



## Banking Union – Single Resolution Mechanism (SRM)

### The SRM – essential for a stronger single market & EMU and to avoid bank bail-outs

On 10 July 2013, the Commission proposed to create a Single Resolution Mechanism (SRM). After the agreement on a Single Supervisory Mechanism (SSM), this is the next step towards Banking Union, indispensable to develop the EU Economic and Monetary Union and to prevent bank bail-outs.

The recent financial crisis in Cyprus highlighted the **need for swift and decisive action backed by EU-level funding arrangements financed by the banking sector**, in order to avoid a situation in which bank resolution conducted at national level would have a disproportionate impact on the real economy, and to curb uncertainty and prevent bank runs and contagion of other parts of the euro area and the Internal Market. A **network of national authorities**, even if coordinated at intergovernmental level, is **not sufficiently operational** in this respect.

As highlighted by the European Council in December 2012 and June 2013, it is **not feasible to have a single European mechanism for the supervision of banks but to leave the resolution of banks to national authorities**. Tensions between the supervisor (ECB) and national resolution authorities could emerge over how to deal with ailing banks.

At the same time, without the SRM market expectations about Member States' ability to deal with bank failure nationally could persist, **reinforcing negative feedback loops between sovereigns and banks**, and **maintaining fragmentation and competitive distortions** across the Internal Market.

The proposed SRM would only apply to banks which are covered by SSM, ensuring high quality common supervision. This means that the SRM would cover all **banks established in all Euro area Member States and any other Member State** deciding to join Banking Union.

Compared to a mere network of national resolution authorities, a Single Resolution Mechanism with a strong central decision-making body and a Single Bank Resolution Fund would provide **key benefits for taxpayers, banks, deposit-holders and financial and economic stability** in the entire EU.

#### ***Does the SRM have a sound legal basis?***

Banking Union must stand on **very solid legal ground** – as any EU legislation. The Commission has a proposed a structure which takes into account the limits set by the existing Treaties.

**Article 114 of the Treaty** on the Functioning of the European Union (TFEU) is a sound legal basis for the proposed SRM. It allows the EU to adopt measures for the **approximation of national provisions laid down by law, regulation or administrative action** aiming at the **establishment and functioning of the Internal Market**.

This is the very objective of the SRM: it **will ensure a**

**uniform implementation of the EU level bank resolution rules** and procedures in the Member States participating in the SSM. This will remove the distortions of competition caused by divergences in the national resolution practices, and the lack of a unified decision-making process at Union level.

Moreover, the SRM will align the level of responsibility for supervision and resolution. This will significantly reduce the risk of uncoordinated action at different levels when a bank gets in difficulties which may give rise to **competitive disadvantages for the banks concerned**. This will **benefit the whole internal market** restoring a level playing field among credit institutions in the Union.

#### ***Why is the SRM needed to prevent bank bail-outs?***

Resolving failing banks can be expensive. Based on the Bank Recovery and Resolution Directive, to be finalised before Christmas, the **SRM** will ensure that any **resolution costs** must first be borne by a bank's **shareholders and creditors**. The Commission has already demonstrated its commitment to this principle by adopting in August 2013 new guidelines requiring that state aid can in principle only be granted after shareholders and classes of creditors have assumed resolution costs ("bail in").

The Bank Recovery and Resolution Directive will enshrine in hard law **minimum thresholds for "bail in"** that must be applied where resolution funding is required.

But putting "bail in" into practice is not always easy, as the recent financial crisis in Cyprus has highlighted. This is where the **SRM** comes into play - a Single Mechanism **can develop the expertise and experience necessary to implement "bail in" much better**, than a system with fragmented responsibilities assigned to 18 or more different national authorities.

Under most scenarios, contributions by shareholders and creditors should be sufficient to finance resolution. If, **exceptionally**, additional resources were needed, a Single Bank Resolution Fund would come into play as a last resort only to finance bank resolution process, and not to directly absorb any losses or recapitalise a bank. Based on the precedent of national funds available in Member States such as Germany, this fund is **financed by ex ante contributions from the banking sector**, building a strong shield to protect taxpayers and avoid contagion of other parts of the euro area and the Single Market. Whether at EU or national level - any resolution fund can only be built up **gradually**. A single European fund will reach a critical mass much quicker than national resolution funds **and therefore protect taxpayers much more effectively**.

Before the fund is sufficiently capitalised, it could, if necessary, levy additional ad hoc funds from the banking sector or borrow funds on the market.

Member States which have **already established national resolution funds** are **not required to transfer the resources** accumulated therein to the

European Resolution Fund. They will continue to be free to decide on the use of the funds.

#### ***Does the SRM impinge on budgetary sovereignty?***

The SRM **fully respects** Member States' budgetary sovereignty - an **explicit safeguard** ensures that under no circumstances will the SRM be able to require Member States to finance resolution from their national budgets.

#### ***What effects on deposit-holders & banks?***

The SRM will contribute to sever the link between banks and sovereigns. It will contribute to overcome the current fragmentation of banking markets within the EU, to the benefit of deposit-holders and banks.

A European Resolution Fund - financed by contributions from all banks in participating Member States - **will make resolution funding more efficient for the banks concerned and deposit-holders**. In an internal market **financial stability is a common good** - why should domestic banks - and ultimately their deposit-holders - foot alone the bill for resolving an international bank headquartered in their country, when the main beneficiaries are banks in other Member States which are in close business contacts with the resolved bank?

**Contributions** to the fund are calculated in a way that **reflects the risks** inherent in different types of banks and their business models. Contributions will be charged based on banks' liabilities but no contributions will be charged on own funds and deposits covered by guarantee schemes. This means that **banks which are financed almost exclusively by deposits** - such as many **local savings or cooperative banks** - would in practice have **very low contributions** if any.

In addition, the SRM would only intervene when private sector solutions were not successful in dealing with a bank failure. That means that institutional protection schemes and other intra-group financing support mechanisms set up by certain groups of credit institutions would maintain their current role.

The Commission **does not propose to merge national deposit guarantee schemes**.

#### ***How does the SRM ensure democratic accountability?***

The SRM would be subject to **strong accountability provisions**, broadly modelled on the SSM, which go beyond the current practice at national level in most Member States. This will ensure democratic accountability towards the European Parliament and the Council of Ministers, but also towards national parliaments.