This document is a working document of the services of DG Internal Market and Services for discussion and consultation purposes. It does not purport to represent or prejudge the formal proposal of the Commission.

DG Internal Market and Services WORKING DOCUMENT

TECHNICAL DETAILS OF A POSSIBLE EU FRAMEWORK FOR BANK RECOVERY AND RESOLUTION

This Working Document from DG Internal Market and Services seeks views on the technical details of a possible EU framework for the management of failing credit institutions and an appropriate class of investment firms.

In its Communication of 20 October 2010, the Commission announced its plans for an EU framework for crisis management in the financial sector, together with a timetable for action to implement the ideas set out in that document. As the first stage of that timetable, the Communication intends to adopt a legislative proposal on bank recovery and resolution in June 2011.

As announced in the Communication, the services of DG Internal Market and Services are now consulting on the technical details of that framework. A formal legislative proposal will then be developed in the light both of responses to this consultation and an impact assessment examining the anticipated effects of options for achieving the outlined policy objectives.

This document is organised as follows:

The sections contain specific questions on areas where the Commission services would particularly welcome views. These questions are summarised in Annex 3. In replying to these questions, please indicate what impact, including benefits and costs, would the potential changes described in each section of this paper have on your activities or activities of firms in your jurisdiction. When describing the costs please attempt, where appropriate, to assess them quantitatively by differentiating between different cost types, such as reporting, systems, personnel capital costs, and between one-off implementation and on-going compliance costs.

The Commission Services welcome responses to the policy objectives and the questions raised in this paper by **3 March 2011**. Responses should be sent to the following email address: **markt-crisis-management@ec.europa.eu**.

Responses will be published on the website of DG Internal Market and Services unless respondents expressly request otherwise.

INDEX

GENERAL INTRODUCTION

The Commission's Communication of October 2010 sets out a general framework for a comprehensive EU framework for troubled and failing banks. The Commission intends to proceed gradually towards such a regime. As a first step it will adopt before the summer 2011 a legislative proposal for a harmonised EU regime for crisis prevention and bank recovery and resolution. This will include a common set of resolution tools and reinforcement of cooperation between national authorities in order to improve the effectiveness of the arrangements for dealing with the failure of cross border banks. As a second step, the Commission will examine the need for further harmonisation of bank insolvency regimes, with the aim of resolving and liquidating them under the same substantive and procedural rules, and will publish a report, accompanied if appropriate by a legislative proposal, by the end of 2012. To this end the services of DG Internal Market and Services are working together with a group of Insolvency Law Experts (ILEG). Finally, the Commission considers that a third step should include the creation of an integrated resolution regime, possibly based on a single European Resolution Authority, by 2014. This would only be possible if we have previously put in place a single set of substantive rules with respect to resolution and insolvency. **This consultation paper presents the technical details for the first step.**

These technical details are intended to give effect to the seven principles mentioned in the Commission's Communication of October 2010:

- **Put prevention and preparation first:** comprehensive planning and preventative measures should help authorities and firms prepare for resolution, and should complement other reforms to reduce risks in the financial system;

- **Provide credible resolution tools** ensuring authorities have options to resolve institutions in a way that minimises risks of contagion and ensures continuity of essential financial services, including continuous access to deposits for insured depositors;

- **Enable fast and decisive action**, by putting in place well defined powers and processes and eliminating legal uncertainty about when authorities can intervene and the actions they can take;

- **Reduce moral hazard** by ensuring an appropriate allocation of losses to shareholders and creditors and protecting public funds. This implies, at a minimum, the costs of resolution should be borne by the shareholders and, as far as possible, the creditors of the institution in question reflecting the normal order of ranking and if necessary by the banking industry as a whole;

- **Contribute to a smooth resolution of cross border groups** to ensure minimum disruption to the internal market, fair sharing of costs and the preservation of essential banking services;

- **Ensure legal certainty,** appropriate safeguards for third parties and restrict any interference with property rights to what is necessary and justified in the public interest.

The framework should aim to ensure that creditors receive a treatment similar to that which they would have received if the bank had been wound up;[1]

- **Limiting distortions of competition**, which derive from interventions that distort the level playing field in the financial sector at European level. This implies that State aid granted under the resolution framework must be compatible with the Treaty rules and the internal market.

In line with these principles, the services of DG Internal Market and Services propose to reinforce the powers of supervisory authorities to act before the situation is irreversible. The authorities should have broad powers of early intervention to allow them to guide a credit institution towards recovery when the situation of the institution is deteriorating.

One has, however to assume that there will be cases when recovery through an early intervention strategy would not always be possible. It is therefore important that the EU is better prepared to handle the possibility of a bank (or multiple banks) failing without the need of financial support by the state. In such cases, it is important that market exit remains a credible option, not only a theoretical possibility. To that effect, on the basis of the Commission's Communication of October 2010 the services of DG Internal Market and Services aim to develop a resolution framework that intends to reinforce market discipline by ensuring that all institutions can effectively fail in a way which minimises financial and economic disruption.

However, a common set of resolution tools is not sufficient to achieve this objective. Without adequate crisis preparation on the part of the authorities to ensure that a credit institution can be effectively resolved in a way that losses fall to the shareholders and creditors (as with any other failed commercial enterprise), it is highly probable that public sector support would still be necessary, with taxpayers continuing to bear the costs of bank failures. The services of DG Internal Market and Services therefore propose to entrust the authorities with new preventative and preparatory powers that would allow them to ensure in good times that there are no significant impediments resulting from banks' legal, operational or business structures that it would make it difficult to apply the resolution tools and resolve them in an orderly manner.

This prevention, recovery and resolution framework should not, however, be considered in isolation. The existence of macro-prudential supervision as well as better focused and more appropriate prudential requirements or a strengthened market infrastructure that include e.g. central clearing for derivatives, are also key to financial stability since they will reduce the likelihood of another crisis of the magnitude of that which broke in 2008 and mitigate the systemic impact of future financial sector failures.

The framework is designed to ensure that, if the problems of an institution are irreversible, rescue of the ailing entity is not the only, or even the preferable option, for the authorities (see diagram). Accordingly, the general rule should be that failing credit institutions should be liquidated under ordinary insolvency proceedings. However, this will not always be feasible, and in some cases an orderly winding down through resolution will be necessary for reasons of financial stability: that is to minimise contagion, ensure continuity of vital economic

[1] In the sense that the creditors are neither better nor worse off than they would have been if the bank would have been wound up.

functions, maximise the value of remaining assets and facilitate their return to productive use in the private sector.[2]

Measures that maintain the entity as a going concern - such as the power to write down debt or convert it to equity - should be a last resort, and only used in justified cases. This would help to underpin market discipline.

Following the principles established in the Commission's Communication of October 2010 the authorities will also therefore be given the necessary legal tools to ensure that they will be able to impose, to the maximum extent possible, the losses on the shareholders and all or part of the creditors of the failing entity.

In case resources from shareholders and creditors are not sufficient it would be necessary to call upon the rest of the financial sector. To this end, and as announced in the Commission's Communications of May and October 2010, this document presents further details about how the funding of bank resolution by the financial sector could be organised. The services of DG Internal Market and Services have considered the possible synergies between the existing Deposit Guarantee Schemes and the financing of resolution and suggest that a comprehensive system for the financing of resolution that could ensure an effective protection of depositors could be based on the following:

– Determine the ex-ante financing needs for resolution. They should be based on the resolution framework and calculated on the basis of the non insured liabilities.

– Determine the ex-ante financing needs for ensuring, at a minimum, that there is money to pay out covered deposits if necessary. [See the DGS proposal]

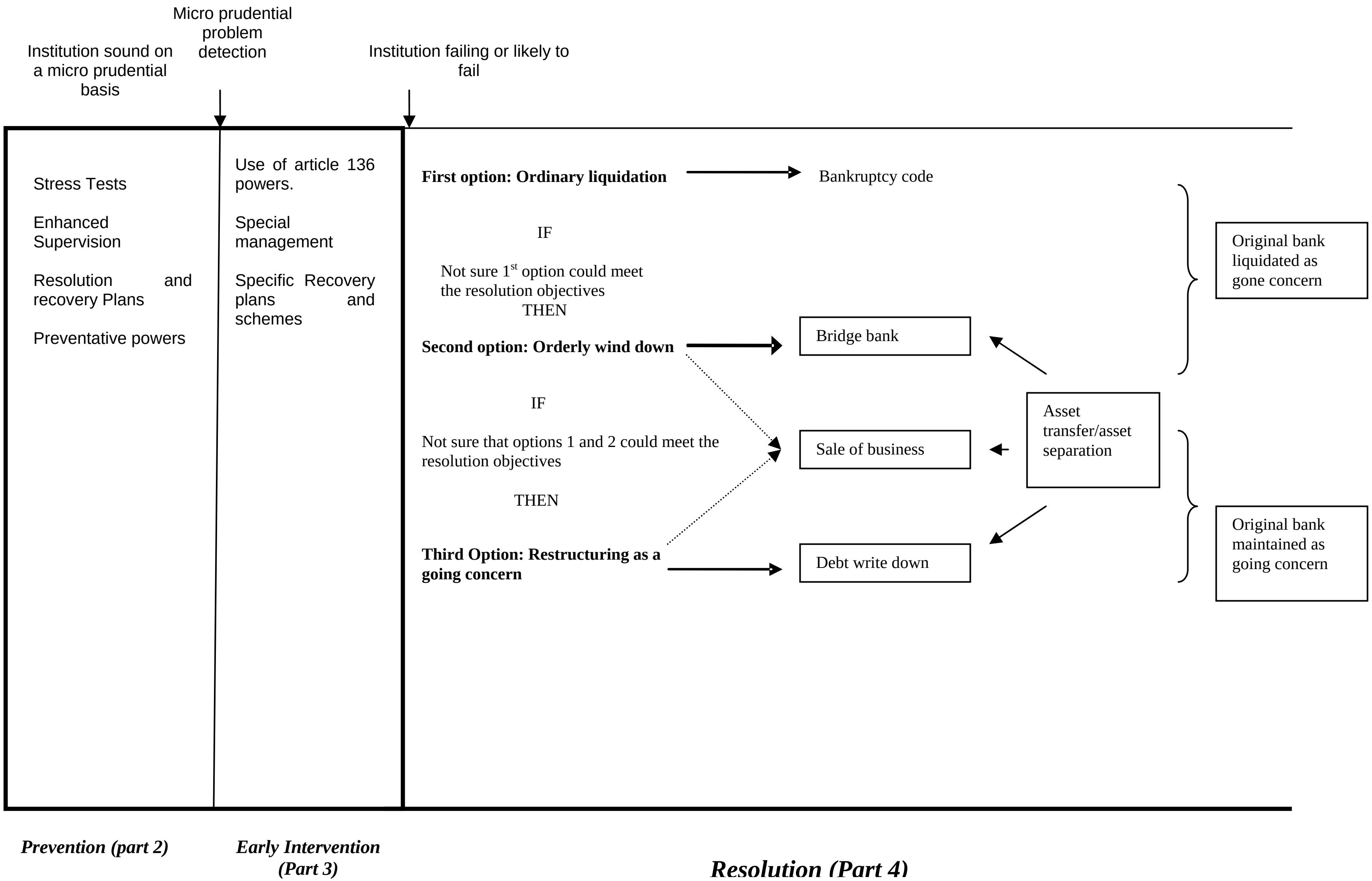
– Allow Member States to choose between merging resolution and deposit insurance into a single fund or to having separate arrangements.

– Ensure that for both resolution and deposit guarantee there are robust ex-post financing arrangements that impose the costs of any intervention on the banking sector and not on taxpayers.

In addition, the Commission is helping to shape the work of the FSB and the G20, and is also closely monitoring other international developments. The G20 summit held in Toronto in June 2010 committed to the design and implementation of systems whereby authorities have the powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden. The G20 also called on the FSB to consider and develop concrete policy recommendations to address problems associated with, and to resolve, systemically important financial institutions. In the US, the Dodd-Frank reform[3] has established a resolution framework for systemic institutions at group level. The ideas set out in this document are consistent with the recommendations being developed by the FSB.

2 In both ordinary liquidation and orderly wind down the firm essentially disappears in full or in part. Therefore it is treated as a gone concern.

3 The Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173).


Micro prudential problem detection
Institution sound on a micro prudential basis
Institution failing or likely to fail
Stress Tests
Enhanced Supervision
Resolution and recovery Plans
Preventative powers
Use of article 136 powers.
Special management
Specific Recovery plans and schemes
First option: Ordinary liquidation
Bankruptcy code
IF
Not sure 1st option could meet the resolution objectives
THEN
Second option: Orderly wind down
Bridge bank
IF
Not sure that options 1 and 2 could meet the resolution objectives
THEN
Third Option: Restructuring as a going concern
Sale of business
Debt write down
Asset transfer/asset separation
Original bank liquidated as gone concern
Original bank maintained as going concern
Prevention (part 2)
Early Intervention (Part 3)
Resolution (Part 4)

PART 1 - SCOPE AND AUTHORITIES

Scope of preparatory and preventative measures and resolution tools

Extract from the Commission's Communication of October 2010:

"The framework outlined in this Communication will apply to all credit institutions and some investment firms (The Commission's policy aim is to cover those investment firms the failure of which risks causing systemic instability, and is considering options as to how that category might be defined), irrespective of whether they operate cross-border or domestically."

The services of DG Internal Market and Services consider that there is a sound case for applying a resolution regime to all credit institutions because there is a systemic risk inherent in banks' activities, resulting from the mismatch between banks' assets and liabilities, their significant role in wholesale payment systems, and their vulnerability to the sudden removal of credit through a bank run. Moreover, bank assets amount to 75% of the assets of the entire EU financial sector.

However, the appropriateness of applying the regime suggested in this paper to all investment firms is much less certain. Because a wide range of activities are regulated under the Markets in Financial Instruments Directive (2004/39/EC), investment firms are diverse and vary greatly in size and business structures. The majority are unlikely to be systemically important, and could almost certainly be dealt with under ordinary insolvency proceedings.[4] *Question Box 1 below discusses whether the class of investment firms covered by the suggested regime should be limited to firms carrying out certain investment services and by size criteria. Beyond this, however, further assessment is needed as to whether the resolution tools and powers suggested in section G of this document would adequately address the specific problems that might be associated with the failure of an investment firm.*

***Scope: credit institutions and certain investment firms* (P1.1a)**

The services of DG Internal Market and Services consider that the preparatory and preventative measures in Part 2 and the resolution tools, powers and connected provisions in Part 4 could apply to:

(a) credit institutions as defined in Article 4 (1) of Directive 2006/48/EC;

(b) An appropriate class of investment firms [see Question Box 1]

Question Box 1

1a. What category of investment firms (if any) should be subject to the preparatory and preventative measures tools and the resolution tools and power?

1b. Do you agree that the categories described below are appropriate? If not, how should the class of investment firm covered by the proposed recovery and resolution framework be defined?

[4] Winding up and reorganisation of cross-border investment firms may be facilitated if brought within a mutual recognition regime equivalent to that which currently applies insolvency proceedings for credit institutions (directive 2001/24/EC) and insurers (directive 2001/17/EC). The Commission Services are considering this.

1c. Are the resolution tools and powers developed for deposit-taking credit institutions appropriate for investment firms?

<u>Discussion</u>

The services of DG Internal Market and Services consider that it is unnecessary, and would be disproportionate, to bring all investment firms within the meaning of the Markets in Financial Instruments Directive (Directive 2004/39/EC) within the scope of this regime. However, it could be appropriate to extend it to some firms, on ground of the activities or services they carry out, their size and interconnectedness, or the fact that they are part of a banking group and it may achieve better results if they can be included in a group resolution.

For these reasons, the services of DG Internal Market and Services consider two categories.

The first category would consist of investment firms that meet the following conditions:

(a) ***Investment activities:*** *they carry on at least one of (i) dealing on own account; (ii) execution of orders on behalf of clients (in addition to any other investment activities or services); and*

(b) ***Size:*** *an appropriate criterion for size would need to be identified. However, this may not be straightforward given the differences between national markets. Specifically, an investment firm that might not be considered sufficiently large to be of systemic significance in a member State with a highly developed and diversified market in investment activities might be systemically important in a Member State with a smaller national market.*

The services of DG Internal Market and Services provisionally consider that those investment firms that are not subject to prudential requirements and supervision under Directive 2006/49/EC should be excluded from the scope of this regime.

The second category would consist of investment firms that are part of a banking group. This could either be drafted broadly as any investment firm that is a member of a group that includes credit institutions; or more narrowly as an investment firm that is either a subsidiary of an investment firm that falls into the first category, or of a credit institution, and that is subject to supervision on a consolidated basis.

Extended scope of resolution tools and powers to bank holding companies (P1.1b)

In addition to the credit institutions and investment firms indicated above, the services of DG Internal Market and Services also consider that the powers of resolution authorities under Part 4 could apply in relation to EU parent credit institutions and EU parent financial holding companies where one or more subsidiary credit institution or investment firm meets the conditions for resolution and the application of the resolution tools and powers in relation to the parent entity is necessary for the resolution of one or more of its subsidiaries or for the resolution of the group as a whole.

Question Box 2

2a. Do you believe that bank holding companies (that are not themselves credit institutions or investment firms) should be within the scope of the resolution regime?

2b. Should resolution authorities be able to include bank holding companies in a resolution even if the holding company does not itself meet the conditions for resolution: i.e. is not failing or likely to fail (see condition for resolution)?

2c. Are further conditions or safeguards needed for the application of resolution tools to bank holding companies?

Authorities responsible for resolution[5]

Extract from the Commission's Communication of October 2010:

"The new crisis management framework will require each Member State to identify a resolution authority to exercise the resolution powers. Those authorities should be administrative rather than judicial, but it does not appear necessary at this stage to prescribe further which national body should act as the resolution authority. This will allow Member States to retain existing national arrangements under which, variously, the Ministry of Finance, the Central Bank or the Deposit Guarantee Scheme may be responsible for resolution. The Commission notes, however, that in many jurisdictions resolution authorities are appropriately separated from supervisors and considers such separation to be important to minimise the risks of forbearance."

The services of DG Internal Market and Services consider that this could be achieved through the following:

Designation and responsibilities of resolution authorities (P1.2)

The services of DG Internal Market and Services consider that Member States could designate one or more administrative authorities to apply the resolution tools and exercise the resolution powers [**the Resolution Authorities**].[6]

That authority may be a supervisor (e.g. for the purposes of Directive 2006/48/EC) provided that there are arrangements in place to ensure the separation between the resolution and the supervisory functions. Where the resolution authority and the supervisor are separate entities, the supervisor would be expected to provide support to the resolution authority.

The services of DG Internal Market and Services consider that those authorities should have the expertise, resources, operational capacity and independence to implement resolution measures, and are able to exercise their power with the speed and flexibility that is necessary to achieve the resolution objectives.

The services of DG Internal Market and Services consider that where more than one authority is designated in a Member State to apply the resolution tools and exercise the resolution powers, the functions and responsibilities should be clearly allocated between them, adequate coordination between those authorities is ensured a single authority is

[5] When this document refers to supervisors it refers to the authorities under Directive 2006/48

[6] '**Group level resolution authority**' means, for credit institutions or investment firms that are subject to supervision on a consolidated or sub-consolidated basis under Articles 125 or 126 of Directive 2006/48/EC, the resolution authority of the Member States where the consolidating supervisor is located, as this terms is defined in Article 4(48) of Directive 2006/48/EC.

designated as a lead point of contact for the purposes of cooperation and coordination with the relevant authorities of other Member States.

Furthermore, the services of DG Internal Market and Services consider that Member States should inform a European Authority (e.g. the European Banking Authority) of the national authority or authorities appointed as resolution authority or authorities and, where relevant, their specific functions and responsibilities. The services of DG Internal Market and Services consider that the European authority (e.g. EBA) could publish the list of those reolution authorities and the allocation of their responsibilities.

This could be supplemented by an explanation on how functions might be divided between different authorities: for example, different authorities might be responsible for (i) the decision whether conditions for resoution are satisfied; (ii) deciding which resolution tool to use; and (iii) the conduct of the resolution. This explanation could also indicate that authorties involved may include supervisors, central banks, Ministries of Finance or DGS, but that there would not be any constrain to national discretion in this respect, beyond what it is warranted to ensure that banks are subject to the same degree of necessary discipline.

The services of DG Internal Market and Services consider that resolution authorities should have proper regard to the impact of their decisions on financial stability in other Member States.

Question Box 3

3a. Do you believe that the choice of the authority or authorities responsible for resolution in each Member State should be left to national discretion? Is this sufficient to ensure adequate coordination in case of cross border crisis?

3b. Is the functional separation between supervisory and resolution functions within the same authority sufficient to address any risks of regulatory forbearance?

3c. Is it desirable (for example, to increase the checks and balances in the system) to require that the various decisions and functions involved in resolution – the determination that the trigger conditions for resolution are met; decisions on what resolution tools should be applied; and the functional application of the resolution tools and conduct of the resolution process – should be allocated to separate authorities?

3d. Even if resolution authorities are a matter of national choice, should an EU framework specify that they should act in accordance with principles and rules such as those set in this document to take account of the fact any bank crisis management action in one Member State is likely to have an impact in other Member States?

Role of the European Banking Authority in the framework (P1.3)

As discussed in its Communication of 20 October, the Services of DG Internal Market and Services consider that the EBA could be given a significant role in the supervision aspects of the proposals outlined here. Additionally, the EBA could, within the limits set by EU law, be given a role in the development and coordination of recovery and resolution plans. Furthermore, and again within the limits set by EU law, the EBA could be given a responsibility to, if required, resolve disagreements between resolution authorities of the application of preparatory and preventative powers discussed in section E4. However, in doing so, it is important to note that some may consider it inappropriate for the EBA's Board of Supervisors, which is composed of representatives from supervisory authorities, to take decisions relating to disagreements between resolution authorities. Therefore, if a mediation role is proposed in this area, specific procedures may be required. One possibility may be to create an additional sub-committee of resolution authorities to take decisions on a delegated basis. Another may be to provide for an alternative panel of resolution authorities which would propose a decision for final adoption by the Board of Supervisors.

Part 2- SUPERVISION, PREVENTION AND PREPARATION

The Commission's October Communication sets as an objective to Put prevention and preparation first: *comprehensive planning and preventative measures should help authorities and firms prepare for resolution, and should complement other reforms to reduce risks in the financial system.*

A. SUPERVISION

Extract from the Commission's Communication of October 2010:

"Failures in effective supervision preceded and contributed to the recent crisis. The Commission therefore intends to reinforce the supervisory regime under the CRD to require the annual preparation of a supervisory programme for each supervised institution on the basis of a risk assessment; greater and more systematic use of on-site supervisory examinations; more robust standards and more intrusive and forward-looking supervisory assessment."

The Services of DG Internal Market and Services are therefore considering a reinforcement of the supervisory regime under the Capital Requirements Directive by e.g. requiring the annual preparation of a supervisory programme for each supervised institution on the basis of a risk assessment and more robust stress testing framework and powers to undertake enhanced supervision. These options are elaborated below.

Supervisory programme (A1)

The Services of DG Internal Market and Services believe that it could be useful for supervisors to adopt annually an examination programme for the credit institutions they are responsible for supervising.

