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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels,
SEC(2009) 1390

COMMISSION STAFF WORKING DOCUMENT

SUMMARY OF THE IMPACT ASSESSMENT

Accompanying document to the

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE, THE EUROPEAN COURT OF JUSTICE AND THE EUROPEAN
CENTRAL BANK**

on an EU Framework for Cross-Border Crisis Management in the Banking Sector

{COM(2009) 561}
{SEC(2009) 1389}

1. WHAT IS THE PROBLEM, WHO IS MOST AFFECTED, WHY IS PUBLIC INTERVENTION NECESSARY?

Over the course of this financial crisis, the ability of authorities to manage crises both domestically and in cross-border situations has been severely tested. Financial markets within the EU have become integrated to such an extent that the effects on credit institutions of problems occurring in one Member State cannot always be contained and isolated and domestic shocks may be rapidly transmitted to firms and markets in other Member States.

While the operation of cross border banks has become highly integrated, (with the result that business lines and internal services are deeply interconnected and cannot be efficiently separated along geographical borders of Member States), crisis management of banks has remained national. As a consequence, in the event of a cross border bank failure, financial supervisors and other (resolution) authorities will only concentrate on the operations located in their respective territories. This may complicate cross border cooperation and lead to inefficient and possibly competing resolution approaches and suboptimal results at EU level.

One of the most important issues concerning actions to maintain financial stability is the ability of authorities to pre-empt (**early intervention**¹) or manage the crisis situations (**resolution**²) of banks. The involvement of authorities may be crucial to maintaining the stability of the whole financial system, to protecting the deposits of people and companies and to maintaining the continuity of the payment systems and other basic financial services.

Although a number of European supervisors have tools available to intervene in a banking crisis, the tools which exist may be different between Member States, or in some cases may not exist at all. These differences and gaps, including legislative differences between Member States and/or a lack of a legislative/institutional basis in some countries, have the potential to complicate and even hinder the efficient cross-border handling of a banking crisis. If different authorities intervene at different points in time, pursue different objectives and use different tools and measures with different criteria conditioning their application according to their own understanding of the problem, the results are likely to be suboptimal.

There is no legislation at EU level governing bank resolution. Beyond introducing a minimum set of powers for supervisory authorities aimed at restoring a situation in a bank³, coupled with some recent changes to the CRD (rules on alerting other authorities in emergency situations, coordination of supervisory activities and exchange of information in emergency situations) and establishing arrangements for the winding-up and reorganisation of credit institutions with branches in other Member States, no EU framework exists which sets out how and under which conditions authorities should act in the event of a crisis arising in a cross-border bank. The management of crises is almost entirely governed by national laws.

¹ Early intervention: early remedial actions of banking supervisors (e.g. raising private capital, modification of business lines, divestiture of assets) which aim at correcting irregularities at banks and hence helping banks returning to normal course of business and avoiding that banks enter in a resolution stage.

² Bank resolution: reorganisation of ailing banks (in either an administrative or judicial process) that aims at maintaining financial stability, the continuity of banking services and the revitalisation of the bank. In addition to traditional reorganisation techniques, bank resolution uses specific tools (e.g. bridge banks, forced merger, assisted acquisition, partial sale of assets) to reach the above objectives. The process is managed by a resolution authority, which can be different in Member States (national bank, financial supervisor, deposit guarantee scheme, ministry of finance, special authority).

³ In Article 136 of the Capital Requirements Directive 2006/48/EC.

The diverging approaches and tools, and conflicting interests between authorities is likely to lead to inefficient crisis prevention and resolution and deliver sub optimal results at EU level. This in turn can produce more costly outcomes for EU citizens and tax-payers, as the bail-out of systemically important cross border banks can be extremely costly compared to the cost of a timely and effective resolution⁴. According to the latest IMF⁵ estimates, crisis related write-downs on assets originated globally will reach \$ 4.1trillion by 2010, with global banking industry expected to bear about two thirds of the losses, half of which (or \$ 1.4 trillion, equivalent to 9% of the EU's GDP) is now attributable to European Banks.

