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FINANCIAL INSTITUTIONS
Banking and financial conglomerates

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Overview of the results of the public consultation on an EU framework for Cross-border crisis management in the banking sector

1. Who responded to the public consultation?

The Commission received 64 responses from a variety of stakeholders.

- 20 responses from national public authorities, from 15 EU Member States and 1 EEA Member State
- 3 responses from EU/international organisations (CEBS, IMF and ECB).
- 30 responses from industry stakeholders (20 trade associations, 6 banks, 4 law firms/legal committees)
- 2 consumer/user associations and 1 trade union
- 1 shareholder association
- 7 private individuals/academic committees

2. Scope

Although most respondents argued that a crisis management framework should ultimately cover all financial institutions, there was general agreement with the Commission's suggestion that it made sense to start in a first phase by focussing the framework on deposit taking institutions. Among the points made about scope were:

- Need to address problems in financial conglomerates – difficulty to apply resolution to just one part of a banking group.
- Need ultimately to cover investment firms (c.f. problems in Lehman Bros).
- Need to promote greater cross-sectoral convergence for cross-border groups.
- Industry generally favoured more immediate application to all types of financial institution.
- A very strong majority of respondents were in favour of not restricting the framework to cross-border banking groups. The framework should apply to all banks operating cross-border (also through branches). A number of respondents favoured applying the framework also to purely domestic institutions for level playing field reasons.
- A strong majority were not in favour of applying the new framework only to SIFIs. Such a distinction would be difficult to define, and may indeed raise moral hazard concerns. The failure even of smaller institutions may have systemic impacts.

3. Objectives for a crisis management framework

There was general agreement with the objectives listed in the Commission's Communication. In particular there appeared to be a high degree of consensus with respect to general objectives such as preserving financial stability, minimizing cost to the taxpayer and protecting depositors. A number of other objectives were also mentioned by Member States:

- Enable sufficient information exchange between authorities
- Introduce compatible instruments across Member States
- Allocate losses to shareholders and as far as possible creditors
- Minimize *social* costs of a banking crisis
- Equip authorities with sufficient powers
- Limit moral hazard
- Ensure business continuity for bank customers
- Preserve critical banking functions
- Minimize the broader economic impact of banking failures
- Avoid contravening property rights as set out in the European Convention on Human Rights

Industry respondents focused on additional objectives such as:

- Strengthening the Internal Market
- Promoting cross-border banking groups so they can compete with non-EU actors
- Ensuring a level playing field within the EEA

- Protecting creditors who are fundamental to funding

Union representatives also mentioned the protection of economic interests of bank employees.

4. Early Intervention Tools

There was general agreement on the need to harmonise supervisory tools to permit early intervention on the basis of a broad and flexible toolkit – interoperable across Member States. The toolbox should be common, with most in favour of minimum as opposed to maximum harmonisation. CEBS had produced an extensive list of tools (minimum harmonisation), which did not distinguish between "early intervention" and "resolution". There was also emphasis on the need for flexibility. Among the tools suggested were capital related measures, powers directed towards the management, obligation to draw up and submit a restoration plan, powers to restrict asset transfers, powers to require an institution to re-structure activities or cease practices, power to initiate re-organisation or winding up, etc. ECB suggested a gradual increase of possible tools in conjunction with the intensification of the bank's problems. Some industry respondents mentioned contingent capital as an early intervention tool.

5. Triggers for the use of Early Intervention tools

There was broad consensus that triggers governing the use of early intervention tools should not be automatic (such triggers were not considered meaningful) and should incorporate a sufficient degree of flexibility and discretion. This view was generally shared by industry respondents. The choice should be based on a wide range of supervisory information. The IMF suggested the need for a clear escalation of supervisory interventions and the establishment of an indicative list of triggers and thresholds as a means of reducing regulatory uncertainty.