The services of DG Internal Market and Services consider that a supervisory examination programme could indicate how the supervisors would carry out their tasks and allocate their resources. It could identify which credit institutions would be subject to enhanced supervision and make provision for such supervision, and include provision for on-site inspections at any of the premises used by a credit institution (including its branches and subsidiaries). The programme could also take into account the risk assessments carried out under Article 124 of the CRD.

Stress testing (A2)

The services of DG Internal Market and Services consider that supervisors could carry out annual supervisory stress tests on credit institutions that they supervise.[7] The purpose of the stress tests would be to evaluate the resilience of the credit institutions tested to conceivable adverse economic developments, including shocks which are of low probability but high impact, and to assess their ability to absorb shocks. It would also be useful in the views of the services of DG Internal Market and Services if supervisors also

[7] These may be additional to stress tests carried out by the EBA.

conduct periodic stress tests to assess the resilience of the banking sector in their Member States to adverse economic developments.[8]

Question Box 4

4a. Should the stress tests be conducted by supervisors, or is it sufficient for institutions to carry out their own stress tests in accordance with assumptions and methodologies provided by or agreed with supervisors, provided that the results are validated by supervisors?

4b. The current crisis has shown that stress test disclosure is necessary to reassure markets and to bring to light potential problems before they become too large to be managed. It cannot, however, be excluded that in some circumstances disclosure without consideration of the possible impact in the market could do more harm than good. Do you agree that under exceptional circumstances the results of the stress tests should be made public only after appropriate safeguards have been agreed and introduced?

4c. Do you agree that in an integrated European market, stress testing should be conducted on the basis of a common methodology agreed at the EU level and subject to cross verification?

Enhanced supervision (A3)

In the view of the services of DG Internal Market and Services, supervisory examination programmes could include provision for the enhanced supervision of:

- those credit institutions for which the results of the stress tests, or the outcome of the supervisory review process, indicate significant risks to their continuing financial soundness or breaches in their compliance with the requirements of the CRD;

- credit institutions that pose systemic risks to the financial system;

- any other credit institution that supervisors consider should be subject to enhanced supervision.

Enhanced supervision could, for example, include the following measures necessary to enable supervisors to monitor the development of risks to the financial soundness of the credit institution or to ensure that the breaches in compliance are rectified:

- an increase in the number or frequency of on-site inspections at any premises maintained by the credit institution;

- the establishment or maintenance of a permanent presence of representatives of the competent authority at any premises maintained the credit institution;

- the requirement for additional or more frequent reporting by the credit institution;

[8] Banks receiving State aid may be subject to stress test requirements at the request of the European Commission, on the basis of a methodology and parameters targeted to the specificities of the particular case.

- additional or more frequent review of the operational, strategic or business plans of the credit institution; or

- thematic examinations for the purposes of monitoring specific risks that are likely to materialise.

Question Box 5

5. Please estimate:

- the <u>one-off costs</u> in EUR (e.g., investments in IT systems);

- the additional ongoing annual costs (e.g. human, subcontracts etc.),

that your institution would be likely incur in carrying out the activities related to <u>enhanced supervision.</u>

B. Recovery planning

Extract from the Commission's Communication of October 2010:

"Work on recovery and resolution plans as an essential element of planning for the failure of major institutions is ongoing at international level, and they are widely regarded as a necessary component of an effective crisis management regime. The Commission is participating in this work and will seek consistency with the outcome of developments at international level.

All credit institutions and investment firms covered by the regime would be required to prepare and keep updated recovery plans setting out measures the institution or group would take in different scenarios to address liquidity problems, raise capital or reduce risk. The plans would be expected to be detailed and realistic, and should not assume access to any support from public funds. However, the requirement to prepare a recovery plan should be applied proportionately, reflecting the size of the firm, the nature of its sources of funding and the degree to which group or other sectoral support would be credibly available. Institutions would be required to submit plans to supervisors for assessment as to whether they are comprehensive and likely to restore the viability of the institution."

The Services of DG Internal Market and Services believe that this could be achieved through the following:

Recovery plans (B1)

The services of DG Internal Market and Services consider that credit institutions should draw up and maintain recovery plans, setting out the arrangements that the credit institution has in place or the measures that it would adopt to enable it to take early action to restore its long term viability in the event of a material deterioration of its financial situation.

In the view of the services of DG Internal Market and Services, these recovery plans *(firm specific or group plans)* should be based on realistic assumptions, should not assume any access to public financial support, and, at least, include:

(a) arrangements and measures to restore the credit institution's own funds;

(b) arrangements and measures to ensure that the credit institution has adequate access to liquidity to ensure that it can carry on its operations and meet its obligations as they fall due;

(c) arrangements and measures to reduce risk and leverage;

(d) preparatory arrangements to facilitate the sale of assets or business lines in a time frame appropriate for the restoration of financial soundness;

(e) where applicable, arrangements for possible intra-group financial support adopted in accordance with any voluntary agreement for group financial support;

(f) other management actions or strategies to restore financial soundness and the anticipated financial effect of those actions or strategies.

Question Box 6

6. *Are the required contents of recovery plans suggested above sufficient to ensure that credit institution undertake adequate planning for timely recovery in stressed situations? Should we include additional elements?*

Assessment of recovery plans (B2)

The services of DG Internal Market and Services consider that credit institutions should submit the recovery plans to supervisors. The supervisors would need to review those plans and assess the extent to which the plan satisfies the following suggested criteria:

(a) whether the arrangements proposed in the plans are credible, realistic and sufficient to the extent that their implementation would be likely to restore the viability of the credit institution or prepare for an orderly winding-down of the problematic activities; and

(b) whether the plans could be implemented without causing systemic disruption, including in the event that a number of firms implemented recovery plans within the same period.

The services of DG Internal Market and Services consider that where supervisors assess that the recovery plan would not be likely to restore the viability of the credit institution in situations of financial stress, or to prepare for an orderly winding-down of the activities causing the problems, or that there are impediments to the timely and effective implementation of those arrangements or measures or to an orderly winding-down of the problem activities, the supervisors should then notify the credit institution of this assessment and require appropriate measures to address the identified shortcomings. Those measures could include (i) requiring the credit institution to submit a revised recovery plan and demonstrate how shortcomings notified by supervisors have been addressed; or (ii) requiring the credit institution to take any necessary measures to ensure that there are no impediments to the implementation of the plan in situations of financial stress.

In the opinion of the services of DG Internal Market and Services, those plans should be drawn up and assessed in accordance with comparable criteria across countries in order to ensure a level playing field. Moreover, given the cross border implications of some measures, they should be subject to some form of coordination

Group recovery plans (B3)

The services of DG Internal Market and Services consider that EU parent credit institutions or EU parent financial holding companies should draw up a group recovery plan, which could include recovery plans for each group entity, and submit it to the consolidating supervisor. The consolidating supervisor should transmit the group recovery plans to the relevant supervisors.

In the view of the services of DG Internal Market and Services, the objective of a group level recovery plan would be to restore the viability of the group where part of the group, or the group as a whole, experiences a material deterioration in its financial situation. A group recovery plan could set out the circumstances under which a group level approach should be pursued, and could also include arrangements to ensure the coordination and consistency of recovery plans of group entities with the group recovery plan.

Assessment of group recovery plans (B4)

The services of DG Internal Market and Services consider that the consolidating supervisor, in cooperation with the other relevant supervisors, could review the group plan in colleges of supervisors and assess the extent to which the plan satisfies the following criteria:

(a) the arrangements proposed in the plan are credible, realistic and sufficient to the extent that their implementation would be likely to restore the viability of the group on a consolidated basis and each credit institution of the group, on a sub-consolidated or individual basis, in accordance with the level of application of the CRD, or to prepare for an orderly winding down of the activities causing the problems;

(b) the plan could be implemented without causing systemic disruption, including in the event that a number of firms implemented recovery plans within the same period;

(c) the measures taken at group level or the measures included in the recovery plans for each group entity would be sufficient to ensure the viability of each credit institution of the group, or to prepare for an orderly winding down of the activities causing the problems.

The services of DG Internal Market and Services consider that where supervisors assess that the arrangements and measures set out in a group recovery plan would not be likely to restore the viability of the group on a consolidated basis and of each credit institution of the group or that there are impediments to the timely and effective implementation of those measures and arrangements, the consolidating supervisor should notify the EU parent credit institutions or EU parent financial holding company of this assessment, supported with reasons. Where appropriate, supervisors should also require measures to address the shortcomings, such as:

(a) requiring the EU parent credit institution to submit a revised group recovery plan and demonstrate how shortcomings have been addressed;

(b) requiring the EU parent credit institution to take any necessary measures to ensure that there are no impediments to the implementation of the plan in situations of financial stress.

Furthermore, the services of DG Internal Market and Services consider that the consolidating supervisor should take into account the views expressed by other supervisors when requiring the credit institution to take action under this paragraph.

In case of disagreement as to the assessment of the group recovery plan or any action that the credit institution should be required to take as a result of that assessment, the services of DG Internal Market and Services consider that there would need to be a mediation procedure (for example, a reference to a European authority that could be the EBA). Pending this mediation, the services of DG Internal Market and Services consider that the consolidating supervisor should defer its decision and shall take its decision in conformity with the decision of mediator.

Question Box 7

7a. Is it necessary to require both entity-specific and group recovery plans in the case of a banking group? How to best ensure the consistency of recovery plans within a group?

7b. Should supervisor of each legal entity be allowed to require any changes to entity-specific recovery plans, or should this be a matter for the consolidating supervisor?

7c. Is a formal joint decision (e.g. in accordance with the procedure set out in Article 129 CRD) between the consolidating supervisor and the other relevant supervisors appropriate for decisions regarding the group recovery plan?

Question Box 8

8. Please estimate:

(a) the one-off initial costs (e.g., investment in IT and other systems);

(b) the additional ongoing annual costs, including the costs of Full-Time Equivalent employees (FTEs), and the number of such FTEs,

that your institution would be likely to incur in carrying out the activities related to ***recovery planning*** *suggested in this section.*

C. INTRA-GROUP FINANCIAL SUPPORT

Extract from the Commission's Communication of October 2010:

"The Commission is considering measures that would specify the circumstances and conditions under which institutions regulated under the CRD may transfer assets within a group, including in situations where group entities are experiencing liquidity stress.[9] *The objective would be to establish an enabling framework for intra-group liquidity management which must include the safeguards necessary to preserve financial stability in Member States where transferring entities are established and to protect the rights of creditors and shareholders."*

Asset transfers from one entity of a cross-border group to another are currently restricted by a number of provisions laid down by national laws. These provisions, based on the principle of corporate legal personality, are designed to protect the creditors and shareholders of each entity. Only in certain national legal systems has the concept of group interest been developed through jurisprudence or legal rules. This concept takes into account, instead of the particular interest of each individual group member, the indirect interest that each entity in a group has in the prosperity of the group as a whole. However, these rules differ from country to country and do not provide the necessary legal certainty. The framework outlined below would clarify under which conditions assets may be transferred within entities of a cross-border banking group in a distressed situation (falling short of insolvency).

A preliminary shareholders agreement should set out the conditions for asset transferability and enable the management to carry out asset transfers when the conditions are met. This would ensure that managers can act with confidence and limit the legal challenges that minority shareholders and creditors may bring against the management. The preliminary shareholders agreement should be approved by the supervisor of the transferor and should be included in the recovery plan of the potential transferee and of the recovery plan for the group as a whole, presented by the parent credit institution.

The services of DG Internal Market and Services consider that in order for the agreement to become effective, the procedure laid down by Article 129 CRD could apply. Under such an approach, the parent credit institution and subsidiaries would file an application with the consolidating supervisor. The supervisors concerned within the college of supervisors would then work together in order to reach a joint decision within a certain period of time (e.g. six months).

The services of DG Internal Market and Services consider that further powers could be granted to a European authority (for example, the EBA) to act as a mediator in case of disagreement amongst members of the college and if an agreement is not achieved, it could take a decision requiring them to take specific action or to refrain from an action.

As a safeguard for the financial stability in the home country, the services of DG Internal Market and Services consider that the supervisor of the transferor could have the power to prohibit or restrict a transfer of assets pursuant to the agreement when this transfer threatens the liquidity or solvency of the transferor or financial stability. For this purpose, the services of DG Internal Market and Services consider that the transferor, before proceeding to transfer

[9] The treatment of such a transfer under the applicable tax regime will need attention. The accounting treatment may also need separate consideration.

the assets, should notify the intended transfer to the supervisor stating the objective and underlying reasons for the transfer. The services of DG Internal Market and Services consider that if the supervisor were not to prohibit the transfer within a set period of time, the transferor should be able to proceed with the transfer.

Question Box 9

9. Is a framework specifying the circumstances and conditions under which assets may be transferred between entities of the same group desirable? Please give reasons for your view.

Group financial support agreement (C1)

The services of DG Internal Market and Services consider that an EU parent credit institution or an EU parent financial holding company and subsidiaries that are credit institutions or investment firms could enter into an agreement to provide financial support to any other party to the agreement that experiences financial difficulties. Such support would have to respect a number of conditions, considerations of which are further outlined below.

The services of DG Internal Market and Services consider that the agreement could:

(a) cover one or more subsidiaries of the group, and could provide for financial support from, for example, the EU parent credit institution or the EU financial holding company to subsidiaries, from subsidiaries to the EU parent credit institution or the EU financial holding company, between subsidiaries of the group that are party to the agreement; and

(b) provide for financial support in the form of a loan, the provision of guarantees, or the provision of assets for use as collateral in transaction between the beneficiary of the support and a third party, or any combination of the foregoing.

The services of DG Internal Market and Services consider that if, under the terms of the agreement, a subsidiary agrees to provide financial support to the EU parent credit institution or to the EU financial holding company, the agreement should be reciprocal.[10]

Question Box 10

10. The considerations above would limit the support that might be provided under an agreement to loans, guarantees and the provision of collateral to a third party for the benefit of the group entity that receives the support. Should financial support should be restricted in this way, or could it allow a broader range of intra-group transactions, for example the definition suggested by UNCITRAL: "trading between group members; channelling of profits upwards from the subsidiary to the parent; loans from one member to another to support continued trading by the borrowing member; asset transfers and guarantees between group members; payments by a company to a creditor of a related company; a guarantee or mortgage given by one group company to support a loan by an outside party to another group company; or

[10] Where applicable, State aid rules will have to be complied with.
[11] Definition of intra group transactions elaborate by the United Nations Commission on International Trade Law (*"Uncitral"*)

a range of other transactions."[11]

The services of DG Internal Market and Services consider that the agreement could also specify the consideration payable, or set out principles for the calculation of the consideration, for any transaction made under the agreement. The consideration should in the views of the services of DG Internal Market and Services represent a reasonable remuneration for the financial support provided.

The services of DG Internal Market and Services consider that the agreement should only be concluded if, at the time the proposed agreement is made, none of the parties is in breach of, or likely to be in breach of, any requirement relating to capital or liquidity or is at risk of insolvency.

Question Box 11

11a. Should this type of financial support be provided only down-stream (parent to subsidiary) or also up-stream (subsidiary to parent) and cross-stream (subsidiary to subsidiary), or should this be left to the discretion of the parties, (subject to approval by supervisors)? What would be the advantages and disadvantages of each option? The provision of support up-stream and cross-stream is subject to more restrictions under national laws.

11b. Should the agreement be restricted to credit institution and investment firms subsidiary, or should it be able to include financial institutions on the grounds that these are also subject to supervision on a consolidated basis?

Review of proposed agreement by supervisors and mediation (C2)

The services of DG Internal Market and Services consider that the EU parent credit institution or the EU parent financial holding company could submit to the consolidating supervisor an application for authorisation of any proposed group financial support agreement (see C1). The application could, for example, contain the text of the proposed agreement and could also identify the group entities that propose to be parties. The consolidating supervisors should then forward the application to each subsidiary's supervisor that proposes to be a party to the agreement.

The services of DG Internal Market and Services consider that the supervisors should grant the authorisation if the conditions for financial support (see C4 below) are satisfied.

In the view of the services of DG Internal Market and Services, the supervisors should try to reach a joint decision on whether the application satisfies the conditions laid down in sections C1 (Group financial support agreement*)* and C4 (Conditions for financial support) within a certain time period (for example, four months).

However, in view of potential disagreements, the services of DG Internal Market and Services consider that mediation (by EBA, for example) could be useful. If any of the supervisors refer the matter to mediation, the services of DG Internal Market and Services consider that the consolidating supervisor should defer its decision and await any decision from the mediator. In order to address the situation quickly, any mediator would have to take a quick decision (for example, within one month).

The services of DG Internal Market and Services consider that in the absence of a joint decision between the competent authorities within the set timeframe, the consolidating supervisor could take its own decision. However, the decision should take into account the views and reservations of supervisors.

The services of DG Internal Market and Services consider that for reasons of legal certainty, decisions of the mediator and the consolidating supervisor would have to be binding on all supervisors concerned.

Question Box 12

12. Is a mediation procedure necessary, and if so, would the approach under consideration be effective?

Approval of proposed agreement by shareholders (or members of credit institutions for cooperatives) (C3)

The services of DG Internal Market and Services consider that any proposed agreement that has been authorised by the competent authorities must be approved by the shareholders' meeting of every group entity that proposes to enter into the agreement.

The services of DG Internal Market and Services furthermore consider that when agreements are approved, the shareholders' meeting of every group entity that will be a party to the agreement must authorise the respective management body to take a decision that the entity will provide financial support.

The services of DG Internal Market and Services also consider that the management body of each legal entity that is party to an agreement that has been approved by the shareholders could report each year to the shareholders or on the performance of the agreement, and on the implementation of any decision taken pursuant to the agreement.

Question Box 13

13a. Should the agreement specify the consideration for the loans, provision of guarantees or assets, or simply set general principles as to how consideration should be determined for each specific transaction under the agreement (e.g. how the rate of interest should be set)?

13b. If the remuneration is determined by the agreement, how frequently should the terms for remuneration be reviewed?

Possible conditions for group financial support (C4)

The services of DG Internal Market and Services consider that group financial support should only be provided under a group financial support agreement if a number of conditions are met and are included in the agreement. For example:

(a) There is a reasonable prospect that the support provided will redress the financial difficulties of the entity receiving the support.

(b) The provision of financial support has the objective of preserving or restoring the financial stability of the group as a whole.

(c) The financial support is provided for consideration provided to the entity providing the support by the entity that receives it in accordance with the terms of the agreement.

(d) The financial support may only be provided if, on the basis of the information available to the management body at the time when the decision to grant financial support is taken, it is reasonably certain that the loan will be reimbursed or the consideration for the support will be paid by the entity receiving the support.

(e) The financial support may only be granted if it does not jeopardize the liquidity or solvency of the entity providing the support.

(f) The financial support provided in accordance with the agreement may only be granted if the entity providing the support complies at the time the support is provided, and will continue to comply after the support is provided, with the prudential requirements of Directive 2006/48/EC, or any higher capital requirement that has been imposed by the competent authorities acting under any power, unless otherwise decided by the competent authority responsible for the supervision of the entity providing financial support (e.g. use of the buffer of liquid assets).

(g) The financial support complies with other relevant Treaty provisions, including State aid rules where applicable.

Question Box 14

14. Do you agree with the conditions for the provision of intra-group financial support suggested above?

Decision to provide group financial support (C5)

The services of DG Internal Market and Services consider that the decision to provide group financial support in accordance with the agreement could be taken by the management body of the entity providing financial support. That decision should be reasoned and should indicate the objective of the proposed financial support. In particular, the decision could:

(a) indicate how the financial support is justified by an economic, commercial or financial common interest of the group as a whole, including the interest of the legal entity providing the support, and preserves or restores the financial stability of the group as a whole;

(b) confirm that the financial support does not exceed the financial capacities of the legal entity providing the financial support;

(c) confirm that the legal entity providing the financial support will continue to meet legal requirements (for example, the requirements of Directive 2006/48/EC).

Question Box 15

15. Do you agree that the decision to provide financial support should be reasoned? Are *the suggested criteria appropriate?*

Notification of group financial support decision to supervisors and their right to object (C6)

The services of DG Internal Market and Services consider that before the provision of support under a group financial support agreement, the management body of an entity that intends to provide financial support should notify its supervisor. The notification should include details of the proposed support.

The services of DG Internal Market and Services consider that within a certain time frame (for example, 48 hours) after receiving a notification, the competent authority could prohibit or restrict the provision of financial support if the conditions for group financial support are not met or if the financial support jeopardizes the financial stability in the Member State where the entity providing it is established.

However, the services of DG Internal Market and Services consider that before taking this decision, the supervisor responsible for supervising the entity providing the support would have to consult the supervisor of the Member State responsible for supervising the entity receiving the support. That authority should then respond promptly.

A decision of the supervisor to prohibit or restrict the financial support should, in the view of the services of DG Internal Market and Services, be reasoned and should take into account the views of the supervisor of the Member State in which the legal entity receiving the support has been authorised, and the potential impact of its decision on the financial stability in that Member State.

In the opinion of the services of DG Internal Market and Services, if the supervisor responsible for the entity receiving the support disagrees with the decision to prohibit or restrict the financial support, it should be able to request the assistance of the a third party which in this case could be a European authority (for example, the EBA). If the supervisor responsible for the entity receiving the support has requested assistance during the conciliation period, the supervisor could have the power to prohibit or restrict a transfer.

If the supervisor does not prohibit or restrict the financial support, the services of DG Internal Market and Services consider that the financial support should be provided in accordance with the terms submitted to the supervisor.

Question Box 16

16a. Do you agree that the supervisor of the transferor should have the power to prohibit or restrict a proposed transaction under a group financial support agreement on the grounds suggested? Should any other grounds for objection be included in the framework?

16b. What is the appropriate time limit for the reaction of the supervisor?

16c. Should a time limit be set also for the reply to the consultation by the supervisor of the beneficiary?

Request for financial support by a supervisor (C7)

The services of DG Internal Market and Services consider that where a credit institution that is party to a group financial support agreement is in breach or is likely to be in breach of the requirements of Directive 2006/48/EC, the supervisor could require the management body of the credit institution to request financial support pursuant to the agreement, after consulting the other supervisors responsible for supervising the entities subject to the agreement.

Question Box 17

17. Do you consider that supervisors should have the power to require an institution to request financial support?

Insolvency protections for the transferor and its creditors (C8)

The services of DG Internal Market and Services consider that it might be appropriate to require Member States to make targeted modifications to national insolvency regimes to protect the claims of a group entity that provides financial support. The mechanisms under consideration are:

(1) A Priority claim for the transferor over unsecured creditors of the transferee if the transferee becomes insolvent

If an entity that has received financial support in accordance with a group financial support agreement is declared insolvent after having received financial support, the entity that has provided financial support pursuant to the agreement might have a priority claim over the claims of the other creditors of the insolvent company for the reimbursement of the loan or the payment of the financial support consideration.

(2) Claw back regime

If a credit institution that has granted group financial support in accordance with a group financial support agreement is declared insolvent after having provided financial support to an entity pursuant to the agreement, the liquidator of that entity could have a claw back claim against the entity that received the support.

Question Box 18

Two safeguards could be provided for the shareholders and creditors of the transferor. First, in the event of the subsequent insolvency of the transferee, the transferor could have a priority claim on the estate of the transferee against the other creditors of the transferee. Second, in the event of the subsequent insolvency of the transferor, the liquidator of the transferor could have a claw back action to recover the transferred assets from the transferee. However, the appropriateness of these safeguards should be carefully examined, considering that other provisions in the framework already ensure that a) the asset transfer is carried out in the mutual interest of the parties, b) the supervisor is empowered to block the transfer if it harms the solvency of the transferor or financial stability and c) insolvency law is not harmonised and therefore the degree of protection offered by these safeguards might differ significantly among Member States.