Due to their broad impact on the financial sector and the whole economy, a crisis in a large international bank will affect a very wide range of stakeholders throughout the EU, i.e.:

- Financial institutions facing difficulties, including their shareholders and employees;
- Healthy financial institutions which are reliant on financial stability;
- Users of financial services, including depositors, investors, pensioners, and non-financial companies, SMEs;
- Public authorities, including supervisors, central banks and finance ministries;
- Taxpayers.

The Communication on "A Bank Resolution Framework for the EU", that this impact assessment accompanies, presents an overview of the problems, the areas under examination related to early intervention measures and bank resolution. It proposes policy objectives and an overall approach. It does not propose specific detailed policy solutions at this stage. Consequently, this impact assessment focuses primarily on the problem definition and the need for and objectives of EU level action in this area. In view of the consultative nature of the Communication, policy options are only considered in the broadest of terms. Any subsequent policy proposals to emerge as a result of this consultation will be subject to further and more thorough impact assessment at the appropriate stage.

2. IS EU ACTION JUSTIFIED ON GROUNDS OF SUBSIDIARITY?

Action at European level is required in this field in light of the high degree of integration of the banking market within the EU. Systems to deal with crises within banks remain nationally based and ill adapted to deal with cross-border situations. Coordination in such circumstances is likely to be complicated and the objectives pursued by each authority may differ. As a consequence, the legal framework cannot ensure that critical problems arising in a cross-border banking group will be solved fairly, effectively and expediently through robust cooperation arrangements.

Underpinning a new framework with the introduction of incentives necessary to induce cross-border cooperation is a task which can most effectively be undertaken at European level (this is particularly true with respect to addressing differences between national resolution and insolvency frameworks as well as arrangements for burden sharing).

⁴ Effective cross border arrangements should ensure a result that is optimal at EU level, taking into account the interests of stakeholders in all Member States, and thus minimising the overall cost all.

⁵ IMF, Responding to the Financial Crisis and Measuring Systemic Risk (Global Financial Stability Report), April 2009.

3. OBJECTIVES

Viewed from an EU perspective, the general objectives of action at EU level could be to:

- Maintain financial stability and confidence in banks, avoid contagion of problems;
- Minimise losses for society as a whole and especially for taxpayers;
- Strengthen the internal market for banking services.

In the context of early intervention, specific objectives could be to:

- Develop tools and triggers to detect problems in banks and intervene at an early stage
- Ensure efficient cooperation between national financial supervisors responsible for cross border banks in crisis situations.

For bank resolution, specific objectives could be to:

- Develop tools and triggers to ensure reorganisation and resolution of cross border banks in a timely and robust manner;
- Improve cooperation of national resolution authorities to deliver optimal solutions at EU level;
- Create certainty and predictability around bank resolutions for all stakeholders;
- Ensure continuity of basic banking services during resolution.

4. POLICY OPTIONS

For the purposes of this impact assessment, the analysis of options is restricted to a general assessment about the introduction of a new framework and the alternatives. A number of areas which might be dealt with under a new framework are also considered - but without favouring or proposing any concrete measures. The list of policy options is not closed and should further options come to light as a result of the stakeholder consultation, these may be assessed at a later stage when the Commission makes firm proposals.

General Considerations about the need for a new bank resolution framework

The starting point for the Communication is that a framework for bank resolution is needed at EU level. It should address the shortcomings which have been extensively identified as part of the problem definition, and it should be designed in such a way as to fulfil a commonly agreed set of objectives about how to deal with ailing banks. This option is compared against two alternative options. The first is the baseline scenario, which would mean that cross-border cooperation for bank resolution would depend on voluntary arrangements set out in the 2008 Memorandum of Understanding (MoU) coupled with newly introduced rules in the Capital Requirements Directive which establish colleges for cross-border banking groups, new alert and information exchange obligations and provisions on joint decision-taking. The second alternative would be to scale back cross-border banking groups in order to manage crises more efficiently under current national regimes. The advantages and disadvantages of this latter option are assessed, with particular stress on the fact that such an option would require a Treaty change and drive up the cost of banking services.

Early Intervention

Options relating to three broad policy areas are considered: options to address differences between the way supervisory actions are triggered, options to address differences in tools and

options to address the misalignment between national responsibilities and the global nature of banking business.