6. Recovery and Resolution plans

The idea of recovery and resolution plans was greeted with a more mixed response. The Communication was drafted in October, at which time the precise nature of such plans was still unclear. With two exceptions, Member States were broadly favourable to the idea of such plans on the grounds that they might help to incite resolution-friendly structures, prepare for burden sharing, and establish clear and transparent thresholds. ECB saw possible benefits but stressed the need for full compliance with the freedom of the Internal Market. Response from industry respondents was on the other hand considerably more mixed, with most reactions unfavourable. Concerns were expressed about sensitive and confidential information and fears that knowledge of the details of such plans could spark market rumours. In particular, there were fears about the implications for a potential reduction of the size of big banks or forced adaptation of corporate structures. Some respondents pointed out that such plans were unlikely to be useful in actual crisis situations, and that it might be difficult to predict in advance which parts of the firm would be under greatest stress. It was also suggested that regular dialogue through supervisors/within a college, or contingency planning might be better ways of understanding group structures. Other industry respondents agreed that wiring diagrams/business information packs could prove useful. One shareholder association was favourable to the idea as a precautionary tool and as a way of promoting good governance.

7. Branch supervision

Respondents were asked whether any modification of the framework for branch supervision might be necessary or desirable. There were only a few responses on this point, and those that responded were mainly Member States. The suggestions included conducting a preliminary review of the current framework, empowering the host to request action from the home authority, adopting powers parallel to those under MiFID Article 62, empowering host authorities to freeze assets of branches in emergency situations and adjusting EU law to empower the host supervisor to convert to a subsidiary (in exceptional circumstances). IMF suggested that a solution might lie in the putting in place of an EU level cross-border crisis management regime and deposit guarantee scheme.

8. Administrative reorganisation/appointment of a special administrator

There were relatively few respondents who commented on the idea of introducing administrative reorganisation as part of a new EU regulatory framework, and their reaction was broadly positive. The appointment of a special administrator was seen by most as a measure which could help to reassure creditors and markets and stabilize the situation. A minority of respondents expressed a concern that on the contrary such an action might exacerbate the situation if it led to a loss of confidence in the institution. One respondent suggested that such an appointment should not be disclosed to the public while another stressed the need to avoid specifying what tools an administrator should use. One respondent suggested there was a need for an EU single administrator.

9. Intragroup asset transfers

In general, respondents expressed considerable interest to look into the feasibility of an asset transferability framework, although others expressed scepticism about the challenges and complexities. Among Member State respondents, a majority was favourable at least to further investigation. Some were of the view that the Rozenblum principles could be a good starting point, and that there was a need to establish clearly defined rules. It was stressed that there would be a need to underpin asset transferability with harmonization of insolvency law and one MS suggested the need to recognize group interest. Another MS suggested that a framework could be desirable, but did not view this as a priority. Those more sceptical MS suggested that asset transferability could have counterproductive contagion effects, would breach the concept of a legal personality, would give rise to possible challenges by creditors and that restriction on transfers had been an effective tool during the crisis. If allowed at all, such transfers should only be permissible in very exceptional circumstances or there was a need to decide on a case by case basis – without any pre-determined framework. CEBS believed that the possibilities for asset transferability should be investigated – but with due regard to possibilities to limit prohibit transfers if there was likely to be a breach of prudential requirements. ECB was of the view that designing an asset transferability framework would be legally very challenging. Industry respondents were generally favourable to the idea and argued that obstacles should be removed. However a minority feared possible disadvantage to creditors of the transferring entity and pointed to significant legal issues raised with respect to process, competing interests of stakeholders and compensation.

Additional questions in this context covered the necessary safeguards and the utility of exploring the concept of a banking group.

On safeguards, a variety of suggestions were made, including ensuring cooperation between authorities, the need to ensure adequate protection of minority shareholders and creditors, the need to safeguard depositors' interests, the need for appropriate compensation and the need for an acceptable claw back mechanism to ensure that the transferor and its creditors would not be prejudiced by the transfer. It was also suggested that rights of shareholders should not be favoured over the rights of creditors (this may entail the need to change insolvency laws). ECB also stressed the need for rules on valuation of the transferred assets, a solvency and necessity test on the transferor, a priority claim for shareholders and creditors of the transferor, and prior notification of the relevant authorities. A shareholder association suggested that asset transferability should be subject to shareholder consent.

On the concept of group interest, there was a mixed reaction from both MS and industry. While some supported the idea, others expressed concerns about how such a concept might disrupt the normal operation of banks if there were conflict with the fiduciary duties of the subsidiary's management, or that it might give rise to legal uncertainty and unintended consequences. There was a particular concern that such a concept would pierce the corporate veil. The IMF on the other hand was favourable to the concept of a "banking group" – based on clear and transparent criteria. Among industry respondents, there were also mixed views, including the idea of exploring a limited group notion based on concepts of interdependence and mutual interest, while preserving the transferor's creditors.