18a. Is either or both of these safeguards appropriate?

18b. If adopted, should either be subject to a time limit (for example, the priority claim or *claw back right would apply only if the relevant insolvency is commenced within a specified period – such as 12 months – after the transfer)?*

Exclusion of liability of management (C9)

The services of DG Internal Market and Services consider that national law should be amended to ensure that the mere act of providing group financial support does not give rise to liability of any kind for the members of the management body, provided that the support is provided in accordance with a group financial support agreement and satisfies the conditions specified in this Section.

Question Box 19

19. Do you agree with the proposed exclusion of liability for management?

Disclosure (C10)

The services of DG Internal Market and Services consider necessary that credit institutions that are party to a group financial support agreement should publicly disclose information regarding the agreement in accordance with Articles 145 to 149 of Directive 2006/48/EC.

Question Box 20

20. Do you agree that agreements for intra-group financial support should be disclosed?

D. RESOLUTION PLANS

Extract from the Commission's Communication of October 2010:

"A requirement for up to date resolution plans would apply to all credit institutions and investment firms covered by the regime, with the aim of ensuring the planning necessary to enable the business of the bank or firm to be transferred or wound down in an orderly manner in the event of its failure. These plans are prepared by resolution authorities and supervisors, in close cooperation with the firms which would be required to supply the necessary information. For example, resolution plans would require detail on group structure, intra-group guarantees and service level agreements, contracts and counterparties, debt liabilities, custody arrangements, as well as operational information about IT systems and human resources."

The Services of DG Internal Market and Services consider that this could be achieved through provision to the following effect. It should be emphasised that if a requirement for resolution plans were to apply to all credit institutions and investment firms within an EU resolution framework, that requirement should nevertheless be applied proportionately. This would mean, for example, that for some smaller institutions with no cross-border operations, the plan might simply specify the resolution option of insolvency accompanied by payout of depositors by the deposit guarantee scheme.

Individual Resolution plans (D1)

The services of DG Internal Market and Services consider that resolution authorities, in consultation with supervisors, should be required to draw up and maintain resolution plans for each credit institution for which they are resolution authority.

A resolution plan could:

- set out options for applying the resolution tools to the credit institution in a range of conceivable scenarios, including circumstances of systemic instability;
- identify critical functions, and the necessary support functions, the sudden withdrawal of which would cause wider financial instability, and set out options for ensuring their continuity on the failure of the credit institution;
- identify preparatory measures, including the legal and economic separation of critical functions, that are necessary to facilitate timely and effective action to ensure their continuity on the failure of the credit institution;
- identify and, where relevant, compile the information that will be necessary for the resolution authorities to apply the resolution tools and exercise the resolution powers to implement those options in a timely and effective manner if the credit institution meets the conditions for resolution;
- identify how the resolution options would be financed. The plan shall not assume extraordinary public financial support.

The services of DG Internal Market and Services consider that, on request by the resolution authorities, credit institutions should supply information necessary for the drawing up and maintenance of resolution plans. It is suggested that information requested may include (but should not be limited to):

- information on the legal and operational structures of the credit institution or of the group to which the credit institution belongs;
- a mapping of business activities to the legal entities that perform them;
- a list of critical economic functions within the Group mapped to business lines;
- quantitative information on each critical economic function, including market share, relevant balance sheet information, and the number and geographical location of customers;
- information on the infrastructure supporting critical economic functions, including staff and real property, contracts and licences;
- information on intra-group exposures and exposures to counterparties; and
- details of intra-group contracts and guarantees.

Where information has been supplied, the services of DG Internal Market and Services consider that credit institutions should notify resolution authorities of any subsequent material change in that information in a timely manner.

The resolution authorities should also assess the ability of credit institution to supply up to date and accurate information in a timely manner if required to do so by the authorities before or after the entry into resolution.

It is suggested that resolution plans should be kept under review and updated at least annually.

The services of DG Internal Market and Services are of the view that credit institutions should promptly notify the resolution authorities of any material change to their legal structure, operational organisation or business. On receiving such notification, it is suggested that resolution authorities should consider what changes, if any, should be made to the resolution plan to ensure that its application to the institution continues to be relevant and feasible.

Question Box 21

21a. Should Resolution plans be required for all credit institutions or only those that are systemically relevant?

21b. Would the requirements for resolution plans suggested above will adequately prepare resolution authorities to handle a crisis situation effectively? Are additional elements needed to ensure that resolution plans will provide adequate preparation for action by the resolution authorities in circumstances of both individual and wider systemic failure?

21c. Please estimate:

- the <u>one-off costs</u> in EUR (e.g., investments in IT or other systems);

- the additional ongoing annual cost (e.g. human, subcontracts etc.), including the cost and number of Full-time Equivalent employees,

that your institution would be likely to incur in complying with requirements related to resolution plans.

Group resolution plans (D2)

The services of DG Internal Market and Services consider that group level resolution authorities should be responsible for drawing up and maintaining group resolution plans in cooperation with the other resolution authorities concerned.

It is suggested that group resolution plans should:

- identify the circumstances in which group resolution would be desirable or appropriate;
- set out options for the application of the resolution tools to the group as a whole in a range of conceivable scenarios, including circumstances of systemic instability;
- examine the extent to which the resolution tools and powers could be applied and exercised at the group level in appropriate circumstances and identify any impediments to such application;[12]
- identify measures, including the legal and economic separation of particular functions or business lines, that are necessary to facilitate group resolution;
- set out options and facilitating arrangements for a coordinated resolution of group entities located in the EU in the event that two or more such entities meet the conditions for resolution;
- identify how the group resolution options would be financed and, where appropriate, set out principles for sharing responsibility for that financing between sources of funding in different Member States. The plan would not assume public financial support.

The services of DG Internal Market and Services consider that the group level resolution authorities should ensure the coordination and consistency of the resolution plans of each of the credit institutions that are part of a group.

Preparatory and preventative powers (D3)

The Commission's Communication of October 2010 says:

Extract from the Commission's Communication of October 2010:

"As a complement to measures on resolution planning, the Commission considers that authorities should have clear preventative powers which may be applied in cases where

[12] In particular, group resolution plans should include an assessment of how to facilitate the purchase by a financially sound third party of either the group as a whole, or separate business lines or activities which cut across legal entities, or particular legal entities, and specify how transfer to a bridge institution can practically be executed.

resolution authorities consider that there are impediments to the resolution of an institution or group under the applicable regimes. The objective would be to allow supervisors,[13] after consultation with resolution authorities, to require institutions to adopt measures, including changes to business operations and corporate structure, necessary to ensure that resolution was viable under the applicable legal framework. The preventative powers under consideration include requirements to limit or modify exposures; to increase reporting; to restrict or prohibit certain activities; or to change to group structures (including the mapping of specific activities with legal entities). Given that powers to require changes to legal structures and business arrangements are without doubt intrusive, appropriate checks and balances would therefore be necessary. These would include a right for the firm to challenge any requirement for restructuring imposed by the supervisor or resolution authority."

The services of DG Internal Market and Services consider that this could be achieved through the following.

In preparing the resolution plan, resolution authorities would need to assess whether there are significant impediments, resulting from the legal, operational or business structures of the credit institution, to the effective and timely application of resolution tools and exercise of resolution powers in a way likely to achieve the resolution objectives in all conceivable situations. In particular, the services of DG Internal Market and Services consider that the authorities should satisfy themselves that critical functions could be legally and economically separated from other functions so as to ensure continuity on the failure of the credit institution.

If, as a result of that assessment, a resolution authority identifies significant impediments to the application of the resolution tools or the exercise of the resolution powers, the services of DG Internal Market and Services consider that a resolution authority should:

(a) in consultation with the competent authority for the credit institution in question, draw up a list of measures that the authorities reasonably believe to be necessary to address or remove those impediments; and

(b) notify those impediments and the list of measures to the credit institution.

The services of DG Internal Market and Services are of the view that measures to address or remove impediments might include, in particular:[14]

(a) Requiring the credit institution to draw up service level agreements (whether intra-group or with third parties) to cover the provision of critical economic functions or services;

(b) Requiring the credit institution to limit its maximum individual and aggregate exposures;

[13] The consolidating supervisor, within the meaning of Directive 2006/48/EC, would be responsible for deciding any changes required at group level.

[14] When measures to address or remove impediments to effective resolution (and in particular those mentioned in paragraph (f)), are applied to the whole group, the Group Level Resolution Authority is considered as the authority responsible for the group as a whole (including the group members entities for the purposes of group – rather than specific entity – resolution).

(c) Imposing specific or regular information requirements relevant for resolution purposes;

(d) Requiring the credit institution to limit or cease certain existing or proposed activities;

(e) Restricting or preventing the development or sale of new business lines or products;

(f) Requiring changes to legal or operational structures of the entity for which the resolution authority is responsible [so as to reduce complexity in order to ensure that critical functions could be legally and economically separated from other functions through the application of the resolution tools];

(g) Requiring the credit institution to issue additional convertible capital instruments in excess of the minimum.[15]

The services of DG Internal Market and Services consider that any measures proposed to address or remove impediments should be proportionate to the systemic importance of the credit institution and the likely impact of its failure on financial stability in Member States. They should also take into account any evaluation of systemic risk.

It must be noted that measures requiring changes to legal or operational structures should not prevent credit institutions from exercising the right of establishment conferred by the EU Treaty by establishing branches.

Where a credit institution receives notification with a list of measures, the services of DG Internal Market and Services consider that it may either implement the measures proposed by the resolution authority, or propose alternative measures that would effectively address the impediments identified by the resolution authority. If the credit institution proposes alternative measures, the resolution authority should notify the credit institution within one month whether it agrees to those alternative measures. Where it does not agree, the resolution authority would have to give reasons, and propose revised measures or require the credit institution to implement the measures originally notified. Subject to the outcome of any judicial appeal or review, the credit institution should implement the measures agreed by the resolution authority or the original or revised measures required by it.

Question Box 22

22a. Are the proposed preparatory and preventative powers sufficient to ensure that all credit institutions can be resolved under the framework proposed? Are any further specific powers necessary?

22b. Specifically, should there be an express power to require limitations to intra-group guarantees (or cross-default provisions), in order to address the obstacles that such guarantees may pose to effective resolution? (The intra-group guarantees may represent an obstacle because the guaranteed activities may be more difficult to

[15] See discussion of debt-write down power in the Annex which proposes, as one option, a requirement for institutions to issue a minimum quantity of 'bail-in' debt. This proposed measure would require the credit institution to issue additional 'bail-in instruments' beyond the minimum required by rules if Option 2 in the Annex is adopted.

separate from the rest of the organisation in times of stress, and may limit the ability to sell the guaranteed business.)

22c. In what cases, if any, might the exercise of such powers have an impact on affiliated entities located in other Member States or on the parent entity? In such cases, should a European Authority that could be the EBA play a mediation role, or should the group level resolution authority make the final decision about the application of measures under (D3) to single group entities (irrespective of where they are incorporated)?

Preparatory and preventative powers: Group treatment (D4)

The services of DG Internal Market and Services consider that the group level resolution authorities and the resolution authorities responsible for subsidiaries of an EU parent credit institution or an EU parent financial holding company should consult each other and do everything within their power to reach a joint decision on the application of measures to address or remove impediments to the effective and timely application of resolution tools and exercise of resolution powers (see D4).

For the purposes of preparing and facilitating the joint decision, it is suggested that the group level resolution authority, in cooperation with the consolidating supervisor, should prepare and submit a report analysing the impediments, if any, to effective application of the resolution tools and exercise of the resolution powers in relation to the group, and recommend any measures that, in the view of the authorities, are necessary or appropriate to remove those impediments.

The services of DG Internal Market and Services consider that a joint decision should be reached within six months after submission of that report. It should be reasoned and set out in a document which should be provided to the EU parent credit institution by the group level resolution authority.

If within six months the resolution authorities fail to reach a joint decision, the services of DG Internal Market and Services consider that the group level resolution authority should make its own decision on appropriate measures under (D3) in relation to the group as a whole.

If the resolution authority responsible for a subsidiary reasonably considers that the decision of the group level resolution authority in relation to the group does not address or remove significant impediments to the resolution of the subsidiary, the services of DG Internal Market and Services suggest that resolution authority might require that subsidiary to adopt preventative measures (in accordance with (D3)), provided that (in addition to complying with the general principles set out in (D5)), the application of those measures to the individual subsidiary does not have a significant adverse impact on the functioning of the group as whole or on the application of the resolution tools to the group as a whole.

The services of DG Internal Market and Services consider that before a resolution authority requires a subsidiary to adopt preventative measures under the preceding paragraph, it should take into account the views and reservations of the other resolution authorities expressed during the process of joint decision. The decision to require preventative measures should be set out in a document that identifies the impediments that the measures are intended to address or remove, and explains how the application of resolution tools and exercise of resolution powers would be facilitated by the application of the measures in question.

Preparatory and preventative powers: General principles (D5)

The services of DG Internal Market and Services consider that the following principles should apply to the exercise of preventative powers under (D4) and (D5) by any resolution authority, including a group level resolution authority.

An assessment of the 'resolvability' of an institution should focus only on the legal form, operations and business structure of the institution in question: the operational and financial capacity of the resolution authority to apply the tools or exercise the powers should not be taken into account.

Before proposing measures to address or remove impediments to the application of resolution tools or the exercise of resolution powers, resolution authorities should consider the impact such measures would have on financial stability in other Member States, and not propose measures that will have a significant adverse impact on that stability.

Any such measures should also satisfy the following conditions:

(a) non-discrimination: the measures should be neither directly nor indirectly discriminatory according to the location of the registered office;

(b) necessity: the measures should be justified by an overriding reason relating to the public interest and for this purpose, the public interest should be understood by reference to the ability of the resolution authorities to achieve the resolution objectives (see F2) in the event of the failure of the institution to which the measures are applied);

(c) proportionality: the measures should be suitable for achieving the exclusive objective of addressing or removing impediments to the application of resolution tools or the exercise of resolution powers; they should not go beyond what is necessary to attain that objective and it should not be possible to replace those measures with other, less restrictive measures which attain the same result.

It is suggested that credit institutions should have a right of appeal to the courts or a right of judicial review of any requirement imposed by resolution authorities under (D3) or (D4).

Question Box 23

23a. Do the provisions suggested in (D3) to (D5) achieve an appropriate balance between ensuring the effective resolvability of credit institutions and groups and preserving the correct functioning of the single market?

23b. Do you consider that only the group level resolution authority (rather than the resolution authorities responsible for the affected entities) should have the power to require group entities to make changes to legal or operational structures (see point (e) in the list of possible preparatory and preventative powers in (D3))?

23c. Are there sufficient safeguards for credit institutions in the process proposed?

Preventative powers as a means to tackle general systemic risk (D6)

The services of DG Internal Market and Services consider that the build up of systemic imbalances in the financial markets could constitute an impediment to the application of the resolution tools and exercise of resolution powers where institutions fail in the context of a financial crisis caused by such imbalances. The functions of the European Systemic Risk Board ('ESRB') include identifying such problems and recommending preventative or remedial actions. The Services of DG Internal Market and Services would like to explore the need to provide supervisory or resolution authorities with powers, additional to those that they already have under the CRD or would have under the framework discussed in this paper, that, used in a preventative manner, would enable them and ensure they have the necessary legal competence to implement recommendations issued by the ESRB.

Part 3- EARLY INTERVENTION

The Commission Communication describes measures under consideration in order to address developing problems at entity and group level at an early stage, prevent them from aggravating and secure recovery.

> *Extract from the Commission's Communication of October 2010:*
>
> *"Supervisors' powers of early intervention will be expanded and clarified. New measures available to supervisors might include clear powers to prohibit payment of dividends and, where feasible, coupons of hybrid instruments eligible as regulatory capital; to require the replacement of managers or directors; or to require a bank to divest itself of activities or business lines that pose an excessive risk to its financial soundness."*

The services of DG Internal Market and Services believe that this could be achieved through provision to the following effect.

Early intervention powers (E1)

The services of DG Internal Market and Services consider that powers of early intervention should be granted to the supervisors in those cases where any credit institution does not meet the requirements of the CRD or is likely to fail to meet the requirements of the CRD. The services of DG Internal Market and Services therefore suggest extending the circumstances in which the supervisory powers of early intervention under Article 136(1) CRD may be exercised to include circumstances of a likely breach, and expanding the list of powers under that Article to include the following powers:

- requiring the credit institution to take steps to raise own funds;
- restricting or limiting the business, operations or network of credit institutions; including requiring the divestment of activities that are deemed to pose excessive risks to the soundness of a credit institution;
- requiring credit institutions to use net profits to strengthen the capital base, including by restricting or prohibiting distributions by the credit institution (including payments to hybrid instrument holders);[16]
- requiring credit institutions to request intra-group financial support in accordance with any relevant voluntary agreement (*see section C on group financial support*);

[16] The services of DG Internal Market and Services consider that the term '**distributions**' could be defined in the CRD as part of the amendments to implement capital conservation buffers (to be inserted by CRD 4). The definition provisionally under consideration by those services, as far as it concerns distributions to members is: "any kind of discretionary distribution of the assets of a credit institution to its members and to holders of any other Tier 1 capital instrument, whether in cash or any other form, other than in the context of winding up, and includes cash dividends, fully or partly paid bonus shares, the redemption or purchase of the credit institution's own shares out of capital or out of profits, the repayment of paid up share capital, the reduction or extinction of the liability of any member in respect of share capital not fully paid up, and equivalent forms of distributions to members of non-joint stock companies."

- requiring credit institutions to replace one or more board members or managing directors or require their dismissal;
- imposing additional or more frequent reporting requirements, including reporting on capital and liquidity positions;
- requiring credit institutions to draw up and implement a specific recovery plan;
- requiring credit institutions to draw up a plan for negotiation on restructuring of debt with some or all of its creditors.
- Requiring the credit institution to carry out a full fledged review of its activities, according to stringent stress test requirements, to be able to have a full and accurate picture of the situation, to be submitted to the competent authority for validation

When exercising the powers referred to above, the services of DG Internal Market and Services suggest that supervisors should only take actions or steps that are proportionate to the nature of the breach in question and appropriate to address that breach and restore compliance with the requirements of the CRD.

In the case that the supervisors exercise powers in relation to a credit institution with one or more branches in other Member States, the services of DG Internal Market and Services consider that they should communicate the action or steps they have required, or are considering requiring, the credit institution to take to the supervisors of the host Member States.

The services of DG Internal Market and Services consider that it is important that the credit institutions themselves are required to inform their supervisors as soon as the requirements of the CRD are no longer complied with, or where they are likely to fail to meet the requirements of the CRD. The services of DG Internal Market and Services also consider that for state aid purposes it will be important that the competent authorities inform the Commission without undue delay of the remedial initiatives undertaken or envisaged.

Question box 24

24a. Is the revised trigger for supervisory intervention under Article 136(1) CRD (i.e. extended to include circumstances of likely breach) sufficiently flexible to allow supervisors to address a deteriorating situation promptly and effectively?

24b. Are the additional powers proposed for Article 136 sufficient to ensure that supervisors take appropriate action to address developing financial problems? Are there any other powers that should be added?

Special management (E2)

Extract from the Commission's Communication of October 2010:

"In addition to expanded supervisory powers under the CRD, supervisors could be given the power to appoint a special manager for a limited period of up to one year to take over the management, or assist the existing management, of an institution that is failing to meet the

requirements of the CRD and either has not submitted a credible plan as mentioned in the previous paragraph or fails to implement that plan effectively. The special manager would exercise all the powers of the management but his primary duty would be to restore the soundness of the institution. Shareholders' rights would not be otherwise affected, and shareholder approval would be required for any action by the special manager that would require consent if taken by the directors. The decision to appoint a special manager should not imply a state guarantee or expose supervisors to liability for the actions of the special manager. The extent of liability of the special manager merits further analysis."

The services of DG Internal Market and Services believe that this could be achieved through provision to the following effect.

The services of DG Internal Market and Services consider that, in addition to expanded supervisory powers under Article 136(1) CRD suggested in E1 above, supervisors could be given the power to appoint a special manager for a limited period of up to one year to take over the management, or assist the existing management, of an institution that is failing or likely to fail to meet the requirements of the CRD and either has not submitted a credible plan as mentioned in the previous paragraph or fails to implement that plan effectively.

The services of DG Internal Market and Services suggest that supervisors should have the power to appoint one or more special managers to assist or replace the management of a credit institution in the following cases:

Option 1:

(a) the credit institution fails to provide a specific recovery plan when requested by the supervisor;

(b) the supervisor consider that the specific recovery plan provided by the credit institution would not restore the financial situation of the credit institution;

(c) the management of the credit institution fails to implement the specific recovery plan fully or effectively; or

(d) there is a reasonable likelihood that the credit institution will not prepare or implement the specific recovery plan requested by the supervisor

Option 2:

The supervisor, in exercising the powers under Article 136 CRD to address breaches that give rise to a substantial risk that the credit institution fail, consider that the management of the credit institution is not willing or not able to take the required measures.

Responsibilities and powers of a special manager

The services of DG Internal Market and Services consider that the primary duty of a special manager would be to restore the financial situation of the credit institution by implementing the recovery plan or prepare for winding-down when it is apparent that recovery cannot be achieved within a reasonable timeframe on the basis of the credit institutions' own resources or other means provided at market terms,as agreed by the supervisor, and this duty should override any other duty of management under the statutes of the institution or national law, insofar as they are inconsistent.

A special manager would have all the powers of the management of the credit institution under the statutes of the credit institution and under applicable national law, including the power to exercise the administrative functions and powers of the management of the credit institution.

In particular, a special manager would have the power to convene the General Meeting of the shareholders or of the members of the credit institution and to set the agenda.

The services of DG Internal Market and Services suggest that the appointment of a special management would be for a limited period specified in the instrument of appointment which shall be no longer than one year. That initial appointment could be extended for an additional year if the conditions for appointing a special manager continue to be met and the supervisor reasonably believes that the extended appointment will enable the special manager to restore the financial situation of the credit institution.

It is suggested that the special manager should prepare a report for the appointing supervisor on the financial situation of the credit institution at the beginning and the end of the mandate.

The services of DG Internal Market and Services consider that supervisors could not be held liable to the shareholders or creditors of a credit institution to which they have appointed a special manager for any actions, decisions taken by, or any failure to take an action or decision by the special manager.

It must be noted that the appointment of a special manager would not imply any state guarantee of the bank to which it is appointed.

Question Box 25

25a. Should supervisors be given the power to appoint a special manager as an early intervention measure?

25b Should the conditions for the appointment of a special manager be linked to the specific recovery plan (Option 1 above), or should supervisors have the power to appoint a special manager when there is a breach of the requirements of the CRD justifying intervention under Article 136, but the supervisors have grounds to believe that the current management would be unwilling or unable to take measures to redress the situation (Option 2)?

25c. If the conditions for appointment of a special manager are based on Article 136, is an express proportionality restriction required to ensure that an appointment is only made in appropriate cases where justified by the nature of the breach?