With respect to the triggers for supervisory actions, two alternatives to the baseline scenario are considered. One would entail harmonising a minimum set of early warning indicators and developing a framework for common assessment as a means of facilitating cooperation in such a way as to enable joint responses but maintaining a sufficient degree of flexibility and discretion. The second would involve developing a set of hard automatic triggers which determine the point at which supervisory action would need to occur – in order to provide a clear (but non-discretionary) framework under which coordinated supervisory actions would take place.

With respect to the differences between early intervention tools, beyond the baseline scenario consideration two possible options are considered. One would supplement the tools listed in Article 136 of the CRD with additional tools that are not currently available to authorities in all Member States - such as powers to require submission of a restoration plan, wind down plans as a precaution against possible failure of a banking group or enhanced powers towards the banks management. The alternative considered is the agreement of a single set of fully harmonised early intervention tools. This second option has the advantage that such an approach would eliminate differences between authorities, but the disadvantage that it might be very difficult to implement given the general differences between supervisory and legal systems.

With respect to the misalignment between national responsibilities and the global nature of banking business, the baseline scenario would entail reliance on the 2008 MoU, although the planned changes to supervisory architecture would bring a more active role for the soon to be created European Banking Authority. An alternative option would be to build on the recent changes, but also to develop rules which would require supervisors to take joint decisions on the basis of a common assessment and a common restoration plan submitted by the parent company for the group as a whole.

Bank resolution

Options to address identified problems in the following five broad policy areas are considered: bank resolution tools and triggers, misalignment between responsibility of national authorities and the global nature of banking business, broader obstacles (company, insolvency law) to bank resolution, the financing of cross-border resolution and continuity of banking services.

With respect to bank resolution tools and triggers, consideration is given to the development of a minimum set of tools (powers to arrange acquisition by a private sector purchaser, to transfer assets and liabilities to a bridge bank or good bank/bad bank, assisted sale of part of the business to a private sector purchaser, or nationalisation) designed to enable fast and effective intervention by resolution authorities. Such tools could either supplement existing national tools (which would be an easier course of action but would leave differences/discrepancies between national toolkits in place), or alternatively a set of common tools could be developed for all national authorities and used under the same conditions (meaning that extensive changes to national laws on resolution would be necessary).

With respect to the misalignment between national responsibilities and the global nature of banking business, consideration is given to developing cooperation arrangements between resolution authorities (on the basis of a set of legally binding obligations), as well as between judicial authorities (courts and insolvency practitioners). This could entail a coordination framework for cooperation and exchange of information (backed by new EU rules), or (more

ambitiously) a more directed coordination of national proceedings in relation to group entities by a lead administrator or liquidator. Consideration is also given to the possibility and challenges of tasking an EU body (possibly the new European Banking Authority) with a role in the resolution of a cross-border institution.

With respect to options to address broader obstacles, consideration is given to whether company law needs to be amended in order to allow resolution authorities to override certain shareholder rights (but subject to appropriate compensation and redress mechanisms) and to whether insolvency laws might also be amended so as to allow resolution of an ailing bank under a special procedure, or to be able to cater with the resolution of the group as a whole. Consideration is also given to whether a separate and self-contained insolvency regime for cross-border banking groups, replacing national regimes is necessary to enable an integrated reorganisation or winding up of a cross-border group. This approach too would pose considerable challenges.

With respect to options to support financing of cross-border resolution, a number of possible and not mutually exclusive options are considered, including the support of private sector financing solutions through adjustments to company and insolvency law, introducing a framework to facilitate intra-group asset transferability after the commencement of an insolvency procedure, exploring the feasibility of using DGS beyond their traditional paybox function and developing public funding arrangements through an agreement of clear burden sharing arrangements.

Finally, with respect to policies to support continuity of banking services, possible measures to support the application of certain resolution tools are considered. These include modifications to company and insolvency law to ensure continued provision of support services in the event a bank is split (as a result of resolution involving a bridge bank or partial sale of assets); restriction of termination rights for a short period in order to allow time for the resolution authority to transfer parts of business to another entity (such as a bridge bank) and a coordinated imposition of a moratorium across a banking group.

This impact assessment supports a Commission Communication which is consultative in nature and open as regards the possible options which could be pursued. Further and more assessment will be necessary should the Commission decide to come forward with concrete policy proposals.