10. Resolution tools

There was strong support for the resolution tools suggested in the Commission's Communication (private sector acquisition, transfer of business to a temporary bridge bank, partial transfer of assets and separation of clean and toxic assets between good and bad banks). Among the other tools suggested by Member States were the imposition of a conservatorship – without the need to consult shareholders, the intervention of a guarantee fund in the event of a risk that deposits might become unavailable and the conversion of debt securities into capital. Several Member States stressed the need for a broad range of tools to be available, and for Member States to be able to maintain existing tools alongside harmonised common tools. The IMF suggested granting an administrator additional powers to allocate losses to shareholders (by imposing write-downs on assets and requiring capital increased which diluted existing shareholders) and in cases of insolvency allocating losses to uninsured creditors (by imposing haircuts on claims). Industry respondents argued for prompt, flexible and effective tools. Additional suggestions included freezing deposits above €100,000 and a power to act against rumour spreading in the media.

11. Threshold conditions

Member States overwhelmingly rejected the idea of hard solvency triggers which did not enable case-by-case assessments and may not be sufficiently robust during a crisis. Most argued for a mix of quantitative and qualitative indicators (capital, liquidity and other aspects of financial soundness) applied with a degree of discretion. Among the suggestions made were the development of a risk assessment system, the need for a link to data on solvency or liquidity and an assessment of the viability of the bank, that thresholds should be based on bank solvency, equity price and a market assessment and that the bank should have the possibility to present a restoration plan before authorities intervened. It was also suggested that a proportionality principle should apply with respect to use of tools and that it was important to ensure that measures could be applied before illiquidity or insolvency occurred. One Member State was opposed to the idea of imposing different conditions for the use of different tools.

The IMF suggested that broadly harmonised triggers would be desirable and that the toolkit should be fully available once official administration had been triggered. The IMF also suggested the triggers could include a serious/persistent breach of regulatory requirements, an assessment that the bank was no longer economically viable, the capital buffer had shrunk below its ability to cover additional expected losses, or that early intervention had failed.

Among suggestions made by industry respondents were the need for a graduated approach, the need for clearly defined thresholds, the importance of creating certainty for stakeholders (triggers needed to be as objective and predictable as possible) and the need for the agreement of the college for the exercise of resolution powers.

A shareholder association suggested that resolution tools should only be permitted where the liquidation of the bank was inevitable and where less dramatic tools would not suffice. It would be important to know precise triggers in advance in order to understand the danger levels.

12. Shareholder and creditors' rights

There was general agreement that, subject to conditions, it should be possible to derogate from certain requirements imposed by company law directives relating to the protection of shareholders' rights, and that this should be before a point of actual bankruptcy had been reached. Views differed between Member States as to how stringent conditions needed to be. Most respondents were of the view that derogation should only be as a last resort or in emergency situations to address problems in severely distressed institutions and justified in the public interest of financial stability, or protecting depositors' or other financial creditors' interests. In particular, Member States pointed to the need to derogate from rules on capital increases and decreases together with the pre-emption rights in the Second CLD, convocation periods in the shareholders' rights Directive, Article 5 of the Take-Over Bids Directive and the Third and Sixth CLDs.

There also appeared to be a consensus among the respondents that stakeholders should be compensated for the losses incurred and that they should not be put in a position that was worse than the one they would be in had no measure been taken. However, it was also suggested that stakeholders should not profit from the state intervention i.e. the compensation should be based on the value of the company ignoring the value-enhancing effects of state intervention. Measures governing compensation should be designed to secure compatibility with the ECHR. Judicial review should be guaranteed but should not allow for a stay of execution or be able to reverse the operations that have taken place, but should be limited to awarding financial compensation or be limited to legal grounds.

13. Protection in case of partial transfers

The main concern among the few respondents to this question was about the need to protect set off and netting arrangements, secured liabilities, and financial market contracts. The IMF also emphasized the need to ensure that partial transfers did not interfere with payment flows in certain types of capital markets transactions, including covered bonds and securitisations. Nor, they suggested, should competent authorities be allowed to cherry pick rights and liabilities protected under financial collateral arrangements. EB suggested to consider amending the Financial Collateral Directive to permit a short delay in the exercise of immediate close-out rights in order for resolution authorities to be able to complete asset transfers.