Implementing the recovery plan (E3)

> *Extract from the Commission's Communication of October 2010:*
>
> *With the aim of ensuring that institutions take timely steps to address problems at an early stage, banks and investment firms covered by the framework should be subject to a new obligation, on demand from supervisors, to submit a plan containing the measures they intend to take to restore the institution in a specific situation of financial stress. This obligation would apply where an institution is failing to meet the solvency requirements of the CRD or any future requirements relating to liquidity. It is expected that in most cases, the plan will draw on and apply contingency measures already set out in the firm's recovery plan.*

The services of DG Internal Market and Services consider that this could be achieved through provision to the following effect.

If, as a result of a material deterioration in its financial situation, the credit institution no longer complies with the requirements of the CRD or is likely to fail to meet those requirements, it should implement one or more of the arrangements or measures set out in its recovery plan that in its reasonable assessment are likely to restore its financial situation and its long term viability.

The services of DG Internal Market and Services consider that the credit institution should notify the supervisor of the arrangements and measures that it intends to implement. If the supervisors considers that those measures or arrangements would not effectively restore the financial situation of the credit institution in a timely manner they may suggest alternative actions.

Group treatment: Group recovery plans, appointment of special manager and coordination of measures under Article 136(1) CRD (E4)

Where the conditions for the imposition of requirements under Article 136(1) CRD, the requirement for the appointment of a special management or the implementation of a recovery plan are met in relation to the EU parent credit institution or two or more subsidiaries, the services of DG Internal Market and Services suggest that the consolidating supervisor, in cooperation with the supervisors involved within the supervisory college established under Article 131a (CRD), should assess whether coordination is desirable, taking into account whether:

(a) the implementation of a group recovery plan, the coordination of measures under Article 136(1) or the coordinated appointment of special managers is more likely to restore the viability of the individual entities and preserve the financial soundness of the group as a whole than separate decisions by the individual supervisors; and

(b) the measures taken by one or more supervisors, including the consolidating supervisor, are likely to have an adverse impact on other entities of the group.

It is suggested by the services of DG Internal Market and Services that the decision of the consolidating supervisor as to whether coordination of measures under Article 136(1), the appointing of a special manager or the implementation of a group recovery plan is desirable should be taken promptly (for example, within 24 hours of the assessment by the relevant supervisor that the conditions referred to above are met). As soon as the decision is taken, the consolidating supervisor should communicate it without delay to the other supervisors involved. The consolidating supervisor should take into account the potential impact of its decision on the financial stability of other Member States.

The services of DG Internal Market and Services also consider that failing a decision within a specified deadline (for example, 24 hours), the supervisor responsible for supervising subsidiaries of an EU parent credit institution or EU financial holding company should be permitted to take their own decisions.

The services of DG Internal Market and Services do not expect that supervisors will always agree on the specific measures to be taken with respect to a group. However, the services of DG Internal Market and Services consider that for the system to be efficient a single decision with respect to the recovery of a group should be encouraged. To this end the services of DG Internal Market and Services consider that, in those cases where the supervisor for an entity covered by the decision taken by the consolidating supervisor does not agree with that decision, it should be able to refer the matter to a third party. Ideally, that third party would be a European authority (for example, the EBA). In that case, the consolidating supervisor would defer the application of its decision and await any decision that the Authority might take. The mediation Authority should take its decision within a specified deadline (for example, 24 hours). The supervisors should comply with that decision.

Question Box 26

26a. Do you agree that the decision as to whether the implementation of the group recovery plan, or the coordination at group level of measures under Article 136(1) CRD or the appointment of special managers, are necessary should be taken by the consolidating supervisor?

26b. Should the supervisors of subsidiaries included in the scope of any such decision by the consolidating supervisor by bound by that decision (subject to any right to refer the matter to a European Authority that could be the EBA)?

26c. Is a mechanism for mediation by a European Authority appropriate in this context, and should the decision of that Authority be binding on all the supervisors involved?

2d. Is the suggested timeframe (24hours) for decisions by the consolidating supervisor and the mediation authority appropriate in the circumstances?

Assessment of group level recovery plans (E5)

The services of DG Internal Market and Services suggest that where the consolidating supervisor decides that it is desirable to implement a group recovery plan (see E4 above*)*, the EU parent credit institution or the EU financial holding company should notify to the consolidating supervisor the arrangements or measures that the EU parent credit institution or the EU financial holding company intends to take to implement the group recovery plan in the specific circumstances to restore the financial situation and the long term viability of the group entities and the group as a whole, and, where appropriate, the measures that individual subsidiaries should take individually to achieve that outcome.

It is the opinion of DG Internal Market and Services that the consolidating supervisor should communicate those arrangements or measures to all supervisors concerned.

The consolidating supervisor, in cooperation with the relevant supervisors in the context of the supervisory college established under Article 131a CRD, would need to assess whether the proposed way of implementing the group recovery plan is sufficient and credible.

It is suggested that if the consolidating supervisor, in cooperation with the relevant supervisors, considers that proposed measures or arrangements would not effectively restore the financial situation of the credit institutions within a group or the group as a whole in a timely manner, it may suggest alternative actions. In taking its decision, the consolidating supervisor should take into account the views expressed by the supervisors responsible for the supervision of the subsidiaries.

In case of disagreement as to the decision taken by the consolidated supervisor, the services of DG Internal Market and Services consider that mediation by a third party (ideally a European authority such as the EBA) could be appropriate.

It is suggested that where the consolidating supervisor decides that the implementation of the group recovery plan is not desirable, each subsidiary credit institution that no longer complies with the requirements of the CRD or is likely to fail to meet those requirements should implement its own recovery plan (see section E3).

Question Box 27

27. Do you agree that the consolidating supervisor should be responsible for the assessment of group level recovery plans?

Part 4- RESOLUTION TOOLS AND POWERS

F- Resolution: conditions, objectives and general principles

Extract from the Commission's Communication of October 2010:

"Triggers for Resolution

For reasons of financial stability, the threshold conditions for the use of resolution tools and powers need to ensure that resolution authorities are able to take action before a bank is balance sheet insolvent. Delaying intervention until the bank has reached that point is likely to limit the choice of effective options for resolution or increase the amount of funds that would need to be committed in support of such an option. However, because the tools may involve a significant interference with the property rights of shareholders and creditors, the triggers for resolution must also ensure that resolution action is not taken before all other realistic recovery options are exhausted and that the intervention is in the public interest.

The Commission is considering a range of options that aim to capture the requirement that an institution should be in serious distress without any realistic prospects of recovery in a timeframe that is appropriate to the risks to financial stability posed by the institution's distress and likely failure. Possible threshold conditions aimed at the solvency or liquidity of an institution include an assessment by supervisors that the institution has incurred or is likely to incur losses that will deplete its regulatory capital; that its assets are likely to be less than its liabilities; that it is likely to be unable to pay its obligations in the normal course of business; or, more broadly, that it does not have adequate resources to carry on its business. More qualitative options include a supervisory assessment that the institution no longer meets, or is expected to fail to meet, the conditions of its licence to carry on banking or investment business. There is obviously a degree of overlap between these options, and the Commission will consider further which strike the best balance between flexibility and objectivity.

In addition to qualitative or quantitative triggers of the kind outlined above, the Commission proposes to include a further condition that resolution is necessary in the public interest. The public interest test would be met, for example, if winding up the institution under ordinary insolvency proceedings did not ensure the stability of the financial system or continuity of essential financial infrastructure services. If the public interest condition not satisfied, the institution should be wound up once the threshold for insolvent liquidation is reached."

Conditions for Resolution *(F1)*

The Services of DG Internal Market and Services consider that resolution authorities should apply the resolution tools and exercise the resolution powers when a credit institution is failing or likely to fail, and the conditions for resolution are met.

The services of DG Internal Market and Services are considering three options for possible trigger conditions for resolution, which might be adopted singly or in combination. Option 1 focuses on conditions that are similar those for insolvency but, by including case where the institution is *likely to* meet the conditions specified, would allow intervention before actual balance sheet insolvency. Option 2 suggests a condition based on supervisory assessment of continued compliance with the conditions for authorisation. Option 3 proposes a purely quantitative, capital trigger.

<u>Option 1</u>

A credit institution is failing or likely to fail if one or more of the following circumstances applies:

(a) it has incurred or is likely to incur in losses that will deplete its equity,

(b) the assets of the credit institution are or are likely to be less than its obligations, or

(c) it is or is likely to be unable to pay its obligations in the normal course of business.

<u>Option 2</u>

A credit institution is failing or likely to fail if the credit institution no longer fulfils, or is likely to fail to fulfil, the financial conditions for authorisation;

<u>Option 3</u>

A credit institution is failing or likely to fail if the credit institution no longer possesses, or is likely to fail to possess, sufficient Tier 1 instruments, as required under Chapter 2 of Title V of the CRD to meet the requirements of Article 75 of the CRD.

In addition to a condition that the institution is failing or likely to fail, however this is defined, the services of DG Internal Market and Services suggest two supplementary conditions.

- The first is that no other measures[17] are likely to avert failure and restore the condition of the institution in a reasonable timeframe. This should ensure that resolution is a 'last resort'.

- The second, mentioned in the Commission's Communication of October 2010, is that the application of resolution tool is necessary in the public interest. The services of DG Internal Market and Services suggest that the public interest should be defined by reference to a set of resolution objectives, based on financial stability, continuity of essential services, protection of public funds and protection of depositors (see section F3 below

Question Box 28

28. Which of the options proposed, either alone or in combination, is an appropriate trigger to allow authorities to apply resolution tools or exercise resolution powers?

In particular, are they sufficiently transparent, and practicable for the authorities to apply? Would they allow intervention at the appropriate stage?

[17] Such as fresh capital rising by the ailing institutions or asset disposal, and excluding public support measures.

The services of DG MARK believe that the triggers should be necessary but not sufficient conditions to apply the resolution tools. In addition, resolution authorities should apply the resolution tools and exercise the resolution powers only if:

(a) there should be no reasonable prospect that the credit institution will be able with its own or other private means to rectify the relevant circumstance within a period that is reasonable given the nature of the circumstances without action by the resolution authorities and liquidation under the generally applicable insolvency regime would not meet the resolution objectives; and

(b) the application of resolution tools or exercise of resolution powers should be justified in the public interest. For this purpose, an action will be justified in the public interest if it is necessary to meet one or more of the resolution objectives.

Notification requirements (F2)

It is suggested by the Services of DG Internal Market and Services that the management of credit institutions should promptly notify their supervisors as soon as they are aware that the credit institution is failing or likely to fail. (This concept refers to the conditions for resolution explored in F1 above.)

The services of DG Internal Market and Services also consider that supervisors should take measures to ensure that they will be aware in a timely manner (irrespective of whether they are notified of the fact) whether a credit institution is failing or likely to fail. Where the supervisors assess that a credit institution is likely to meet the conditions for resolution in the near future, they should notify without delay that assessment to the resolution authorities under, including, where applicable, the group level resolution authority and to the consolidating supervisor.

It is suggested that the supervisors should inform the resolution authorities of any measures they require to be taken under Article 136(1) CRD designed to address breaches that give rise to a substantial risk that the credit institution will meet the conditions for resolution, and their assessment as to whether the implementation of credit institution's recovery plans is likely to restore the financial situation of the credit institution.

On receiving notification from the competent authority that a credit institution is likely in the near future to meet the conditions for resolution, it is suggested that the resolution authority should monitor whether the credit institution in fact meets the conditions for resolution. When those conditions are met and the resolution authority formally decides to apply a resolution tool, it should make that decision public.

Resolution Objectives (F3)

As mentioned in the Introduction, the overriding goal of an EU resolution framework is to ensure that authorities have at their disposal credible resolution tools, allowing them to resolve failing institutions in a way that minimises risks of contagion and ensures continuity of essential financial services, including continuous access to deposits for insured depositors. The availability of such tools is also intended to minimise moral hazard.

The services of DG Internal Market and Services suggest that when applying the resolution tools and exercising the resolution powers, resolution authorities should have regard to the resolution objectives, and choose the tools and powers that best achieve the objectives that are relevant in the circumstances of the case.

The following resolution objectives are suggested:

(a) to ensure the continuity of essential financial services;

(b) to avoid adverse effects on financial stability, including by preventing contagion;

(c) to protect public funds;

(d) to protect insured depositors.

It must be noted that the resolution objectives should be of equal significance, and resolution authorities should balance them as appropriate to the nature and circumstances of each case.

Where the use of resolution tools or powers is not necessary having regard to the resolution objectives, the services of DG Internal Market and Services consider that a credit institution that is failing or is likely to fail should be liquidated under the applicable insolvency proceedings.

Question Box 29

29. Do these objectives comprehensively encapsulate the public interest considerations that justify resolution? Should any have precedence? Are there any other objectives that we should consider?

General principles governing resolution *(F4)*

This section sets out general principles that should guide actions by resolution authorities. They are intended to be subordinate to the resolution objectives (which define the necessary element of public interest that justifies resolution).

The services of DG Internal Market and Services suggest that when applying the resolution tools and exercising the resolution powers, resolution authorities should take all appropriate measures to ensure that:

(a) shareholders first bear the losses of the credit institution;

(b) unsecured creditors bear the residual losses;

(c) where appropriate, senior management of the credit institution is replaced and bear losses in accordance with its responsibility;

(d) creditors of the same class are treated in fair and equitable manner, and no creditor incurs greater losses that would be incurred under liquidation.

(e) interference with property rights does not contravene the European Convention on Human Rights and fundamental freedoms, including as they result from the constitutional conventions common to Member States.

In determining which resolution tool and power to exercise, it is suggested that the resolution authorities should seek to minimise the overall costs of the resolution.

When applying the resolution tools and exercising the resolution powers, the services of DG Internal Market and Services consider that resolution authorities should ensure that a fair and realistic valuation of the credit institution is carried out by an independent valuer appointed by the resolution authority. Where independent valuation is not possible in the circumstances of the case, the authorities could carry out the valuation, provided that it is subsequently verified by an independent valuer. That valuation should be based on prudent and realistic assumptions, including as to rates of default and severity of losses, and its objective should be to assess the market value, on the basis that any losses that could be derived from the assets transferred are recognised at the moment the resolution tools are exercised, with full transparency and disclosure of impairments.

Question Box 30

30a. Are these principles appropriate?

30b. In particular, is it necessary to include a general principle that creditors of the same class should be treated equally or should resolution authorities be able to derogate from this principle in specific circumstances?

30c. Is it necessary to require independent valuation, and are the objectives of that valuation appropriate?

G: RESOLUTION TOOLS, POWERS, MECHANISMS AND ANCILLARY PROVISIONS

Extract from the Commission's Communication of October 2010:

"The resolution framework will need to consist of resolution tools that comprise a combination of resolution powers. The framework will specify both the tools and the powers, together with threshold conditions that must be satisfied before they can be applied and exercised.

The ***resolution tools*** *include a sale of business tool which will enable authorities to effect a sale of the credit institution or parts of its business to one or more purchasers without the consent of shareholders;[1] a bridge bank tool which would enable authorities to transfer some or all the business of a failing credit institution (including its deposits or mortgage book) to a temporary bridge bank;[1] an asset separation tool to enable authorities to transfer under-performing or 'toxic' assets to a separate vehicle (a 'bad bank') in order to 'cleanse' the balance sheet of a troubled bank; and a debt write down tool. The* ***resolution powers*** *are the various legal powers that, in different combinations, authorities exercise when applying the resolution tools. These include the core powers to transfer shares in, or assets, rights or liabilities of, a failing bank to another entity such as another financial institution or a bridge bank; powers to write off or cancel shares, or write down or convert debt of a failing bank; power to replace senior management and power to impose a temporary moratorium on the payment of claims. Supplementary powers may also be needed, including a power to require continuity of essential services from other parts of the group."*

The services of DG Internal Market and Services consider that this could be achieved through the following elements specifying the tools listed in the Communication, certain conditions governing their use, the core powers that authorities need to be able to apply the tools, together with ancillary powers designed to ensure that transfers of ownership, securities or other assets, rights or liabilities are effective, and that transferred business can continue to operate immediately after the transfer.

Resolution Tools: General (G1)

The services of DG Internal Market and Services consider that the resolution authorities should have the power to apply the following resolution tools, either singly or in conjunction, to a credit institution in any case where the circumstances and conditions specified in [see threshold conditions] apply and are satisfied:

(a) the sale of business tool;

(b) the bridge bank tool;

(c) the asset separation tool;

(d) the debt conversion tool [**see discussion of debt write down or conversion in Annex**].

The use of these tools is without prejudice to the application of State aid rules, where applicable.

Question Box 31
31a. Are these tools sufficiently comprehensive to allow resolution authorities to deal effectively with failing banks in the range of foreseeable circumstances? Are there any others that we should consider?
31b. Should resolution authorities be restricted to using these tools, or should Member States be able to supplement the proposed EU resolution framework with national tools and powers?

The sale of business tool (G2)

The sale of business tool enables resolution authorities to effect a sale of the credit institution or the whole or part of its assets and liabilities to one or more purchasers on commercial terms, without requiring the consent of the shareholders or complying with procedural requirements that would otherwise apply.

It is suggested that the resolution authorities should market, or make arrangements for the marketing of, the credit institution, or the rights, assets and liabilities of the credit institution that are intended to be sold. Where appropriate, pools of rights, assets, and liabilities could be marketed separately. The marketing could be carried out by the solicitation of particular potential acquirers. The process must be open, transparent, unconditional, non-discriminatory, free from any conflict of interest and does not confer any unfair advantage on any potential acquirer. The resolution authority should establish that the sale of the business is less costly compared to alternative options (e.g. partial or total liquidation).

It must be noted that transfers between the affected credit institution and the third party purchaser are subject to the safeguards for partial property transfers suggested in sections H1 to H6.

The services of DG Internal Market and Services consider that supervisors should carry out the requirements of Article 19 of Directive 2006/48 (supervisory approval of change of control) in a timely manner that does not delay the application of the sale of business tool.

Question Box 32
32. Do you agree with the proposed conditions for the sale of business tool, and in particular the requirement for marketing?

Bridge bank tool (G3)

For the Services of DG Internal Market and Services, the bridge bank tool is a tool that enables resolution authorities to transfer all or part of the business of the credit institution to a bridge bank.

For the purposes of the bridge bank tool, a "bridge bank" should mean a company or other legal person which is wholly owned by one or more public authorities (which may include the resolution authority). It is suggested that the resolution authorities would specify the contents of the constitutional documents of the bridge bank.

It must be noted that use of this tool is without prejudice to other restructuring measures that may be needed to ensure the robustness of the financial situation of either the bridge bank or the credit institution.

The services of DG Internal Market and Services consider that the total value of liabilities transferred to the bridge credit institution should not exceed the total value of the rights and assets transferred or provided from other sources.

The Services of DG Internal Market and Services consider that the bridge bank tool should be used in the following way. In applying the bridge bank tool, the resolution authorities should be able to:

(a) transfer rights, assets or liabilities from the affected credit institution to the bridge bank on more than one occasion; and

(b) transfer rights, assets or liabilities back from the bridge bank to the affected credit institution if this is necessary in view of the resolution objectives.

Transfers between the affected credit institution and the bridge bank would be subject to safeguards for partial property transfers. Such possible safeguards are discussed in Section H of this consultation document.

The Services of DG Internal Market and Services consider that a bridge bank should be licensed in accordance with the Capital Requirements Directive (Directive 2006/48/EC) or (in the case of a 'bridge investment firm' should such a structure be appropriate – see Question Box 1) with the Market in Financial Instruments Directive (Directive 2004/39/EC), and must have the necessary authorisation under the applicable national law to carry on the business resulting from the transfer of rights, assets or liabilities by means of the bridge bank tool. It would be subject to supervision in accordance with the relevant EU and national implementing law. The resolution authority (or another public authority) should appoint directors and managers of the bridge bank, who would have the duties and liabilities under the applicable law and, subject to any constraints under EU competition law, would operate the bridge bank as a commercial enterprise.

The Services of DG Internal Market and Services consider that for the purpose of the free provision of services and the freedom of establishment, the bridge bank should be considered as a continuation of the credit institution that is being resolved.

In the view of the Services of DG Internal Market and Services, the ultimate objective of the bridge bank tool should to facilitate the sale of the bridge bank, or the whole or part of its business, to one or more purchasers on commercial terms. The management of the bridge bank should aim at maintaining rather then expanding the business. The operations of a bridge bank are temporary, and its operations should be terminated within one year. However, the resolution authorities may extend this period for no more than 2 additional 6-month periods in duly justified circumstances. If the bridge credit institution is not sold before the end of the maximum period, it should be wound up.

The Services of DG Internal Market and Services consider that shareholders of the affected credit institution, and its creditors, should not have any rights over the bridge bank or its property, except the right to any residual value realised from the sale of a bridge bank once all other creditors and claimants and expenses of the crisis management authorities (other than those to be met by Deposit Guarantee Scheme) have been repaid in full.

The Services of DG Internal Market and Services consider that the residual bank should be managed as to ensure its winding-up and its short-fall be at charge of the credit institutions shareholders and uninsured creditors, according to the relevant national liquidation rules.

In this section, the term "affected credit institution" refers to a credit institution to which resolution tools are applied.

Question Box 33

33a. Should the EU framework include an express requirement that the residual bank (that is,. the entity that remains after the transfer of some, but not all, assets and liabilities to a purchaser) must be wound up? Are there likely to be circumstances where the residual bank is required to provide support to the purchaser or other remaining group entities?

33b.Should a bridge bank be permitted to operate without complying with the initial authorisation and ongoing requirements of the CRD, in particular without minimum capital? If that is the case, should its activities be subject to restrictions?

33c. A bridge bank is intended to be a temporary structure. Is it appropriate to limit the operation of the bridge bank to 2 years maximum? Would it be preferable to impose a shorter or a longer limit?

Asset separation tool (G4)

The purpose of the asset separation tool would be to enable resolution authorities to transfer certain assets of a credit institution to an asset management vehicle for the purpose of facilitating the use or ensuring the effectiveness of another resolution tool. In this context, an "asset management vehicle" refers to a legal entity which is wholly owned by one or more public authorities (which may include the resolution authority).

The Services of DG Internal Market and Services consider that the asset separation tool should be used in the following way. First, in order to address concerns about moral hazard associated with the use of this tool that might otherwise arise, it should only be used in conjunction with another resolution tool.

The Services of DG Internal Market and Services consider that in using the asset separation tool, resolution authorities should identify assets of the affected credit institution which, as a result of the level of risk they entail or of difficulties in establishing their value, jeopardise the financial soundness of the affected credit institution, and transfer those assets to an asset management vehicle for fair consideration. The resolution authority should appoint asset managers to manage the assets transferred to the asset management vehicle with the objective of maximising their value through eventual sale, while avoiding conflicts of interest, and in accordance with any other objectives imposed by the resolution authority. Shareholders of the affected credit institution, and its creditors, should not have any rights over the asset management vehicle or it assets.

In order for the tool to be effective, the Services of DG Internal Market and Services consider that the resolution authorities should be able to:

(a) transfer assets from the affected credit institution to the asset management vehicle on more than one occasion; and

(b) transfer assets back from the asset management vehicle to the affected credit institution if this is necessary in view of the resolution objectives.

Transfers between the affected credit institution and the asset management vehicle would be subject to safeguards for partial property transfers. Such possible safeguards are discussed in Section H of this consultation document.

