three stages: preparatory and preventative, early intervention, and resolution.

The key elements of the Directive are the following:

Recovery plans: banks will have to draw up and regularly update (at least annually) recovery plans setting out the measures they would take to restore their financial position in the event of significant deterioration. Such plans should be detailed and based on realistic assumptions applicable in a range of robust and severe scenarios, corresponding to serious situations. They should not assume access to extraordinary public financial support.

Institutions should be required to submit their plans to competent authorities for a complete assessment.

When assessing the appropriateness of the recovery plans, the competent authority shall take into consideration the appropriateness of the institutions capital and funding structure to the level of complexity of the organisational structure and the risk profile of the institution.

The competent authorities should evaluate each recovery plan within six months of their presentation. Where the competent authority assesses that there are material deficiencies in the recovery plan, it shall notify the institution or the parent undertaking of the group of its assessment and require the institution to submit, within two months, a revised plan.

Where the competent authority does not consider the deficiencies to have been adequately addressed by the revised plan, it may direct the institution to amend the plan. It may, among other things, direct the institution to reduce the risk profile of the institution, including liquidity risk and to review the institutions strategy and structure. The decision shall be notified in writing to the institution and subject to a right of appeal.

Resolution plans: the resolution authorities should draw up resolution plans for each bank, showing the measures they could ake if the bank was in a resolution procedure. The group resolution plans should identify measures in relation to a parent institution as well as all individual subsidiaries that are part of a group. They shall not have a disproportionate impact on any Member State and should include procedures for informing and consulting employee representatives throughout the recovery and resolution processes where appropriate.

Among the main resolution measures, resolution authorities shall have the power to take any of the following measures:

- require the institution: i) to revise any intragroup financing agreements or review the absence thereof; ii) to limit its maximum individual and aggregate exposures; iii) require the institution to divest specific assets;
- restrict or prevent the development of new or existing business lines or sale of new or existing products;
- require changes to legal or operational structures of the institution or any group entity, either directly or indirectly under its control, so as to modify its legal and operational structure.

Resolution authorities may also appoint a special manager to replace the management body of the institution under resolution.

Early intervention: in order to preserve financial stability, it is important that competent authorities are able to remedy the deterioration of an institutions financial and economic situation before that institution reaches a point at which authorities have no other alternative than to resolve it.

To this end, they shall be given early intervention powers, including requiring the removal of the senior management or management body of the institution. One or several temporary administrators may be appointed, whose task will be to promote solutions to address the financial situation of the institution.

Bail-in: this provision, which enters into force in January 2016, will reduce to a minimum the costs to the taxpayer of the resolution procedure of a failing bank. It will enable resolution authorities to write down or convert into equity the claims of the shareholders and creditors of banks that are failing or likely to fail.

Resolution measures may be taken in accordance with the following principles:

- the shareholders of the institution under resolution bear first losses;
- creditors of the institution under resolution bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings;
- management body and senior management of the institution under resolution are replaced;

- natural and legal persons are made liable, under civil or criminal law;
- covered deposits are fully protected.

Resolution fund: the Directive requires member states, as a general rule, to set up ex-ante resolution funds to ensure that the resolution tools can be applied effectively. These national funds will have to reach, by 2025, a target level of at least 1% of covered deposits of all the credit institutions authorised in their country.

National resolution authorities will be able, in exceptional cases, to exclude some liabilities and use the resolution fund to absorb losses or recapitalise a bank. However, such flexibility will only be available after a minimum level of losses equal to 8% of total liabilities including own funds has been imposed on an institution's shareholders and creditors, or under special circumstances 20% of an institution's risk-weighted assets where the resolution financing arrangement has at its disposal ex-ante contributions that amount to at least 3% of covered deposits.

The contribution of the resolution fund is capped at 5% of a bank's total liabilities. In extraordinary circumstances, where this limit has been reached, and after all unsecured, non-preferred liabilities other than eligible deposits have been bailed in, the resolution authority may seek funding from alternative financing sources.

Government financial stabilisation tools: Member States may provide extraordinary public financial support through additional financial stabilisation tools, for the purpose of participating in the resolution of an institution or an entity including by intervening directly in order to avoid its winding up. Such an action shall be carried out under the leadership of the competent ministry or the government in close cooperation with the resolution authority.

The financial stabilisation tools consist of the following elements: a) public equity support tool to recapitalise an establishment; b) temporary public ownership tool.

However, the possibility of calling on alternative funding on the basis of recourse to State stabilisation tools is subject to the 8% bail-in requirement and conditional on approval by the Commission under state aid rules.

Loss absorbing capacity: to ensure that banks always have sufficient loss-absorbing capacity, the Directive provides for national resolution authorities to set minimum requirements for own funds and eligible liabilities (MREL) for each institution, based on its size, risk and business model.

Based on a report by the European Banking Authority (EBA), the Commission shall, if appropriate, submit by 31 December 2016, to the European Parliament and the Council a legislative proposal on the harmonised application of the minimum requirement for own funds and eligible liabilities.

Review: no later than 1 June 2018, the Commission will examine the implementation of the Directive and submit a report to the European Parliament and the Council.

ENTRY INTO FORCE: 02.07.2014.

TRANSPOSITION: no later than 31.12.2014. The measures shall apply from 01.01.2015 (no later than 01.01.2016 regarding the measures relating to the bail-in instrument).

DELEGATED ACTS: the Commission can adopt delegated acts, in order to specify the criteria for defining critical functions and core business lines for the purposes of this Directive. The power to adopt such acts is conferred on the Commission for an unlimited period from 2 July 2014. The European Parliament or the Council may object to a delegated act within a period of three months from the date of notification (this period can be extended for three months). If the European Parliament or the Council make objections, the delegated act will not enter into force.