One MS had experience with a recently established framework which allowed for partial transfers and suggested that there was a need for a number of additional powers (to carry out supplemental, reverse and onwards transfers of property or securities, to take holding companies into temporary public ownership, to impose continuity obligations on affiliates to enable the transferee to operate the transferred business effectively). Safeguards were necessary to ensure that counterparties and creditors would be protected, and enhanced protections needed for partial property transfer, although this did not mean that creditors should not suffer losses in a resolution. A "no creditor worse off" safeguard should also be considered in order to provide that no pre-transfer creditors should be worse off after a partial transfer than they would have been had the institution gone into insolvency.

One industry association argued that there was a need to take account of legal mechanisms for restructuring /winding up of banks, in particular to ensure that the interests of preferential creditors, e.g. Pfandbrief holders should not be undermined.

14. Improvement of communication and cooperation between resolution and insolvency authorities

Respondents made a number of suggestions about how to improve communication and cooperation between authorities. Some advocated binding rules, while others disagreed, arguing that this was an area where it may be difficult to legislate. Several respondents suggested a possible role for the EBA to act as a mediator in conflicts, or else a suggestion was made for a lead authority to collect and channel flow of information exchange and act as coordinator. It was suggested that the agreement of a common set of tools should help coordination between authorities. There were also suggestions that Cross-Border Stability Groups – as defined in the 2008 MoU - could help improve cooperation and communication, while others suggested a role for streamlined colleges of supervisors/ core colleges. CEBS indicated that work was already underway in this respect. ECB suggested that promotion of practical cooperation and coordination between national resolution authorities could be conferred to a specific body or authority created under EU law. The IMF proposed that an authority (possibly the EBA or a European Resolution Authority) could draw up a concrete proposal for a resolution strategy, while another MS suggested that work on preparedness for a crisis would help to improve cooperation.

Suggestions from industry respondents included the development of common IT systems based on identical information inputs from institutions, and the establishment of solid legal agreements on the division of responsibilities. One respondent remarked that unless burden sharing arrangements were in place, there would be little incentive to cooperate.

15. Integrated resolution/ERA

A strong majority of respondents were not in favour of establishing a European Resolution Authority at this stage. The resistance to such an idea was particularly strong among MS, who argued that it would not be feasible, that national authorities were closer to the markets and that it would have fiscal implications with potential impacts on national budgets. The priority should instead be to harmonize common intervention tools and foster coordination between national authorities. One MS argued that the framework should take account of the reality of an integrated EU banking sector, while another suggested an alternative approach of establishing a system of administrators. A number of MS supported introducing a coordination function for the EBA during crises. CEBS argued that the focus should be on improving effectiveness of MoU and colleges, ECB argued for a realistic approach, while the IMF supported the idea of a European Resolution Authority as a first best solution to overcome conflicts of interest and pursue common good.

The position of industry respondents with respect to a single resolution authority was less clear-cut, with several expressing their support while others rejected the idea. A number of respondents proposed introducing a lead authority for coordination of integrated resolution of group entities. Others stressed a role to be played by cross-border stability groups.

16. Changes to insolvency including more integrated insolvency framework for banking groups

Suggestions from Member State respondents regarding specific areas where changes to the insolvency framework could be needed included changes to support asset transferability, harmonisation of the criteria under which insolvency proceedings are initiated and compulsory coordination of insolvency proceedings. ECB was in favour of initiatives to improve coordination between supervisors and other administrative and judicial authorities – including legally authorizing EU insolvency courts to share information with courts in other EU jurisdictions that are dealing with the insolvency of other legal entities of the same group.

Industry respondents suggested the need for consideration about how to enable continuity of services between the failed institution and a bridge bank or private sector transferee, and the modalities for the imposition of a moratorium – in particular the need to take account of interest of counterparties and the need to set a time limit.

There were also suggestions from academic respondents, including the idea of a separate bank insolvency regime, the need for a common definition of insolvency and the need for a standard insolvency model for systemically important financial institutions.