In order to minimise distortions of competition between banks and between Member States, State aid rules will need to be complied with.

Question Box 34

34. Should the use of the asset management tool as a stand-alone tool for resolution be prohibited in order to avoid the 'rescue' of a failing bank?

Debt write down tool*: *See Annex I

The Services of DG Internal Market and Services consider that a mechanism which would enable resolution authorities to write down the claims some or all of the unsecured creditors of a failing institution and, possibly, to covert debt claims to equity, would offer a valuable additional resolution tool that would allow authorities greater flexibility in their response to the failure of large, complex financial institutions. However, the Services are also aware of the practical and legal challenges in designing an appropriate mechanism. A number of work streams currently underway in international fora are relevant to the Commission's policy development in this area. These include, in particular, the work of the Basel Committee on Banking Supervision on capital instruments that absorb losses at the point of non-viability, and the FSB work stream on 'bail in' in the context of improving the resolvability of systemically important financial institutions (SIFIs). It is important that EU policy in this area should take proper account of the outcome of such work, and aim for international consistency as far as possible.

Given this, the Services of DG Internal Market and Services consider that it is more appropriate at this stage to consult in more general terms on the legal and practical questions raised by the concept of debt-write or conversion as a resolution tool and on the possible design options. The key issues and a brief presentation of alternative approaches, together with related questions, are set out in **Annex I**.

Resolution powers (G5)

The Services of DG Internal Market and Services consider that in order to apply the resolution tools, resolution authorities would need the following resolution powers:[18]

(a) the power to take control of the affected credit institution;

(b) the power to transfer shares and other instruments of ownership issued by an affected credit institution. For the purposes of this power, instruments of ownership should include instruments that confer ownership in mutual associations, instruments that are convertible into or give the right to acquire shares or instruments of ownership, instruments representing interests in shares or instrument of ownership;

(c) the power to transfer debt instruments issued by an affected credit institution. For the purposes of this power, 'debt instruments' would encompass bonds and other forms of transferable debt, any instrument creating or acknowledging a debt, and instruments giving rights to acquire debt instruments.

(d) the power to transfer to another undertaking or person specified rights, assets and liabilities of a credit institution to which resolution tools are applied;

(e) the power to write off or cancel the shares or other instruments of ownership issued by the affected credit institution;

(f) the power to reduce or write off the claims of unsecured creditors of an affected credit institution;

(g) the power to convert certain debt instruments or other non-core Tier 1 instruments issued by an affected credit institution or an affiliate into shares or other instruments of ownership in that credit institution or in a parent credit institution or parent financial holding company;

(h) the power to require the conversion of debt instruments which contain a contractual term for conversion on an official action or decision that an institution is failing or that intervention by resolution authorities is or is likely to be necessary;

(i) the power to remove or replace the senior management of an affected credit institution;

(j) the power to issue new shares.

In this context, "affected credit institution" refers to a credit institution to which resolution tools are applied.

The Services of DG Internal Market and Services believe it is important that, subject to the provision of adequate compensation, resolution authorities should be able to exercise the resolution powers without complying with any procedural requirements, or receiving any

[18] The powers suggested in (e) to (h) to write off shares and write down or convert debt should be available in connection with the use of all resolution tools (and are not proposed only for the purpose of the possible debt write down tool that is discussed in Annex I).

consent from the creditors or shareholders of the credit institution to which the resolution tools are applied, that would otherwise apply by virtue of EU or national law.

> ***Question Box 35***
>
> *35. The powers set out in this section G5 are intended to ensure that resolution authorities have all the necessary powers to apply the resolution tools. Are the suggested powers comprehensive? Are any additional powers necessary?*

Transfer powers*: *Ancillary provisions (G6)

The Services of DG Internal Market and Services believe that, in order for the resolution tools and transfer powers to be effective, the following ancillary provisions would be necessary.

First, the framework should provide that the powers to transfer shares, other instruments of ownership, debt instruments and assets, rights and liabilities must be exercisable irrespective of any restriction on, or requirement of consent for, transfer of the financial instruments, rights, assets or liabilities in question that might apply otherwise apply.

Second, the Services of DG Internal Market and Services consider that, when effecting a transfer of shares, other instruments of ownership, debt instruments or assets, rights or liabilities, resolution authorities should, where necessary for the effective application of the resolution tools, be able to:

(a) provide for the transfer to take effect free from any liability or encumbrance affecting the financial instruments, rights, assets or liabilities transferred (subject to the appropriate compensation of affected third parties);

(b) remove rights to acquire further shares or other instruments of ownership (subject to the appropriate compensation of affected third parties);

(c) discontinue the admission to trading on a regulated market or the official listing of financial instruments that have been transferred;

(d) provide for the recipient to be treated as if it were the transferor for the purposes of any obligations, contracts or arrangements or actions taken by the transferor; and

(e) require the transferor or the recipient to provide the other with information and assistance.

Third, the Services of DG Internal Market and Services consider that, when effecting a transfer of shares, other instruments of ownership, debt instruments or assets, rights or liabilities, resolution authorities should be able to provide for continuity arrangements necessary to ensure the effective application of the resolution tools and the smooth operation of the business transferred. Such continuity arrangements would include, in particular:

(a) the continuity of contracts entered into by the transferor, so that the recipient assumes the rights and liabilities of the transferor relating to any financial instrument, right, asset or liability that has been transferred and is substituted for the transferor (whether expressly or impliedly) in all relevant contractual documents;

(b) the substitution of the recipient for the transferor in any legal proceedings relating to any financial instrument, right, asset or liability that has been transferred.

Fourth, The Services of DG Internal Market and Services believe it is important to provide that where a resolution authority applies a resolution tool or exercises a resolution power, no person may exercise any right or power to terminate, accelerate or declare a default under any contract or agreement to which the credit institution is a party or to obtain possession or exercise control over any property of the credit institution or affect any contractual rights of the credit institution without the consent of the resolution authority. (Related provision to this effect is discussed in Section H.)

Question Box 36

36. The ancillary provisions set out in this section G6 are intended to ensure that where business has been transferred to another entity through the use of a resolution tool, the transfer is effective and the business can be carried on by the recipient. Are the suggested provisions sufficient? Are any additional provisions necessary?

Transfer powers: continued support from transferor (G7)

The Services of DG Internal Market and Services believe it is important that resolution authorities have the power to require a residual credit institution to provide any services or facilities that are necessary to enable a recipient to operate effectively the business transferred to it by virtue of the application of the sale of business tool or the bridge bank tool. Any such contractual arrangements should, as far as possible, be on commercial terms.

Question Box 37

37. Should this power be extended to allow authorities to impose equivalent requirements on other entities of the same group as the residual credit institution?

Transfers of foreign property (G8)

The Services of DG Internal Market and Services believe that provision is needed to ensure that, where a transfer of shares, other instruments of ownership, debt instruments, or assets, rights or liabilities includes:

(a) assets that are located in a Member State other than the State of the resolution authority; or

(b) rights or liabilities under the law of a Member State other than the State of the resolution authority,

the transfer has effect in or under the law of that other Member State. In particular, Member States should provide the resolution authority that has made or intends to make the transfer with all reasonable assistance to ensure that the assets, rights or liabilities are transferred to the recipient in accordance with any applicable requirements of national law.

The Services of DG Internal Market and Services consider that creditors and third parties that are affected by the transfer of assets, rights or liabilities that are located in or subject to the law of a different Member State should not be entitled to prevent, challenge, or set aside the transfer under any provision of law of that other State. Such creditors and third parties should have the same rights and protections, including the right to compensation and the safeguards for partial transfers as creditors and third parties that are affected by the transfer of assets, rights or liabilities that are located in or under the law of the State of the resolution authority and, in particular, should receive compensation on the same terms, if applicable. This principle, if adopted, might require modifications to the Directive on the reorganisation and winding up of credit institutions (Directive 2001/24/EC) where the provisions of that Directive are inconsistent. Otherwise, the rights of creditors and third parties as against the recipient should not be affected, and the law governing those rights should be determined in accordance with the normal principles.

Finally, the Services of DG Internal Market and Services consider that where a transfer of shares, other instruments of ownership, debt instruments or assets, rights or liabilities includes assets that are located in a third country, or rights or liabilities under the law of a third country and the transfer is not immediately effective as a matter of the law of the relevant third country:

(a) the transferor and the recipient must take all necessary steps to ensure that the transfer becomes effective; and

(b) the transferor must hold the assets or rights or discharge the liability on behalf of the recipient until the transfer becomes effective, and the recipient meets the expenses of transferor in doing so.

Question Box 38

38. The objective of the provisions suggested in this section G8 is to ensure that where a transfer includes assets located in another EU Member State (e.g. in a branch) or rights and liabilities that are governed by the law of another Member State, the transfer cannot be challenged or prevented by virtue of provisions of the law of that other Member State. Are the suggested provisions sufficient to achieve this objective? Is any additional provision necessary?

Legal means by which resolution powers are exercised

> *Extract from the Commission's Communication of October 2010:*
>
> *"It is proposed that the framework should not be rigidly prescriptive about the legal means by which the powers are exercised. A number of models currently exist in Member States, including administration, receivership and the simple exercise of executive power. It does not appear necessary for efficient cooperation to impose a single model at this stage."*

Resolution mechanisms (G9)

The Services of DG Internal Market and Services are considering possible mechanisms through which resolution can be carried out, and seeks views on whether an EU legislative framework should include provision on such mechanisms.

The first possible mechanism under consideration is a receivership model. Under this model, and in order to apply the resolution tools, resolution authorities would have the power to take control of a credit institution upon a decision that it is failing or likely to fail. Upon taking control of the credit institution, the resolution authority would manage its property and exercise all the powers of its shareholders and its management, exercise the transfer powers and wind up the residual failed institution.

The second mechanism under consideration is based on administration. The resolution authority would appoint an administrator to the failing bank who would carry out the resolution and wind up the residual failed institution.

Under the final option under consideration, the resolution tools would be applied and the resolution powers exercised through executive order or decree in accordance with national administrative competences and procedures, without control of the credit institution to the which the resolution tool is applied being assumed by the resolution authority or a person appointed by the resolution authority.

The Services of DG Internal Market and Services provisionally consider that resolution authorities should be able decide which resolution mechanism is used in a particular case having regard to the resolution objectives and the general principles governing resolution, the specific circumstances of the credit institution in question and the need to facilitate the effective resolution of cross border groups.

> ***Question Box 39***
>
> *39a. Should all member States be required to make provision in national law for all three mechanisms by which resolution can be carried out that that are suggested above? If the same mechanisms are not available in all Member States, could this pose an obstacle to coordinated cross-border resolution?*
>
> *39b. Should receivership – which allows resolution authorities to take full control of the failing institution - be the primary framework for resolution?*

39c. Is any provision considered in this section necessary, or is it sufficient simply to provide for the resolution tools and powers?

Procedural obligations of resolution authorities *(G10)*

The Services of DG Internal Market and Services consider that an EU legislative framework should include procedural requirements to ensure that resolution measures are properly notified and made public. To this effect, as soon as reasonably practicable after applying the sale of business tool, the bridge bank tool or the asset separation tool or exercising a resolution power to transfer shares, other instruments of ownership, debt instruments or assets, rights or liabilities, resolution authorities should comply with the following procedural requirements.

First, resolution authorities should notify the affected credit institution and the EBA.The notification should include a copy of any order or instrument by which the relevant powers are exercised and shall indicated the date from which the resolution tool is and powers are effective.

Second, the Services of DG Internal Market and Services consider that resolution authorities should be required to publish either a copy of the order or instrument by which the relevant powers are exercised, or a notice summarising the effects of the application of the resolution tool and exercise of the power:

(a) on their official website or on the website of the European Banking Authority; and

(b) in one or more newspapers circulated throughout, or widely circulated within, the Member States where the bank is located, has established branches or provides services.

The Services of DG Internal Market and Services also consider that specific notification requirements would be necessary if the EU legislative framework contains a debt write down tool. Accordingly, they suggest that the resolution authorities should comply with the following procedural obligations as soon as reasonably practicable after applying the debt write down tool or exercising a resolution power to write off or cancel shares or other instruments of ownership, write down claims of creditors, or convert or require the conversion of debt instruments.

First, resolution authorities should notify:

(a) the affected credit institution;

(b) every creditor whose claim is affected by the application of the tool or exercise of the relevant power or powers that the resolution authority is able with reasonable efforts to identify;

(c) every shareholder or holder of an instrument of ownership. Where shares are held by an intermediary for a beneficial owner, resolution authorities may comply with this requirement by notifying the intermediary;

(d) any market where shares in the affected bank or debt instruments that are subject to the write down tool are admitted to trading; and

(e) the EBA.

This notification should include a copy of any order or instrument by which the relevant powers are exercised and indicate the date from which the tool is or powers are effective.

Second, the Services of DG Internal Market and Services consider that resolution authorities should publish either a copy of the order or instrument by which the relevant powers are exercised, or a notice summarising the effects of the application of the debt write down tool:

(a) on their official website or on the website of the European Banking Authority;

(b) in one or more newspapers circulated throughout, or widely circulated within, the Member States where the bank is located and in all jurisdictions where its shares and any debt instruments that are subject to the application of the debt write-down tool are admitted to trading on a market, or in a newspaper.

In this context, "affected credit institution" refers to a credit institution to which resolution tools are applied.

It is finally recalled that where the activation of the resolution tools involve a State aid, a notification by the Member States to the European Commission is warranted under State aid rules of the TFEU.

Question Box 40

40. Are the suggested notification and publication requirements appropriate and sufficient to ensure that all affected parties are adequately informed about a resolution action?

Protection of stakeholders: compensation

Extract from the Commission's Communication of October 2010:

"The application of these tools and powers may interfere with the rights of shareholders and, in most cases, creditors. Accordingly, the framework would include safeguards and mechanisms for compensation where necessary. The guiding principle for compensation that the Commission is considering is that affected stakeholders should suffer no greater loss than they would have suffered if the institution had been wound up under the applicable insolvency regime."

The Services of DG Internal Market and Services are considering the following requirements and principles to give effect to those objectives.

Compensation and valuation (G11)

The Services of DG Internal Market and Services consider that where resolution authorities apply the resolution tools, shareholders and creditors of the credit institution should receive adequate compensation for any interference with their interests in property that the application of the tool or the exercise of the power entails.

Member States should be able to choose the mechanisms by which that compensation is determined and provided, provided that they meet the following core requirements.

The first core requirement that the services of DG Internal Market and Services consider appropriate is that the amount of compensation should be determined by a valuer who is independent from the resolution authority or any other public authority. However, this would not prevent the resolution authority from prescribing principles that the valuer must apply when determining the amount of compensation, including:

(a) the method of valuation;

(b) specified dates or periods on which the valuation must be based;

(c) assumptions as to the ability of the credit institution to meet the conditions under which authorisation was granted or to carry on its activities as a going concern;

(d) any other matters that must or must not be taken into account in the valuation.

The fact that the resolution authority (or the resolution fund) provides remuneration for a valuer's services or allowances to cover the costs of the valuation does not prevent that valuer from being considered as independent.

The second core requirement that the services of DG Internal Market and Services consider appropriate is that, as far as possible, compensation should ensure that creditors do not receive less favourable treatment as a result of the application of the resolution tool or use of the resolution power than they would have received if the resolution tool or power had not been used and the entire credit institution had, at the point when the resolution tools were applied, instead entered insolvency under the applicable national law.

In particular, where a creditor's claim remains with a credit institution from which assets, rights or liabilities have been transferred to another entity and credit institution is wound up following that transfer, the creditor should be compensated if the amount received in that winding up is less than the creditor would have received in the insolvency of the institution if the transfer had not been made.

Finally, the services of DG Internal Market and Services consider that the compensation, if any, should be paid with the proceeds of the sale or transfer of assets. Any difference between these proceeds and the amount of the compensation determined by the valuer should be paid by the resolution fund.

Question Box 41

41. Are the suggested principles sufficient to ensure that creditors receive appropriate compensation?

Temporary suspension of rights

Extract from the Commission's Communication of October 2010:

"[T]he Commission considers that the framework should include provision for a temporary stay on rights to close out netting where authorities transfer relevant contracts as part of a resolution measure, and will consult with experts on the details of such a provision."

The following sections propose a short, temporary suspension of rights enforce obligations against a credit institution under resolution and rights to close out netting, in order to give resolution authorities time to decide which assets or liabilities should be transferred and to effect the transfers. These restrictions should be understood in conjunction with the suggested safeguards for partial transfers described in Section H. The Services of DG Internal Market and Services also consider that rights to challenge the actions of resolution authorities should be restricted to a review of the legality of the action, and that remedies should be limited to financial compensation. In particular, courts should not be able to reverse a resolution action.

Limited suspension of certain obligations (G12)

The Services of DG Internal Market and Services consider that resolution authorities should have the power to suspend any payment or delivery obligations pursuant to any contract to which a credit institution is a party from the time when the credit institution enters into resolution until the later of:

(a) forty-eight hours after the time the suspension is notified; or

(b) 5 pm on the business day following the decision to put the credit institution under resolution.

However, the Services of DG Internal Market and Services believe that eligible deposits within the meaning of the Deposit Guarantee Schemes Directives should not be covered by any such suspension.

Question Box 42

42. Please give your views on the suggested temporary suspension of payment or delivery obligations? Is it appropriate to exclude eligible deposits? Should any other obligations be excluded?

Temporary suspension of close out netting (G13)

The Services of DG Internal Market and Services consider that resolution authorities should have the power impose a temporary suspension of all close out rights of any party under a netting arrangement with a failing credit institution that arise solely by reason of an action or anticipated action by the resolution authority (that is, use of resolution tools or resolution powers).

The suspension should last no longer than:

(a) forty-eight hours after the time the suspension is notified; or

(b) 5 p.m. on the business day following the day on which the suspension is notified

(which ever is the longer period).

In order for a provision of this kind to be effective, it is necessary to identify a clear point from which the suspension would take effect. The Services of DG Internal Market and Services suggest that the suspension might begin from the point when it is notified, and for this purpose it would be treated as notified when the resolution authority makes public its decision. (See section F2, which suggests a requirement for resolution authorities to make public a formal decision to put a bank or investment firm into resolution.)

The provision outlined above provides for determinate point at which the suspension would expire. However, the services of DG Internal Market and Services consider that it might also be appropriate to provide that a person should be able to exercise a right under a netting arrangement before that determinate point if that person receives notice from the resolution authority that the rights and liabilities covered by the netting arrangement will not be transferred to another entity.

The Services of DG Internal Market and Services consider that it is also necessary to include provision about what rights may be exercised on the expiry of the suspension, and in this regard it is appropriate to distinguish between counterparties whose covered rights and liabilities have been transferred to a private sector purchaser or another entity such as a bridge bank, and those whose covered rights and liabilities remain with the residual, failed bank. On the expiry of the suspension:

(a) if the rights and liabilities covered by a netting arrangement have been transferred to another entity ('the transferee'), a person may exercise all rights under that arrangement on the occurrence of any default event under the arrangement in relation to the transferee, as if the default event had occurred in relation to the failing credit institution, but the transfer and any related action by the resolution authority shall not be treated as a default event (and any term to that effect under a netting arrangement shall be void);

(b) if the rights and liabilities covered by a netting arrangement remain with the relevant credit institution, a person may exercise all rights under that arrangement.

In this context:

(a) "close out right" refers to any right of a party to a netting arrangement to close out, terminate, accelerate or net contracts or liabilities;

(b) "netting arrangement" has the meaning given in Section H below (Partial transfers: safeguards for counterparties);

(c) "failing credit institution" refers to a credit institution in relation to which the resolution authority of its home Member States has made a determination that the conditions for resolution are met;

(d) "business day" refers to any day other than Saturday, Sunday and any day which is a public holiday in the home Member State of the failing credit institution;

(e) references to time should be construed as the time in the home Member State of the failing credit institution.

Question Box 43

43. Please give your views on the suggested temporary suspension of close out netting rights, including the appropriate length of the suspension. Should any classes of counterparty be excluded from the scope of such a suspension: for example, Central Banks, CCPs, payment and securities settlement systems that fall within the scope of the Settlement Finality Directive?

Scope of rights to challenge resolution (G14)

The Services of DG Internal Market and Services consider that persons affected by a decision by the resolution authorities to apply, or not to apply, a specific resolution tool or to exercise, or not to exercise, a specific resolution power should have the right to apply to the courts for judicial review of the decision

However, those Services also believe that it is necessary to limit the right to judicial review to a review of the legality and legitimacy of the decision and its implementation by the resolution authority. The court should not have the power to quash or render void the decision under review or reverse its effect, and remedies for a wrongful decision or action by the resolution authorities should be limited to compensation for the loss suffered by the applicant as a result of the decision or action or the level of compensation awarded to classes of persons affected by the decision or action.

Furthermore, the Services of DG Internal Market and Services consider that it is necessary to prevent the opening or pursuit of other legal actions in relation to a bank that is under resolution. To this effect, they consider that resolution authority should have the right to apply to the court to request a stay of up to 90 days in any judicial action or proceeding in which the affected credit institution is or becomes a party.

In addition, an EU framework should include provision to ensure that no insolvency or winding up proceedings under national law can be commenced with respect to a credit institution to which a resolution tool is applied or in relation to which a resolution power is exercised. If any an application for any such proceedings is pending at the time of the decision of the resolution authority to apply a resolution tool, it should be terminated. This suspension should apply until the resolution authority notifies the court that the resolution process is terminated.

Question Box 44

44. Do you agree that judicial review of resolution action should be limited to a review of the legality of the action, and that remedies should be limited to financial compensation, with no power for the court to reverse any action taken by resolution authorities?

Alternatively, should the court have the power to reverse a transfer of assets and liabilities in limited circumstances where unwinding of the transfer is practically feasible and would not cause systemic risk or undermine legitimate expectations?

Confidentiality *(G15)*

Information obtained by resolution authorities and their professional advisers is likely to be sensitive, and the Services of DG Internal Market and Services consider that it should be subject to an effective confidentiality regime. To this end, they suggest that an EU framework should provide that the following persons would be bound by the requirements of professional secrecy:

(a) resolution authorities;

(b) employees or former employees of those authorities;

(c) auditors, accountants, legal and professional advisors and other experts engaged by the resolution authorities;

(d) potential acquirers that are solicited by the resolution authorities, irrespective of whether that solicitation was made as preparation for the use of the sale of business tool, and irrespective of whether the solicitation resulted in an accquisition; and

(e) any other persons who provide or have provided services to the resolution authorities.

The effect of the suggested regime would be that no confidential information received by any such persons in the course of their professional, or from a resolution authority in connnection with its functions, could be divulged to any person or authority unless it is in summary or collective form such that individual credit institutions cannot be identified.

However, the Services of DG Internal Market and Services consider that, for reasons of public interest, certain targeted exceptions to the proposed confidentiality regime are appropriate. First, it is necssary to exclude disclosures made for the purposes of criminal law.

Second, where a credit institution is subject to insolvency proceedings, confidential information which does not concern third parties involved in attemps to rescue that credit institution may be divulged in civil or commercial proceedings.

Finally, the Services of DG Internal Market and Services consider that these restrictions should not prevent resolution authorities from sharing information with other EU resolution authorities, competent authorities, the EBA, or third country authorities that carry out equivalent functions to resolution authorities. However, the provision of information in such circumstances should be subject to the conditions of professional secrecy.

Question Box 45

45. Would the suggested provisions provide adequate protection for confidential information?

H. SAFEGUARDS

> *Extract from the Commission's Communication of October 2010:*
>
> *"In addition, the framework will also include safeguards for counterparties and market arrangements that may be affected by a transfer of property, assets or liabilities, together with provisions on judicial review to ensure that affected parties have appropriate rights to challenge the actions of authorities and seek financial redress, without undermining the legal certainty of the action."*

The provisions suggested in this section are intended to safeguard the interests of counterparties under netting agreements and in connection with security rights. The objective is to prevent resolution authorities for 'cherry picking' rights and liabilities under such protected arrangements. They must either all be transferred together, or not at all.

Partial transfers: safeguards for counterparties (H1)

The Services of DG Internal Market and Services consider that the safeguards for counterparties under consideration should apply where:

(a) a resolution authority transfers some but not all of the property, rights or liabilities of a credit institution to another entity ('a partial transfer'); and

(b) where a resolution authority uses ancillary powers (see section G6 above) to cancel or modify the terms of a contract to which the credit institution under resolution is a party or to substitute a transferee as a party.

In the view of the Services of DG Internal Market and Services, the safeguards under consideration should apply to the following arrangements and the counterparties to such arrangements:

(a) Security arrangements, under which a person has by way of security an actual or contingent interest in the property or rights that are subject to transfer, irrespective of whether that interest is secured by specific property or rights or by way or a floating charge or similar arrangement;

(b) Title transfer financial collateral arrangements under which collateral to secure or cover the performance of specified obligations is provided by a transfer of full ownership of assets from the collateral provider to the collateral taker, on terms providing for the collateral taker to transfer assets if those specified obligations are performed;

(c) Set off arrangements under which two or more claims or obligations owed between the bank and a counterparty can be set off against each other

(d) Netting arrangements under which a number of claims or obligations can be converted into a single net claim, including close-out netting arrangements under which, on the occurrence of an enforcement event (however or wherever defined) the obligations of the parties are accelerated so as to become immediately due or are terminated, and in either case are converted into or replaced by a single net claim.

(e) Structured finance arrangements, including securitisations and covered bonds, which involve the granting and holding of security by a party to the arrangement or a trustee, agent or nominee.

The Services of DG Internal Market and Services consider that the safeguards under consideration should apply to those arrangements irrespective of how they have been created and irrespective of the number of parties involved in the arrangements. In particular, they would apply regardless of whether the arrangements:

- are created by contract, trusts or other means, or arise automatically by operation of law;

- arise under or are governed in whole or in part by the law of another jurisdiction.

The safeguards suggested in this Section would, however, be subject to the restrictions on the exercise of contractual rights to terminate, accelerate or otherwise close out suggested under G13 above (*Temporary stay on close-out netting rights*).

The Services of DG Internal Market and Services consider that it would also be necessary to specify that where a resolution authority purports to transfer all of the property, rights and liabilities of a credit institution to another entity, but the transfer is or may not be effective in relation to certain property because it is outside the European Union, or to certain rights or liabilities because they are under the law of a territory outside the European Union, that transfer should not be treated as a partial transfer and should not be subject to the suggested safeguards.

The following section H2 to H4 suggest further detail about the forms of the safeguards that the Services of DG Internal Market and Services consider appropriate for the classes of arrangements outlined above.

Question Box 46

46a. Do you agree that the classes of arrangement suggested in this section should be subject to the suggested safeguards in the case of partial property transfers? Should any other market arrangements be included?

46b. As a general approach, this Section H suggests a set of outcomes that Member States need to achieve (i.e. transfer of all or none of the property, rights and liabilities that covered by the various kinds of market arrangements that are specified here). It does not prescribe how that should be done or, in particular, the consequences if a transfer contravenes these provisions. Is such further provision necessary?

46c. Is further harmonisation of the definitions of the financial markets arrangements covered under this section necessary for the safeguards to be effective?

46d. The objective is to ensure appropriate protection ('no cherry picking') for legitimate financial market arrangements. Is there a risk that the necessary flexibility for resolution authorities could be undermined or frustrated, for example if non-related derivatives are included in a protected netting arrangement?

Appropriate protection for financial collateral, set-off and netting arrangements (H2)

The Services of DG Internal Market and Services consider that the appropriate safeguard for title transfer financial collateral arrangements and set-off and netting arrangements should prevent:

(a) the transfer of some, but not all, of the rights and liabilities that are protected under a title transfer financial collateral arrangement, a set-off arrangement or a netting arrangement between the credit institution and another person; and

(b) the modification or termination of rights and liabilities that are protected under such a title transfer financial collateral arrangement, a set-off arrangement or a netting arrangement through the use of ancillary powers.

For this purpose, the Services of DG Internal Market and Services consider that it would be necessary to specify that rights and liabilities are to be treated as protected under such an arrangement if the parties to the arrangement are entitled to set-off or net those rights and liabilities.

The Services of DG Internal Market and Services take the provisional view that Member States should be able to exclude from the protection suggested in this provision:

- retail rights and liabilities,
- rights and liabilities that relate to arrangements entered into by the credit institution under resolution otherwise than in the course of its core banking business;
- rights and liabilities that relate to subordinated debt issued by a party to the arrangement;
- rights and liabilities which relate to a claim against the credit institution under resolution (including an award of damages or a claim under an indemnity) which arose in connection with the core banking business of that institution.

In this context:

(a) "retail rights and liabilities" refers to:

- rights and liabilities that relate to eligible deposits;
- liabilities owed to the credit institution under resolution by eligible depositors;

(b) "core banking business" means the activities specified in Annex 1 to Directive 2006/48/EC and activities of the credit institution which relate to financial instruments;

(c) "financial instruments" means transferable securities and money market instruments within the meaning of Article 4(18) and (19) of Directive 2004/39/EC and the following classes of instrument (irrespective of whether they are transferable securities):

- loans or other instruments creating or acknowledging debt;
- units in collective investment undertakings;

- any option, future, swap, forward, contract for differences or other derivative contract (including all instruments listed in points (4) to (10) of Section C of Annex 1 to Directive 2004/39/EC);

- any contract for the sale, purchase or delivery of transferable securities, currency, or commodities; or

- any combination of any such instruments.

Where a netting arrangement contains some provisions relating to rights or liabilities that are excluded from protection, the protection suggested in this section should apply to that arrangement only insofar as it contains provisions relating to rights or liabilities that are not excluded that protection.

Question Box 47

47a. Please give your views on the safeguards for title transfer financial collateral arrangements and set-off and netting arrangements suggested in this section.

47b. Do you agree that certain retail rights and liabilities and rights and liabilities relating to subordinated debt should be excluded from the suggested safeguard?

Appropriate protection for security arrangements (H3)

The Services of DG Internal Market and Services consider that the appropriate safeguards for liabilities secured under a security arrangement should prevent:

- the transfer of assets against which the liability is secured unless that liability and benefit of the security are also transferred;

- the transfer of a secured liability unless the benefit of the security are also transferred;

- the transfer of the benefit unless the secured liability is also transferred; and

- the modification or termination a security arrangement through the use of ancillary powers, if the effect of that modification or termination is that the liability ceases to be secured.

Question Box 48

48. Please give your views on the safeguards for security arrangements suggested in this section.

Appropriate protection for structured finance arrangements (H4)

The Services of DG Internal Market and Services consider that the appropriate safeguards for structured finance arrangements should:

(a) prevent the transfer of some, but not all, of the property, rights and liabilities which constitute or form part of a structured finance arrangement to which the credit institution under resolution is a party.

(b) prevent the termination or modification through the use of ancillary powers of the property, rights and liabilities which constitute or form part of a structured finance arrangement to which the credit institution under resolution is a party.

However, the Services of DG Internal Market and Services take the provision view that these safeguards should not apply where only property, rights and liabilities that relate to deposits are transferred or not transferred, terminated or modified.

Question Box 49

49a. Please give your views on the safeguards for structured finance arrangements suggested in this section.

49b. Do you consider that property, rights and liabilities relating to deposits should be excluded from the suggested safeguards?

Partial transfers: Protection of trading, clearing and settlement systems *(H5)*

The Services of DG Internal Market and Services consider that where:

(a) a resolution authority transfers some but not all of the property, rights or liabilities of a bank to another entity (using either sale of business tool, bridge bank tool or asset separation tool); or

(b) a resolution authority uses ancillary powers to cancel or modify the terms of a contract to which the credit institution under resolution is a party or to substitute a transferee as a party;

that transfer, cancellation or modification should not affect the operation of systems and rules of systems covered by the Settlement Finality Directive (Directive 98/26/EC). In particular, such a transfer, cancellation or modification may not revoke a transfer order in contravention of Article 5 of that Directive; and may not modify or negate the enforceability of transfer orders and netting as required by Articles 3 and 5 of that Directive; the use of funds, securities or credit facilities as required by Article 4 of that Directive; or protection of collateral security as required by Article 9 of that Directive.

Question Box 50

50. Is express provision in relation to the protection of trading, clearing and settlement systems necessary, or are the provisions of the Settlement Finality Directive sufficient? If express provision is needed in this context, should the protections be drafted more broadly than those in the Settlement Finality Directive?

Partial transfers: Compensation for third parties (H6)

The Services of DG Internal Market and Services consider that an EU framework should require Member States to put in place arrangements to ensure that where a resolution authority transfers some but not all of the property, rights or liabilities of a credit institution to another entity ('a partial transfer'), creditors receive adequate compensation.

In the view of those Services, this principle should apply both in the case of partial transfers from a credit institution to a bridge bank or a private sector purchaser, and partials transfer from a bridge bank to a private sector purchaser.

Furthermore, the Services of DG Internal Market and Services consider that the framework should specify that, In designing those arrangements, Member States should have regard to the desirability of ensuring that creditors of the credit institution immediately before the transfer do not receive less favourable treatment as a result of the transfer (including any compensation paid under the arrangements referred to above) than they would have received if the partial transfer had not been made and the bank had instead entered insolvency at that time. Insolvency for this purpose would include any winding up or insolvent reorganisation proceedings under the applicable national law.

The compensation arrangements under consideration should include provision for the appointment of an independent valuer to determine which creditors, if any, should be paid compensation and the amount of compensation that should be paid to each such creditor. That assessment should take into account the treatment that each creditor or class of creditor would have received if the credit institution had entered insolvency at the time of (and instead of) the partial transfer being made.

Question Box 51

51. Is the provision suggested in this section sufficient to ensure that creditors would receive appropriate compensation? Is it necessary to specify the details of such compensation arrangements in an EU framework?

Part 5. GROUP RESOLUTION

Extract from the Commission's Communication of October 2010:

"The measures outlined in the communication will ensure that resolution authorities have the same tools and powers at their disposal. This will facilitate coordinated action in the event of a failure of a cross-border group, but further action appears necessary to promote cooperation and prevent fragmented national responses.

In principle, an integrated framework for resolution of cross border entities by a single European body would deliver a rapid, decisive and equitable resolution process for European financial groups, and better reflect the pan EU nature of banking markets. However, the Commission recognises that it would be difficult to establish an EU integrated resolution model for cross-border banking groups in the absence of a harmonised insolvency regime and of a Single European Supervisory authority for those entities. The Commission considers that the European approach to resolution should mirror the broader approach to supervisory arrangements.

For that reason, the Commission favours, as a first step, a coordination framework based on harmonised resolution tools and a requirement for authorities to consult and cooperate when resolving affiliated entities. To this end, the Commission is considering two principal reforms.

First, resolution colleges would be established around the core of the existing supervisory colleges through the inclusion of resolution authorities for group entities. Resolution colleges would be chaired by the resolution authority responsible for the EU parent credit institution ('the group level resolution authority'), and would be responsible for crisis planning and the preparation of resolution plans including, if appropriate, principles for burden sharing. In the event of a crisis, the resolution college would provide a forum for the exchange of information and the coordination of resolution measures.

Second, group level resolution authorities should have the power to decide in cases of group failure whether a group resolution scheme is appropriate. Pending that decision, which would need to be taken quickly, national authorities would be required to refrain from adopting national measures that could prejudice the effectiveness of the group resolution scheme. The group level resolution authority, in cooperation with the other authorities in the resolution college, may conclude that separate entity resolution best suits the structure and organisation of the group, and in that case each national authority would take independent decisions. A group resolution scheme would be based on the group resolution plan already prepared by the relevant authorities and would be implemented by national authorities using the resolution tools and powers under the new framework.

The production of a group resolution scheme in appropriate cases should facilitate coordinated resolution that is more likely to deliver the best result for the group. However, because resolution powers are applied to individual legal entities and the competence for resolution would remain national, the group resolution scheme would not be binding. National authorities that disagreed with the scheme would not be prevented from taking independent action where they considered that necessary for reasons of national financial stability, but in doing so would be required to consider the impact of that action on financial stability in other Member States, give reasons for their decision to the resolution college and, where feasible within the time constraints, discuss those reasons with the other members of the college before taking individual action."

The Services of DG Internal Market and Services consider that this could be achieved through provision to the following effect.

Resolution colleges (P5.1)

The Services of DG Internal Market and Services suggest that resolution colleges, modelled on the existing supervisory colleges, should be for cross-border groups. The intention of the Services of DG Internal Market and Services is to 'institutionalise' the cross-border stability groups that have been developed by the Economic and Financial Committee (EFC), while keeping the composition of resolution colleges flexible and open to third countries so that this cooperation structure fits in with crisis management groups developed at international level. Resolution colleges would be chaired by the resolution authority responsible for the EU parent credit institution ('the group level resolution authority'), and would be responsible for crisis planning and the preparation of resolution plans including, if appropriate, principles for burden sharing (see section on group resolution plan). In the event of a crisis, the resolution college would provide a forum for the exchange of information and the coordination of resolution measures.

The Services of DG Internal Market and Services suggestion would be that the group level resolution authority establishes resolution colleges to facilitate the exercise of the tasks in relation to group resolution plans and the effective coordination and cooperation between resolution authorities and, where appropriate, with third country authorities that perform equivalent functions within their territories.

It is the believe of the Services of DG Internal Market and Services that Resolution colleges will provide a framework for resolution authorities to exchange information and to undertake the planning and coordination of activities related to resolution, in preparation for and during emergency situations in cooperation with colleges of supervisors established under Article 131a of Directive 2006/48/EC in particular, the Services of DG Internal Market and Services consider that this could be done by:

(a) developing group resolution plans and assessing the impediments to effective application of the resolution tools and resolution powers (see section E5 on preparatory and preventative powers, group treatment];

(b) developing common approaches to the application of resolution tools on an individual or group wide basis;

(c) providing a framework for the agreement on group resolution schemes;

(d) coordinating decisions and actions by resolution authorities.

(The task mentioned in (b) would typically involve Ministries of Finance if designated as the national authority responsible for taking decisions on resolution. The tasks mentioned in (c) and (d) would typically involve supervisors or central banks if designated as the national authority responsible for implementing decisions on resolution.)

The Services of DG Internal Market and Services suggest that it should be the group level resolution authority the authority that should coordinate all activities of resolution colleges and chair all meetings of the resolution college and (subject to the specification suggested at the end of this section P3.1 that for certain purposes particular authorities must be included in the college) decide which of the authorities eligible to participate in the resolution colleges should participate in particular meetings or particular activities of the college. According to that, the Services of DG Internal Market and Services believe that the decision of the group level resolution authorities will then have to take account of the relevance of the meetings or activities in question for those authorities and the stability of the financial system in the Member States concerned. The Services of DG Internal Market and Services consider that it would be useful that the EBA participates in any meetings and any activities of any resolution college.

The Services of DG Internal Market and Services consider that the authorities eligible to participate in resolution colleges are resolution authorities responsible for the resolution of subsidiaries of an EU parent credit institution or an EU parent financial holding company, the authorities specified in Article 131a(2) of Directive 2006/48/EC and, where appropriate, authorities of third countries that carry out functions equivalent to those of resolution authorities, provided that they are subject to confidentiality requirements that are equivalent, in the opinion of all resolution authorities, to the requirements under Chapter 1, Section 2 of Title V of Directive 2006/48.

The Services of DG Internal Market and Services believe that the group resolution authority shall promptly inform the authorities that do not participate in a meeting or in specific activities of the resolution college about the decisions taken in those meetings.

The Services of DG Internal Market and Services suggest that the group level resolution authority inform the EBA of the activities of the resolution college, and communicate to the EBA all information that is of particular relevance for the purposes of convergence of resolution practices.

The Services of DG Internal Market and Services consider that the arrangements and procedures for the establishment and functioning of the resolution college are to be set out in writing.

The Services of DG Internal Market and Services consider that participation in the resolution colleges is of the upmost importance and to that end and for the purposes of carrying out the following activities:

- developing common approaches to the application of resolution tools on an individual or group wide basis;

- providing a framework for the agreement on group resolution schemes; and

- coordinating decisions and actions by resolution authorities,

the services of DG Internal Market and Services consider that the resolution authorities of credit all group entities that meet the threshold conditions for resolution must participate in the resolution college. Besides, the services of DG Internal Market and Services consider that the resolution authorities of Member States in which the application of resolution tools on an individual or group-wide basis, or the implementation of a group resolution scheme may have an impact on the financial situation of the credit institutions and investment firms authorised in their Member States, should also have the right to participate in the meeting of the resolution college.

As for affiliated entities, the services of DG Internal Market and Services believe that where affiliated entities established in a third country meet the conditions for actions equivalent to resolution under the law of that third country or are included in the group resolution scheme, authorities of those third countries that carry out functions equivalent to those of resolution authorities may also participate in the college, provided that they are subject to confidentiality requirements that are equivalent, in the opinion of all resolution authorities, to the requirements under Chapter 1, Section 2 of Title V of Directive 2006/48.

Question box 52

52. Do you agree that the group level resolution authority should decide on the composition of the resolution college?

Group resolution (P5.2)

The Services of DG Internal Market and Services believe that the framework should facilitate and, in appropriate cases, prioritise group resolution (as opposed to the uncoordinated resolution of group entities at national level).

To this end, the framework would identify a 'group level resolution authority' for every EU consolidated cross-border group (or sub-group of an international banking group). This would be the resolution authority of the Member State where the consolidating supervisor of that group or sub-group is located.

Group resolution would be considered In every case where more than one group member that is covered by the scope of the resolution regime (see P1.1) meets the conditions for resolution.

Below are examples of how a group resolution might be carried out through the application of specific resolution tools.

The group level resolution authority has the power to sell fully-owned assets of the EU parent credit institutions (subject to approval of change of control by the supervisor of the subsidiary that would have to be taken at short notice). This may include fully-owned subsidiaries. In case of non-fully owned subsidiaries, the sale of business tool would be applied by the authorities responsible for resolving the subsidiary, provided that the subsidiary meets the trigger conditions for resolution. This would have to be coordinated as part of group resolution scheme, so that each national authority would (as part of a group resolution scheme) which (partial) make the transfer necessary to sell the group as a whole (or part of the group) to a third party purchaser.

The group level resolution authorities has the power to apply the bridge bank tool at group level (which may involve, where appropriate, burden sharing arrangements) to stabilise a group as a whole. Ownership of subsidiaries could be transferred to the bridge bank with a view to onward sale, either as a package or singly, when market conditions are right.

The group level resolution authority has the power to apply the debt conversion tool at parent level. As part of a group resolution scheme, national authorities may be invited to apply the same tool to legal entities meeting the trigger conditions for resolution. Once the banking group has been stabilised, authorities would have to coordinate the reorganisation of legal entities.

Under the suggested framework, national authorities could not object to resolution tools applied at group level which falls within the responsibility of the group resolution authority, *i.e. application of bridge bank tool at parent level, sell of assets of the parent credit institution, debt conversion at parent level.*

For the Services of DG Internal Market and Services, group resolution means, in any relevant case:

(a) the application of resolution powers and resolution tools at the level of the parent entity with a view to resolving two or more credit institutions of the group that meet the conditions for resolution and stabilising the group as a whole; and

(b) the coordination of the application of resolution tools and the exercise of resolution powers by resolution authorities in relation to the legal entities of the group that meet the conditions for resolution.

The Services of DG Internal Market and Services consider that group resolution would be relevant when:

(a) where the EU parent credit institution or EU parent holding company and at least one covered subsidiary[19] meet the conditions for resolution (see section F1); or

(b) two or more covered subsidiaries meet the conditions for resolution;

Cooperation is necessary in order to achieve an efficient group resolution. To this end, the services of DG Internal Market and Services believe that the resolution authorities must cooperate closely with a view to achieving group resolution, and shall provide one another with any information which is needed for the exercise of their tasks under the EU resolution framework.

It is the believe of the Services of DG Internal Market and Services that it should be the group level resolution authority, in cooperation with the resolution authorities concerned, the authority that should determine whether group resolution is desirable, taking into account:

(a) whether the resolution objectives would be better achieved by group resolution than discrete or uncoordinated national measures;

(b) whether the measures that one or more resolution authorities, are likely to take would have an adverse impact on different entities of the group, and group resolution would avoid such adverse impact.

If the system is to be efficient the, the services of DG Internal Market and Services consider that the decision of the group level resolution authority as to whether group resolution is desirable must be taken promptly, must be reasoned, and must demonstrate that its decision does not have any significant impact on the financial stability in other Member State and is consistent with the resolution objectives.

Failing a decision within [e.g. 1 calendar day], the other relevant resolution authorities may take their own decisions.

[19] In this context, "covered subsidiary" would mean any subsidiary that is a credit institution or an investment firm that falls within the scope of the EU resolution framework (see P1.1a and discussion in Question Box 1).

As the primary decision would be left to the group level resolution authority, the Services of DG Internal Market and Services consider that the resolution authorities responsible for resolving other group entities may not apply any resolution tool or exercise any resolution power in relation to a group entity that would be included in the resolution scheme before the group level resolution authority has decided whether a group resolution scheme is desirable. The decision of the group level resolution authorities as to whether a group resolution is needed must be taken without any delay.

Where the group level resolution authority decides that group resolution is desirable, it must promptly prepare a group resolution scheme outlining the resolution tools and powers that should be coordinated.

According to the Commission's Communication of October 2010, the Services of DG Internal Market and Services believe that a resolution authority responsible for an entity covered by the resolution scheme may decide not to comply with the scheme and to take independent measures where they reasonably consider that such measures are necessary for reasons of national financial stability. This decision shall be proportionate. Where an authority makes such a decision, it must consider the impact of that action on financial stability in other Member States, give reasons for their decision to the resolution college and, where feasible within the time constraints, discuss those reasons with the other members of the college before taking individual action.

The decision of national authorities not to adopt the group resolution scheme shall by no means affect the power of the group level resolution authorities to apply resolution tool at parent entity level.

Question box 53

53a. Does this suggested framework strike an appropriate balance between the coordination of national measures that is necessary to deal effectively with a failing group, and the proven need for authorities to act quickly and decisively where the situation requires it?

53b. Should the framework set out explicit detail about how each resolution tool might be applied at group level?

Multilateral arrangements with third country (P5.3)

Effective resolution of internationally active groups requires, as a minimum, mutual recognition and enforcement of measures taken by resolution authorities in the relevant jurisdictions. The international agreements necessary to achieve this will be easier if resolution regimes are based on common principles and approaches, and the Commission strongly supports the FSB and G20 work in this regard. The development of firm specific cooperation agreements between the national authorities responsible for managing the failure of global firms, should also be a means to ensure effective planning, decision-making and coordination in respect of international groups.