On the question of whether a more integrated framework was needed, a strong majority of MS opposed such a move as being premature, unnecessary, carrying risks to financial stability in host countries or representing a fundamental breach of company law principles. Cooperation between insolvency authorities was seen by several as an important first step, and one MS suggested that solutions might lie in dealing with insolvency at the pre-insolvency stage.

Among industry respondents, the positions were marginally more nuanced, although a large majority rejected the idea as impractical, overly complex and with fiscal ramifications. Several respondents were strongly opposed to the idea of asset pooling or substantive consolidation. Among the suggestions were to first concentrate on enhancing national insolvency frameworks so that they could handle resolution of groups situated in the same jurisdiction, exploring the idea of a lead administrator, reinforcing coordination between authorities, and concentrating on the elimination of differences between national insolvency laws which might give rise to conflicts.

17. 28th regime

A majority of MS respondents reacted negatively to the idea of introducing a 28th regime, questioning the feasibility and challenges given the links to property, company commercial and securities laws. Such a regime would also require putting in place effective burden sharing arrangements. There was also a level playing field issue. Two MS respondents felt the idea merited further consideration, and in particular wished to understand better what such a regime might look like. CEBS questioned how it might be possible to move existing entities into such a regime without huge market upheavals. IMF on the other hand viewed a separate regime for systemic cross-border banks as a first best option.

There was a more positive response from some industry respondents and some suggestions as to how it might work in practice: for example, it might be possible to introduce such a regime via a regulation and allow banks to opt in. Those that opted for such a regime should have the flexibility to arrange assets and responsibilities across their group as thy chose, implying increased responsibility for the parent. Another suggestion was for a separate regime in order to ensure continued provision of important services even after institution is declared insolvent.

18. Financing

There was general agreement among MS respondents that private sector financing should be available for crisis resolution measures in order to reduce public expenditures. However there was little consensus on how this might be achieved. It was suggested that the idea of a rescue fund was premature, and there was some scepticism as to whether it would be capable of fully covering the cost of the crisis. Some interest was expressed in the idea of uses for contingent capital. The idea of associating DGS with resolution funds received a mixed response, with some MS supportive, while others were opposed. It was suggested that the work on DGS should in any case be closely associated to work on financing arrangements for crisis resolution. There appeared to be little appetite for the idea of an EU fund at this stage, which raised moral hazard issues as well as practical difficulties, although the idea of a network of national funds met with some support.

ECB responded that the Eurosystem would support exploring the feasibility of establishing mechanisms that could ensure that private sector funds would be available at a time of crisis, and that further efforts could be devoted to identifying additional tasks that may be delegated to DGS, subject to harmonised rules. IMF remarked that gross funding needs may be much large than net needs, and that given Treaty constraints, financing may need to come from both national and EU sources.

A majority of industry were either opposed or at least sceptical about the idea of using pre-financed funds to cover the cost of resolution measures – as this might imply a heavy burden for banks and it was doubtful how effective a role such funds might be able to play. There were mixed views on the possible involvement of DGS: depositor compensation should not be put at risk and contributors to a national DGS should be entitled to have a say in the use of funds for a resolution.

With respect to burden sharing, MS respondents were generally in favour of conducting further work – either on the basis of principles, or by agreeing case by case group approaches. There was a general view that detailed binding ex ante arrangements may not be feasible. One MS supported the idea of ex post definition of burden sharing rules. Another MS suggested that burden sharing should be on basis of economic criteria (e.g. ratio of assets of a branch/sub of the entire group + division of responsibility for prudential supervision of the group).

Industry respondents also supported the need for progress on burden sharing, although there were contrasting views about the feasibility of pre-determined binding rules. Some felt that mere principles would not be sufficient. Progress on burden sharing would be the basis for enhanced cooperation between authorities, and it was argued that focus should be on shared understanding on a set of principles/criteria (e.g. De Larosière criteria). One respondent remarked that it was important to give a message that authorities are not committed to rescuing failing institutions. Another respondent commented that unless burden sharing arrangements were in place, MS would have incentives to impose increasing requirements on branches or require subsidiarisation.

One academic respondent argued the case for legally binding ex ante burden sharing arrangements, as this was more feasible than the alternative of a supranational body with fiscal powers.