The Services of DG Internal Market and Services consider that the Commission may submit proposals to the Council, either at the request of a Member State, a European authority that could be the EBA or on its own initiative, for the negotiation of agreements with one or more third countries regarding the coordination of resolution of the following:

(a) credit institutions the parent undertakings of which have their head offices in a third country;

(b) credit institutions situated in third countries the parent undertakings of which, whether credit institutions or financial holding companies, have their head offices in the Community;

(c) branches of credit institutions having their head office outside the Community;

(d) branches situated in third countries of credit institutions having their head offices in the Community.

As for the content of those agreements, the Services of DG Internal Market and Services believe that they should, in particular, seek to ensure that the resolution authorities and the authorities in third countries consult each other when the use of a resolution power or tool may have an impact on the financial stability in third countries or in the EU, and strive to reach common and consistent approaches to the resolution of a credit institution, or a third country branch.

Question box 54
54. Should it be an EU priority to strive for an internationally co-ordinated approach?

Firm specific arrangements (P5.4)

The services of DG Internal Market and Services believe that pending further coordination by means of multilateral arrangements (See section P5.3 above), the resolution authorities of the home Member State of a credit institution that has a subsidiary or a branch in a third country and the resolution authorities of a Member State responsible for resolving a credit institution the parent undertaking of which has its head office in a third country, or for resolving a branch of a credit institution having its head office in a third country, may enter into firm specific arrangement regarding the resolution of any such institution.

The Services of DG Internal Market and Services consider that the purpose of those agreements should be essentially the same as the one of the multilateral arrangements, to that end the agreements should, in particular, seek to ensure that the resolution authorities and the authorities in third countries performing equivalent functions consult each other when the use of a resolution power or tool, or powers with an equivalent purpose under the law of the third country, may have an impact on the financial stability in one or EU Member States or any third country, and strive to reach common and consistent approaches to the resolution of a credit institution, or a third country branch.

Where different EU resolution authorities are responsible for resolving a branch or a subsidiary of the same third country parent credit institution or investment firm, firm specific arrangements with third countries should be coordinated by a European authority that could be the EBA, and should be subject to the consent of all resolution authorities involved.

Question box 55
55. Should firm specific arrangements with third country authorities be required?

Assessment of third country resolution arrangements (P5.5)

The Services of DG Internal Market and Services believe that it is also necessary to ensure resolvability in an international context. This could be achieved by ensuring that the group level resolution authorities of a credit institution with a subsidiary in a third country, or the resolution authorities of the Member State responsible for resolving a credit institution with a branch in a third country, assesses whether the relevant third country has in place an effective resolution framework and the capacity to cooperate in a manner that preserves financial stability and ensures the equitable treatment of all stakeholders in a cross-border context. In particular, the resolution authorities should assess the interest in minimizing the overall costs of resolution and maximising group value.

As for the previous paragraph, the Services of DG Internal Market and Services consider that the Resolution authorities responsible for resolving a third country branch in accordance with Directive 2001/24/EC and a credit institution, the parent undertaking of which is a credit institution or a financial holding company, the head office of which is in a third country shall assess whether the resolution arrangements in the third country are adequate and compatible with EU arrangements and whether the resolution authorities may rely or defer to the third country for taking the lead in resolution.

The services of DG Internal Market and Services consider that, on the basis of the assessments carried out in accordance with the preceding paragraphs, the resolution authorities may decide to require changes to the organisation and operating structure of credit institutions established in the community.

Question box 56

56. Do you agree that if the resolution authority is not satisfied about the resolution framework of a third country it should be able to require changes to the organisation or operating structure of the credit institution?

Part 6. FINANCING ARRANGEMENTS

As indicated in the October 2010 communication, the Commission considers that the cost of resolution should primarily be paid by shareholders and creditors but in most of the cases this would not be enough. If resolution is to be a credible option, appropriate financing arrangements should be put in place. The Commission therefore intends to propose the establishment of national funds to support bank resolution, as credible resolution financing arrangements contribute to strengthening financial stability and result in a more resilient system.

A common approach to resolution funds would (i) improve the prospects for effective cross-border cooperation, (ii) in the long run reduce costs for society as a whole, and (iii) could facilitate agreement on appropriate burden sharing arrangements for the costs of resolution, which will be important for the efficient resolution of cross border entities. The remainder of this part outlines the Services of DG MART' current approach to delivering the above objectives.

The Services of DG Internal Market and Services have examined the possible synergies between resolution funds and DGS and consider that, provided that there is still an adequate protection for depositors that ensure their pay-out, both DGS and resolution funds could be merged into a single fund.

Requirement for each Member State to establish a bank resolution fund (P6.1)

The Services of DG Internal Market and Services consider that each Member State should ensure within its territory the establishment of a Fund to be available to resolution authorities for the sole purpose of covering the costs incurred in connection with the use of resolution tools and in accordance with the resolution objectives and the general principles governing resolution. (This is referred to in the rest of this Section as 'the Fund'.) This obligation would not necessarily require Member States to establish a new and separate fund. Member States could choose to meet this requirement through the DGS (see discussion in section P6.4 below).

The Services of DG Internal Market and Services believe that every credit institution and certain investment firms authorised under the territory of each Member State (contributing institution) shall contribute to the fund. The Services of DG Internal Market and Services also suggest that, subject to Article 38(1) of Directive 2006/48/EC, branches established by a credit institution which has its head office outside the Union would have to contribute to the Fund within the territory in which they are established.

The Fund should have a target size. The Services of DG Internal Market and Services consider that the target size should be defined as a percentage of the total eligible liabilities[20] of all contributing institutions. The Services of DG Internal Market and Services consider that this target size should be achieved during a long period. To this end they will propose that the target size of the Fund is achieved by 31December 2020[21].

[20] "Eligible liabilities" should mean liabilities of contributing institutions net of Tier 1 capital and covered deposits, as defined under the DGS Directive.

[21] The set up and operation of a Fund should comply with state aid rules where applicable

Question Box 57

57. Is it sufficient to make a general reference to the financing of resolution tools or is it necessary to be more explicit about what a fund can or cannot finance (e.g. recapitalisation, loss sharing, etc.)?

Financing of the Fund (P6.2)

In order to ensure that funds are appropriately financed, the Services of DG Internal Market and Services are considering the following approach:

- It should be ensured that the Fund has in place adequate funding arrangements which enable it to provide the funds necessary for the purpose mentioned in P6.1 (Requirement for each Member State to establish a bank resolution fund).
- The amount of ordinary funds should at least be equivalent to the target size. Funds should be raised on the basis of regular contributions paid by contributing institutions. If the amount falls short of the target size, the payment of contributions should resume at least until the target size is reached again.
- If the funds referred to in the preceding paragraph are unlikely to cover the costs of an imminent resolution, contributing institutions would need to pay on request of the Fund extraordinary contributions not exceeding [y]% of eligible liabilities. Where the extraordinary contributions have not been used entirely or only partially within x weeks/months after the request, they would be redistributed to the contributing institutions.
- Where funds raised on the basis of the preceding paragraphs are still insufficient, Member States would need to ensure that alternative funding arrangements are in place. The use of these alternative funding arrangements would have to be repaid in full by the contributing institutions.

Question Box 58

58. Should there be more explicit provision about the alternative funding arrangements, for example reference to specific types of arrangements such as debt issuance or guarantees?

Calculation of contributions to the Fund (P6.3)

The Services of DG Internal Market and Services consider that unless otherwise decided by the Member State; the contributions to the Fund should be determined for each contributing institution pro-rata on the basis of its eligible liabilities.

Question Box 59

59a. Should the basis for the calculation of contributions be fully harmonised or left to the discretion of Member States?

59b. Are eligible liabilities an appropriate basis for calculating contributions from individual institutions, or a more risk adjusted basis be preferable? The latter might take account *of elements such as: a) the probability that the institution would enter into resolution, b) its eligible liabilities, c) its systemic importance for the markets in question, etc. However, would that add too much complexity?*

Relationship with the DGS (P6.4)

The Services of DG Internal Market and Services consider that it is important to exploit synergies between resolution funds and deposit guarantee systems. However, while both instruments broadly aim to safeguard the financial system, they have different objectives: DGS insures depositors; resolution funds finance the costs of resolution, which may go beyond depositor insurance. Accordingly, any attempt to reap synergy between the two instruments would need to safeguard these differences. The services of DG Internal Market and Services are therefore considering the following approach:

- The Services of DG Internal Market and Services are of the opinion that DGS should also be allowed to finance resolution measures (resolution measures are those that have been explained in the previous sections of this document). Where this is the case, the amount of the (resolution) Fund as well as the individual contributions to resolution funding (calculated in accordance with the principles suggested in sections P6.2 and P6.3 above) should be adapted accordingly. In this case, the contribution by each contributing institution to the DGS should be deducted from the contribution calculated in accordance with the suggestion in section P6.3 above. This could imply that in certain cases the contributing institutions would only have to contribute to the DGS.

- The Services of DG Internal Market and Services are also of the opinion that Member States should be permitted to merge the DGS and the Fund into a single legal entity. In this case, the individual contributions (if any) to the resolution fund and the DGS, calculated in accordance with the previous paragraph will be contributed into the single legal entity.

Question Box 60

60. Do you agree that when the DGS of a Member State is also able to finance resolution, this should be taken into account when calculating the contributions to the Fund? Are additional safeguards necessary to protect the interests of insured depositors?

Privileged creditor position (P6.5)

The Services of DG Internal Market and Services further consider it important that the Fund has, with respect to the amounts paid out to cover the costs incurred in connection with the use of resolution tools, a priority ranking over all the other unsecured creditors of the credit institution that is under resolution.

Question Box 61

61. Do you agree? Do you consider that this privileged position should be extended to other creditors in order to ensure temporary funding in the context of resolution?

ANNEX

Debt write down as an additional resolution tool

Alongside the traditional resolution tools presented in this consultation document and used during the financial crisis, a tool to write down certain liabilities of a credit institution could provide resolution authorities with additional flexibility when they deem that the triggers for resolution have been met and the failing institution cannot in the circumstances be wound up under the ordinary insolvency regime. It is important to note that this consultation concerns possible future legislative changes which would be subject to a full impact assessment, appropriate transitional provisions and transitional periods of sufficient length and designed in such a way so as to avoid any market instability or unintended consequences. It is not envisaged to apply measures ultimately adopted in this area to any debt currently in issue.

Such a tool would be designed for cases where the application of the standard resolution tools (such as transfer of business to a private sector entity or bridge bank, or a 'good bank / bad bank' split) is not an option because of the nature of the failing institution or its business or where, in the opinion of the resolution authorities, other tools would not be sufficient to achieve the resolution objectives. In practice, such a tool might be most useful in the case of systemically important institutions which are considered to be ‘too big to fail’, or in a generalised situation of stress where there is unlikely to be a large pool of potential third party purchasers. Additionally, creating a bridge bank or effecting a ‘good bank, bad bank’ split may not be possible in the time available given the size and complexity of a particular institution’s asset or trading book or the interconnectedness within the same group or externally. Such a tool may also help to provide time for coordination and consultation in the event there are significant cross border activities which need to be dealt with by third country resolution authorities.

It should be clear, however, that the writing down of certain liabilities would not be the end of the resolution process. Rather it would accompany significant restructuring to return a 'new' institution to viability. While debt write down (unless used in conjunction with other resolution tools) would preserve the legal entity and technically maintain the institution as a going concern (for example, so as not to trigger close out provisions), the use of such a tool must be accompanied by significant restructuring measures, including the sale or closure of parts of the business, necessary to restore it to long term financial viability. Restructuring may also be required to the extent that the institution has benefited from state aid. Statutory control of the process will ensure that the write down is accompanied by restructuring, removal of problem assets, replacement of management or any other measure necessary to put an institution on a sound footing for future viability. The support, if necessary, of liquidity provision from the resolution fund or Central Banks could also play a key role in supporting the process. The institution and its business, its owners and management would therefore change substantially in the short to medium term.

There are a number of proposals, both from regulators and from industry, that explore the use of contingent capital or 'bail-in' debt with a range of 'going concern' or point of non-viability triggers. More generally, enhanced regulatory requirements such as contingent capital can complement additional resolution tools by making the likelihood and impact of a resolution much smaller. In a non-zero failure regulatory regime, enhanced prevention can complement the need to be prepared with a wide set of resolution tools which adequately address the too big to fail problem.

While forms of contingent capital and bail-in debt may in theory be complementary, any co-existing regimes, if developed, would need to be coordinated. In particular, it will be important to avoid overlapping regimes or unnecessary complexity. The services of DG Internal Market and Services are helping to shape this work and will meet its international commitments in this area, and will press strongly for rapid progress on developing the concept of debt write down as a resolution tool. While there may be a role in the capital structure for convertible instruments that trigger at an earlier stage, the Services of DG Internal Market and Services would welcome views on how the co-existence of such instruments might affect the market appetite for and price of 'bail-in' instruments that would be written down or converted at a resolution trigger.

The debt write down tool

Resolution authorities could be given a statutory power, exercisable when an institution meets the trigger conditions for entry into resolution, to write off all equity, and either write off subordinated debt or convert it into an equity claim. However, in some cases this will not be sufficient to ensure that an institution in difficulty returns to viability so as to maintain market and creditor confidence when the markets next open. (For example, RBS' balance sheet at the end of 2007 contained £38bn in subordinated liabilities, while losses before tax in 2008 and 2009 amounted to around £43bn.[22])

Thus, to provide additional flexibility and to ensure that any write down power is sufficient to deliver the policy objectives, this consultation outlines two possible models for additional write down powers. Building on the minimum powers above, the first 'comprehensive' approach aims to make a broad range of senior creditors face the real risk associated with bank failure. The second 'targeted' approach aims to create a more focused tool for resolving in particular, institutions which have been assessed as likely to prove difficult to resolve with traditional resolution tools at a time of fast moving idiosyncratic or systemic crisis. It is important to note that these options are not mutually exclusive and elements of each could be combined to leverage the relative pros and cons. The Services of Dg Internal Market and Services invite views on each model, and on the specific questions identified below.

1: Comprehensive approach

In addition to the power to write off equity and write down or convert subordinated debt that is outlined above, resolution authorities could be given a statutory power, exercisable in conjunction with the core power when an institution meets the trigger conditions for entry into resolution, to write down by a discretionary amount[23] or convert to an equity claim, all senior debt deemed necessary to ensure the credit institution is returned to solvency.

Such a power would only apply to new debt issued (or existing debt contracts renewed or rolled over) after entry into force of the power. It would be exercisable in principle in relation to all senior debt, and resolution authorities would have a discretion as to which classes of debt would be written down or converted in a particular case, the extent of the 'haircut' and, where relevant the rate of conversion. The exercise of that discretion might take into account, among other things the systemic risks of writing down certain creditors.

[22] http://annualreport2009.rbs.com/microsites/annual-report-2009/business_review/income_statement/2008_to_2007_pro_forma.html
[23] Possibly with a fixed upper cap – see technical considerations for further discussion.

The size of the write down would be determined by a valuation of the assets and liabilities of the institution, the amount deemed necessary to restore viability and maintain market confidence, the improvement in viability realised by actions taken on equity and subordinated debt holders, and the total amount of senior debt in scope.

To ensure that the power could be exercised effectively in relation to debt that is booked in or governed by the law of a third country, new debt issued by EU credit institutions would be required to include a clause recognising the statutory power. This contractual recognition should minimise the risk that any write down pursuant to the power would not be recognised or enforced by foreign courts.

To ensure proper functioning of credit markets, certain exclusions might be necessary. The Services of DG Internal Market and Services currently consider that the following, in particular, may need to be excluded: swap, repo and derivatives counterparties and other trade creditors; short-term debt (defined by a specified maximum maturity); retail and wholesale deposits and secured debt (including covered bonds). It is also questionable whether the power could in practice be exercised to claims that are covered by master netting agreements (even if uncollateralised). However, to prevent further withdrawal of liquidity, measures would be needed to ensure that acceleration or termination rights under excluded claims were not triggered by the use of this tool.

As a matter of principle, the design and exercise of a debt write down power should preserve as far as possible the ranking of claims on insolvency. For this reason, equity should be wiped out before any debt is written down, and subordinated debt should be written down completely before senior debt holders bear any losses. This option respects that principle. However, it must be recognised that a power to write down some, but not all senior debt in resolution - with some senior liabilities either excluded entirely from the regime or excluded through exercise of discretion by the resolution authority on a case-by-case basis – would subvert the normal rankings and the principle of *pari passu* treatment of creditors within the same class.

Such a regime would create maximum flexibility for the resolution authorities to return an institution to viability, install new the management, and implement a recovery or restructuring plan to retain market confidence and access to funding. In practice, the broader the eligible base of liabilities, the smaller any individual write down may need to be. However, a broad scope may also mean a higher impact on the cost of finance compared with a narrower scope. The disruption of insolvency rankings would almost certainly aggravate that, and could lead to debt being restructured as excluded forms of liability – an incentive to financial engineering that might not be desirable from a broader prudential point of view. Finally, there is a risk that funding may be driven into excluded areas (such as secured or insured financing – in particular in periods of stress).

Question Box 62

62a. What classes of debt (if any) may need to be excluded from a statutory power to write down senior debt?

62b. Is it desirable to undermine the principle that creditors of the same ranking should be treated similarly? Should a discretionary power allow authorities to discriminate within classes of debt?

62c. What are the consequences of the fact that this approach may result in the ranking of creditors in the context of resolution being different to that in normal insolvency? Is further provision needed to address this?

62d. What measures would be appropriate to reduce debt restructuring and regulatory arbitrage? For example, would it be necessary to require that a minimum amount of debt remains in scope at all times?

<u>2: Targeted approach</u>

An alternative to a comprehensive approach would be for resolution authorities to require credit institutions to issue a fixed volume of 'bail-in able' debt which, in addition to the power to write off all equity, and either write off existing subordinated debt or convert it into an equity claim, could written down or converted into equity on a statutory trigger. Such debt would need to include a contractual term which would specify that the relevant resolution authority could use a statutory power to write down the debt when the institution meets the trigger conditions for entry into resolution. The amount of the write down or conversion rate could be either specified in the instrument, or it could be left to the discretion of the resolution authorities (subject to the principle that the affected debt holder should be 'no worse off than in liquidation').

The requirement could include a fixed minimum[24] for all institutions (for example as a percentage of total liabilities), and the power for authorities to increase it further in the event that resolution plans identify impediments to resolution by other means. Such a tailored requirement could help to ensure that debt contracts are not able evolve in a way that would reduce the effectiveness of the regime and would provide certainty for both the institution and creditors about what would happen in a resolution. Additionally, the bulk of issuance could be restricted solely to SIFIs.

However, it would not effectively ensure all creditors are 'at risk' and judging the appropriate issuance level (whilst avoiding distortions to the single market) may be challenging. The EBA could play a useful role in ensuring similar and consistent treatment across jurisdictions.

Question Box 63

63a. What factors should authorities take into account when determining the correct amount of 'bail-in debt' that should be issued acknowledging the need to ensure that institutions are 'resolvable' while avoiding single market distortions?

63b. Would a market for large amounts of such debt exist at a cost which is lower than equity?

63c. As an alternative to a statutory requirement to issue certain instruments with specified terms, might institutions be permitted to insert a write down term in any debt instrument they deem appropriate to meet the fixed requirement for 'bail in' debt? Would there be any drawbacks to such an approach?

Technical considerations

With either option, a number of technical considerations would need to be addressed and, for the most part, these are similar regardless of the option chosen. However, respondents are encouraged to identify areas where they believe technical aspects might differ based on the option chosen.

Market capacity for such instruments

[24] The public interventions during the crisis ranked between 4 and 19 per cent in terms of risk weighted assets.

Some have argued that the market appetite for instruments with write down or conversion features may be limited. Arguments have focussed on the fact that such instruments would offer a fixed return but have risk bearing properties similar to equity; the desirability of a conversion feature which would turn a debt holder into an equity holder; and lack of predictability about the circumstances in which it would be triggered and size of the write down.

On the first concern, a higher cost of such instruments may simply reflect the view that risk has been transferred from society to the bondholder by the removal of the implicit State guarantee for creditors that may have artificially reduced the costs of debt funding. This may in particular be the case for those institutions that have been considered 'too big to fail'.

On the second point, the Services of DG Internal Market and Services would welcome views from respondents on the implications, from both a regulatory and a corporate governance perspective, of replacing the original shareholders with converted debt holders, having particular regard of the need to avoid a significant sale of newly-converted equity at a time when it is essential to restore market confidence in the institution. On the final point, the Services of DG Internal Market and Services believe that the resolution trigger is close to the point of failure for an institution, and therefore should be linked to the probability of failure of a bank which is regularly assessed by rating agencies and market participants. However, the Services of DG Internal Market and Services recognise that holders of 'bail-in debt' would want the trigger to be as transparent, objective and predictable as possible, and would welcome views on how this might be designed.

Question Box 64

64a. Would the trigger be sufficiently clear and predictable (i.e. will instruments be rateable and will markets be able to price them) if linked to the failure of an institution?

64b. Are market participants likely to have an appetite for such instruments? Why or why not? If you consider that the pool of likely investors would be small, are there any adjustments which could be made to make such instruments more attractive without undermining the objectives of the tool?

64c. What are the most likely classes of investor: e.g. other banks or investment firms, insurers, pension funds, hedge fund and other high yield investors, retail? Should certain types of investor be restricted from holding such instruments?

Compensation mechanisms

The general framework would provide a mechanism for compensation in the event that creditors are left worse off than in insolvency as a result of the use of the resolution tools. If the debt write down tool is triggered at a point close to insolvency, the services of DG Internal Market and Services believe further compensation mechanisms, such as warrants or 'write up' features may not be necessary. Moreover, conversion to equity may be treated as compensation for the write down in applicable cases. However, in the event that the tool subverted insolvency ranking (i.e. in the first approach described above), such mechanisms might need to be considered.

Question Box 65

65. Under what circumstances would additional compensation mechanisms be needed and what form might they take?

Group treatment

For some groups, the triggering of resolution at the subsidiary level and the application of the debt write down tool could significantly dilute or eliminate the equity holding of the parent. This entails the risk that the parent will decide that it is no longer in its interest to continue to provide support to the subsidiary. To an extent, this is a normal outcome which could be avoided if the parent were to support the subsidiary. In more integrated group structures, it might make sense for convertible 'bail in' debt to be issued by the parent institution, while it might be consistent in groups organised by more autonomous, stand-alone subsidiaries for such debt to be issued by each regulated entity. Additionally, in the EU, the provision for group resolution and the cross-border coordination framework proposed in this consultation would allow for resolution to be carried out at the parent level, regardless of which Member State it was based in. However, further consideration of these issues might be needed, particularly for parent entities outside of the EU.

Question Box 66

66. Should a regime of the kind discussed in this Annex allow flexibility in where within the group 'bail in debt' issue or held? What are the relative pros and cons of such an approach and what mechanisms would there be for ensuring all resolution authorities have viable resolution tools?

Ensuring creditor confidence and adequate liquidity

Applying the debt write down tool to an institution (and the implementation by the resolution authorities of necessary associated restructuring measures) should ensure that institution is returned to balance sheet solvency with the ability to absorb losses in a range of conceivable scenarios. However, solvency alone would not necessarily ensure liquidity or access to wholesale funding markets. Following the triggering of any debt write down tool and associated restructuring, the institution should be able to retain confidence of creditors in the market. To the extent that an institution is returned to solvency, it may be eligible for access to Central Bank liquidity facilities. However, to encourage the availability of funding to the newly restored institution, creditors that provided (unsecured) funds in the period immediately following the resolution could receive temporary (or permanent) 'super senior' status. This could reduce the burden on the public authorities to continue to finance such institutions, but clearly the details of any such preferred ranking, together with the likely impact on the availability of funding to an institution experiencing problems (if those creditors would be prejudiced by being subordinated to new, post bail-in creditors), need to be considered carefully.

Question Box 67

67. Is there a case for giving some creditors of a newly bailed in institution 'super senior' status? Should such a status be discretionary or a rule? What sorts of claim should be included and what mechanisms for transition back to a normal state should be considered?

Question Box 68

68. Is it necessary to design a 'bail-in' mechanism for non-joint stock companies? How might this be achieved without unduly benefitting the members at the expense of creditors?

ANNEX 2

Derogations needed for Company Law Directives

Use of resolution powers

The Company Law Directives contain mandatory rules for the protection of shareholders and creditors. Some of these rules relating especially to the shareholders' decision making powers in the public limited liability companies and shareholders' participatory rights in the listed companies may hinder rapid actions by the resolution authorities in a crisis situation. Therefore there is a need to adjust some of these provisions in order for the mandatory EU rules not to prevent the Member States from implementing the crisis management framework effectively. At the same time a maximum legal security have to be guaranteed for the stakeholders. Member States would be able to derogate from clearly defined Company Law rules to the extent necessary for the application of resolution powers provided that trigger conditions and public interest test for their use are met.

Possibility to derogate from the following EU Company Law Rules has been identified as necessary:

1) Articles 17(1), 25, 29(1),(3) and (4), 30 and 40 of the Directive 77/91/EEC on capital maintenance and alteration of public limited liability companies.

2) Directive 78/855/EEC on the mergers of public limited liability companies. Currently the Member States do not need to apply the Directive in cases where the company or companies who are being acquired or will cease to exist are the subject of bankruptcy proceedings, proceedings relating to the winding-up of insolvent companies, judicial arrangements, compositions and analogous proceedings. This derogation will be explicitly extended to cover the use of resolution powers.

3) Directive 82/891/EEC on divisions of public limited liability companies. A similar derogation than to mergers Directive applies also to this Directive and its scope will be similarly extended.

4) Article 5 of Directive 2004/25/EC on take-over bids.

5) Directive 2007/36/EC on shareholders' rights.

Question Box 69

69. Are these proposals sufficient for the effective application of the resolution powers? Please specify the missing provisions, if any.

Early intervention

There may be a a need to create a mechanism for a rapid increase of capital in the early intervention phase for emergency situations when the credit institution does not meet or is likely not to meet the requirements of the Capital Requirements Directive and an increase of capital is likely to restore the financial situation and avoid a situation where the threshold conditions for the resolution are met.

There are two possible options for the creation of such a mechanism:

Option 1: The general meeting (GM) would ex ante – i.e. outside any crisis - decide on a shortened convocation period to convene the GM to decide on an increase of capital in an emergency situation. The second GM would otherwise follow normal rules. This presupposes a derogation from the Shareholders' Rights Directive 2007/36/EC.

Option 2: The GM would ex ante mandate the management body of a credit institution to take a decision on the capital increase in an emergency situation as defined above. The mandate should specify the term of the mandate and the maximum amount of the increase. This presupposes a derogation from the Second Company Law Directive 77/91/EEC.

Question Box 70

70. Do you agree on the need to create a mechanism for a rapid increase of capital? What would be your preferred option for the mechanism? Is there a need to specify that this mechanism can only be used close to the resolution triggers, i.e. not throughout the entire early intervention phase?

ANNEX 3

Summary of Questions

Institutional Scope

1a What category of investment firms (if any) should be subject to the preparatory and preventative measures tools and the resolution tools and power?

1b. Do you agree that the categories of investment firm described in Question Box 1 are appropriate? If not, how should the class of investment firm covered by the proposed recovery and resolution framework be defined?

1c. Are the resolution tools and powers developed for deposit-taking credit institutions appropriate for investment firms?

2a. Do you agree that bank holding companies (that are not themselves credit institutions or investment firms) should be within the scope of the resolution regime?

2b. Should resolution authorities be able to include bank holding companies in a resolution even if the holding company does not itself meet the conditions for resolution: i.e. is not failing or likely to fail (see conditions for resolution)?

2c. Are further conditions or safeguards needed for the application of resolution tools to bank holding companies?

Authorities

3a. Do you agree that the choice of the authority or authorities responsible for resolution in each Member State should be left to national discretion? Is this sufficient to ensure adequate coordination in case of cross border crisis?

3b. Is the functional separation between supervisory and resolution functions within the same authority sufficient to address any risks of regulatory forbearance

3c. Is it desirable (for example, to increase the checks and balances in the system) to require that the various decisions and functions involved in resolution – the determination that the trigger conditions for resolution are met; decisions on what resolution tools should be applied; and the functional application of the resolution tools and conduct of the resolution process – are allocated to separate authorities

3d. Even if resolution authorities are a matter of national choice, should an EU framework specify that they should act in accordance with principles and rules such as those set in this document to take account of the fact any bank crisis management action in one Member State is likely to have an impact in other Member States?

Supervision

4a. Should the stress tests be conducted by supervisors, or is it sufficient for institutions to carry out their own stress tests in accordance with assumptions and methodologies provided by or agreed with supervisors, provided that the results are validated by supervisors?

4b. The current crisis has shown that stress test disclosure is necessary to reassure markets and to bring to light potential problems before they become too large to be managed. It cannot, however, be excluded that in some circumstances disclosure without consideration of the possible impact in the market could do more harm than good. Do you agree that under exceptional circumstances the results of the stress tests should be made public only after appropriate safeguards have been agreed and introduced?

4c. Do you agree that in an integrated European market, stress testing should be conducted on the basis of a common methodology agreed at the EU level and subject to cross verification

5. Please estimate:

- the <u>one-off costs</u> in EUR (e.g., investments in IT systems);

- the additional ongoing annual costs (e.g. human, subcontracts etc.)

that your institution would be likely incur in carrying out the activities related to <u>enhanced supervision.</u>

Recovery Planning

6. Are the required contents of preparatory recovery plans suggested in section B1 sufficient to ensure that credit institution undertake adequate planning for timely recovery in stressed situations? Should we include additional elements?

7a. Is it necessary to require both entity-specific and group preparatory recovery plans in the case of a banking group? How to best ensure the consistency of recovery plans within a group?

7b. Should supervisor of each legal entity be allowed to require any changes to entity-specific recovery plans, or should this be a matter for the consolidating supervisor?

7c. Is a formal joint decision (in accordance with the procedure set out in Article 129 CRD) between the consolidating supervisor and the other relevant competent authorities appropriate for decisions regarding the group preparatory recovery plan?

7d. Should the EBA play a mediation role in the case of disagreement between competent authorities regarding the assessment of group preparatory recovery plans?

8. Please estimate:

(a) the <u>one-off initial costs</u> (e.g., investment in IT and other systems);

(b) the additional ongoing annual costs, including the costs of Full-Time Equivalent employees (FTEs), and the number of such FTEs,

that your institution would be likely to incur in carrying out the activities related to recovery planning suggested in section B.

Intra-group Financial Support

9. Is a framework specifying the circumstances and conditions under which assets may be transferred between entities of the same group is desirable? Please give reasons for your view.

10. Section CI suggests that the support that might be provided under an agreement should be limited to loans, guarantees and the provision of collateral to a third party for the benefit of the group entity that receives the support. Do you agree that financial support should be restricted in this way, or should it allow a broader range of intra-group transactions?

11a. Should this type of financial support be provided only down-stream (parent to subsidiary) or also up-stream (subsidiary to parent) and cross-stream (subsidiary to subsidiary), or should this be left to the discretion of the parties, (subject to approval by competent authorities)? What would be the advantages and disadvantages of each option?

11b. Should the agreement be restricted to credit institution and investment firms subsidiary, or should it be able to include financial institutions on the grounds that these are also subject to supervision on a consolidated basis?

12. Is a mediation procedure necessary, and if so, would the approach under consideration be effective?

13a. Should the agreement specify the consideration for the loans, provision of guarantees or assets, or simply set general principles as to how consideration should be determined for each specific transaction under the agreement (e.g. how the rate of interest should be set)?

13b. If the remuneration is determined by the agreement, how frequently should the terms for remuneration be reviewed?

14. Do you agree with the conditions for the provisions of intra-group financial support suggested in section C4?

15. Do you that decision to provide financial support should be reasoned? Are the criteria suggested in section C5 appropriate?

16a. Do you agree that the supervisor of the transferor should have the power to prohibit or restrict a proposed transaction under a group financial support agreement on the grounds suggested? Should any other grounds for objection be included in the framework?

16b. What is the appropriate time limit for the reaction of the competent authority?

16c. Should a time limit be set also for the reply to the consultation by the supervisor of the beneficiary?

17. Do you consider that supervisors should have the power to require an institution to request financial support?

18a. Is either or both of the suggested mechanisms for protecting the claim of a transferor in relation to intra-group financial support appropriate?

18b. If adopted, should either be subject to a time limit (for example, the priority claim or claw back right would apply only if the relevant insolvency is commenced within a specified period – such as 12 months – after the transfer)?

19. Do you agree with the exclusion of liability for management proposed in section C9?

20. Do you agree that agreements for intra-group financial support should be disclosed?

Resolution Plans

21a. Should resolution plans be required for all credit institutions or only those that are systemically relevant?

21b. Would the requirements for resolution plans suggested above will adequately prepare resolution authorities to handle a crisis situation effectively? Are additional elements needed to ensure that resolution plans will provide adequate preparation for action by the resolution authorities in circumstances of both individual and wider systemic failure?

21c. Please estimate:

- the <u>one-off costs</u> in EUR (e.g., investments in IT or other systems);

- the additional ongoing annual cost (e.g. human, subcontracts etc.), including the cost and number of Full-time Equivalent employees,

that your institution would be likely to incur in complying with requirements related to <u>recovery and resolution plans.</u>

Preparatory and Preventative powers

22a. Are the preparatory and preventative powers proposed in section D3 sufficient to ensure that all credit institutions can be resolved under the framework proposed? Are any further specific powers necessary?

22b. Specifically, should there be an express power to require limitations to intra-group guarantees, in order to address the obstacles that such guarantees may pose to effective resolution? (The FSB has identified such an obstacle: the guaranteed activities may be more difficult to separate from the rest of the organisation in times of stress, and may limit the ability to sell the guaranteed business.)

22c. In what cases, if any, might the exercise of such powers have an impact on affiliated entities located in other Member States? In such cases, should the EBA play a mediation role, or should the group level resolution authority make the final decision about the application of measures under section D4 to single group entities (irrespective of where they are incorporated)?

23a. Do the provisions suggested in sections D4 to D6 achieve an appropriate balance between ensuring the effective resolvability of credit institutions and groups and preserving the correct functioning of the single market?

23b. Do you consider that only the group level resolution authority (rather than the resolution authorities responsible for the affected entities) should have the power to require group entities to make changes to legal or operational structures (see point (e) in the list of possible preparatory and preventative powers in (E4))?

23c. Are there sufficient safeguards for credit institutions in the process for the application of preparatory and preventative measure that is proposed in sections D4 to D6?

Early Intervention

24a Is the revised trigger for supervisory intervention under Article 136(1) CRD (i.e. extended to include circumstances of likely breach) sufficiently flexible to allow supervisors to address a deteriorating situation promptly and effectively?

24b. Are the additional powers proposed for Article 136 sufficient to ensure that competent authorities take appropriate action to address developing financial problems? Are there any other powers that should be added?

25a. Should supervisors be given the power to appoint a special manager as an early intervention measure?

25b Should the conditions for the appointment of a special manager be linked to the specific recovery plan (Option 1 in section E2), or should supervisors have the power to appoint a special manager when there is a breach of the requirements of the CRD justifying intervention under Article 136, but the supervisors have grounds to believe that the current management would be unwilling or unable to take measures to redress the situation (Option 2 in section E2)?

25c. If the conditions for appointment of a special manager are based on Article 136, is an express proportionality restriction required to ensure that an appointment is only made in appropriate cases where justified by the nature of the breach?

Recovery plans

26a. Do you agree that the decision as to whether a specific group recovery plan, or the coordination at group level of measures under Article 136(1) CRD or the appointment of special managers, are necessary should be taken by the consolidating supervisor?

26b. Should the supervisors of subsidiaries included in the scope of any such decision by the consolidating supervisor by bound by that decision (subject to any right to refer the matter to a European Authority that could be the EBA)?

26c. Is a mechanism for mediation by a European Authority appropriate in this context and should the decision of that Authority be binding on all the supervisors involved?

26d. Is the suggested timeframe (24hours) for decisions by the consolidating supervisor and the EBA appropriate in the circumstances?

27. Do you agree that the consolidating supervisor should be responsible for the assessment of group level recovery plans?

Conditions for resolution

28. Which of the options proposed, either alone or in combination, is an appropriate trigger to allow authorities to apply resolution tools or exercise resolution powers? In particular, are they sufficiently transparent, and practicable for the authorities to apply? Would they allow intervention at the appropriate stage?

Resolution objectives and principles

29. Do the resolution objectives suggested in section F3 comprehensively encapsulate the public interest considerations that justify resolution? Should any have precedence? Are there any other objectives that we should consider?

30a. Are the guiding principles for resolution suggested in section F4 appropriate?

30b. In particular, is it necessary to include a general principle that creditors of the same class should be treated equally or should resolution authorities be able to derogate from this principle in specific circumstances?

30c. Is it necessary to require independent valuation, and are the objectives of that valuation appropriate?

Resolution tools, powers and mechanisms

31a. Are the tools suggested in section 2 and elaborated in the following sections sufficiently comprehensive to allow resolution authorities to deal effectively with failing banks in the range of foreseeable circumstances? Are there any others that we should consider?

31b. Should resolution authorities be restricted to using these tools, or should Member States be able to supplement the proposed EU resolution framework with national tools and powers?

32. Do you agree with the conditions for the sale of business tool suggested in section G2, and in particular the requirement for marketing?

33a. Should the EU framework include an express requirement that the residual bank (i.e. the entity that remains after the transfer of some, but not all, assets and liabilities to a purchaser) must be wound up? Are there likely to be circumstances where the residual bank is required to provide support to the purchaser or other remaining group entities?

33b. Should a bridge bank be permitted to operate without complying with the CRD requirements, in particular without minimum capital? If that is the case, should its activities be subject to restrictions

33c. A bridge bank is intended to be a temporary structure. Is it appropriate to limit the operation of the bridge bank to 2+3 years? Would it be preferable to impose a shorter or a longer limit?

34. Should the use of the asset management tool as a stand-alone tool for resolution be prohibited in order to avoid the 'rescue' of a failing bank?

35. The powers set out in this section G5 are intended to ensure that resolution authorities have all the necessary powers to apply the resolution tools. Are the suggested powers comprehensive? Are any additional powers necessary?

36. The ancillary provisions set out in section G6 are intended to ensure that where business has been transferred to another entity through the use of a resolution tool, the transfer is effective and the business can be carried on by the recipient. Are the suggested provisions sufficient? Are any additional provisions necessary?

37. Should the power suggested in section G7 be extended to allow authorities to impose equivalent requirements on other entities of the same group as the residual credit institution?

38. The objective of the provisions suggested in section G8 is to ensure that where a transfer includes assets located in another EU Member State (e.g. in a branch) or rights and liabilities that are governed by the law of another Member State, the transfer cannot be challenged or prevented by virtue of provisions of the law of that other Member State. Are the suggested provisions sufficient to achieve this objective? Is any additional provision necessary?

39a. Should all member States be required to make provision in national law for all three mechanisms by which resolution can be carried out that that are suggested above? If the same mechanisms are not available in all Member States, could this pose an obstacle to coordinated cross-border resolution?

39b. Should receivership – which allows resolution authorities to take full control of the failing institution - be the primary framework for resolution?

39c. Is any provision considered in this section necessary, or is it sufficient simply to provide for the resolution tools and powers?

40. Are the notification and publication requirements suggested in section G10 appropriate and sufficient to ensure that all affected persons are adequately informed about a resolution action?

41. Are the principles suggested in section G11 sufficient to ensure that creditors receive appropriate compensation?

42. Please give your views on the suggested temporary suspension of payment or delivery obligations? Is it appropriate to exclude eligible deposits? Should any other obligations be excluded?

43. Please give your views on the temporary suspension of close out netting rights suggested in section G13, including the appropriate length of the suspension. Should any classes of counterparty be excluded from the scope of such a suspension: for example, Central Banks, CCPs, payment and securities settlement systems that fall within the scope of the Settlement Finality Directive?

44. Do you agree that judicial review of resolution action should be limited to a review of the legality of the action, and that remedies should be limited to financial compensation, with no power for the court to reverse any action taken by resolution authorities?

    Alternatively, should the court have the power to reverse a transfer of assets and liabilities in limited circumstances where unwinding of the transfer is practically feasible and would not cause systemic risk or undermine legitimate expectations?

45. Would the provisions suggested in section G15 provide adequate protection for confidential information?

Safeguards for counterparties

46a. Do you agree that the classes of arrangement suggested in this section should be subject to the suggested safeguards in the case of partial property transfers? Should any other market arrangements be included?

46b. As a general approach, this Section H suggests a set of outcomes that Member States need to achieve (i.e. transfer of all or none of the property, rights and liabilities that covered by the various kinds of market arrangements that are specified here). It does not prescribe how that should be done or, in particular, the consequences if a transfer contravenes these provisions. Is such further provision necessary?

46c. Is further harmonisation of the definitions of the financial markets arrangements covered under this section necessary for the safeguards to be effective?

46d. The objective is to ensure appropriate protection ('no cherry picking') for legitimate financial market arrangements. Is there a risk that the necessary flexibility for resolution authorities could be undermined or frustrated, for example if non-related derivatives are included in a protected netting arrangement?

47a. Please give your views on the safeguards for title transfer financial collateral arrangements and set-off and netting arrangements suggested in section H2.

47b. Do you agree that certain retail rights and liabilities and rights and liabilities relating to subordinated debt should be excluded from the suggested safeguard?

48. Please give your views on the safeguards for security arrangements suggested in section H3.

49a. Please give your views on the safeguards for structured finance arrangements suggested in section H4.

49b. Do you consider that property, rights and liabilities relating to deposits should be excluded from the suggested safeguards?

50. Is express provision in relation to the protection of trading, clearing and settlement systems necessary, or are the provisions of the Settlement Finality Directive sufficient? If express provision is needed in this context, should the protections be drafted more broadly than those in the Settlement Finality Directive?

51. Is the provision suggested in section H6 sufficient to ensure that creditors would receive appropriate compensation? Is it necessary to specify the details of such compensation arrangements in an EU framework?

Group Resolution

52. Do you agree that the group level resolution authority should decide on the composition of the resolution colleges?

53a. Does the framework suggested in Part 5 strike an appropriate balance between the coordination of national measures that is necessary to deal effectively with a failing group, and the proven need for authorities to act quickly and decisively where the situation requires it?

53b. Should the framework set out explicit detail about how each resolution tool might be applied at group level?

54. Should it be a priority for the EU to strive for an internationally coordinated approach?

55. Should firm specific arrangements with third country authorities be required, as suggested in section P5.4?

Financing Arrangements

56. Do you agree that if the resolution authority is not satisfied about the resolution framework of a third country it should be able to require changes to the organisation or operating structure of the credit institution?

57. Is it sufficient to make a general reference to the financing of resolution tools or is it necessary to be more explicit about what a fund can or cannot finance (e.g. recapitalisation, loss sharing, etc.)?

58. Should there be more explicit provision about the alternative funding arrangements, for example reference to specific types of arrangements such as debt issuance or guarantees?

59a. Should the basis for the calculation of contributions be fully harmonised or left to the discretion of Member States?

59b. Are eligible liabilities an appropriate basis for calculating contributions from individual institutions, or a more risk adjusted basis be preferable? The latter might take account of elements such as: a) the probability that the institution would enter into resolution, b) its eligible liabilities, c) its systemic importance for the markets in question, etc. However, would that add too much complexity?

60. Do you agree that when the DGS of a Member State is also able to finance resolution, this should be taken into account when calculating the contributions to the Fund? Are additional safeguards necessary to protect the interests of insured depositors?

61. Do you agree that a resolution fund should have a priority ranking over the claims of all other unsecured creditors? Do you consider that this privileged position should be extended to other creditors in order to ensure temporary funding in the context of resolution?

Annex I: Debt write-down

62a. What classes of debt (if any) would need to be excluded from a statutory power to write down senior debt?

62b. Is it desirable to undermine the principle that creditors of the same ranking should be treated similarly? Should a discretionary power allow authorities to discriminate within classes of debt?

62c. What are the consequences of the fact that this approach may result in the ranking of creditors in the context of resolution being different to that in normal insolvency? Is further provision needed to address this?

62d. What measures would be appropriate to reduce debt restructuring and regulatory arbitrage? For example, would it be necessary to require a minimum amount of debt remains in scope at all times?

63a. What factors should authorities take into account when determining the correct amount of 'bail-in debt' that should be issued acknowledging the need to ensure that institutions are 'resolvable' while avoiding single market distortions?

63b. Would a market for large amounts of such debt exist at a cost which is lower than equity?

63c. As an alternative to a statutory requirement to issue certain instruments with specified terms, might institutions be permitted to insert a write down term in any debt instrument they deem appropriate to meet the fixed requirement for 'bail in' debt? Would there be any drawbacks to such an approach?

64a. Would the trigger be sufficiently clear and predictable (i.e. will instruments be rateable and will markets be able to price them) if linked to the failure of an institution?

64b. Are market participants likely to have an appetite for such instruments? Why or why not? If you consider that the pool of likely investors would be small, are there any adjustments which could be made to make such instruments more attractive without undermining the objectives of the tool?

64c. What are the most likely classes of investor: e.g. other banks or investment firms, insurers, pension funds, hedge fund and other high yield investors, retail? Should certain types of investor be restricted from holding such instruments?

65. Under what circumstances would additional compensation mechanisms be needed and what form might they take?

66. Should a regime of the kind discussed in this Annex allow flexibility in where within the group 'bail in debt' issue or held? What are the relative pros and cons of such an approach and what mechanisms would there be for ensuring all resolution authorities have viable resolution tools?

67. Is there a case for giving some creditors of a newly bailed in institution 'super senior' status? Should such a status be discretionary or a rule? What sorts of claim should be included and what mechanisms for transition back to a normal state should be considered?

68. Is it necessary to design a 'bail-in' mechanism for non-joint stock companies? How might this be achieved without unduly benefitting the members at the expense of creditors?

Annex II: Derogations to Company Law Directives

69. Are these provisions sufficient for the effective application of the resolution powers? Please specify the missing provisions, if any.

70. Do you agree on the need to create a mechanism for a rapid increase of capital? What would be your preferred option for the mechanism? Is there a need to specify that this mechanism can only be used close to the resolution triggers, i.e. not throughout the entire early intervention