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# A common backstop to the Single Resolution Fund

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## Abstract

During the establishment of the Banking Union it has been agreed to develop a common backstop to the Single Resolution Fund. The following key principles constitute the point of departure of this paper:

1. Fiscal neutrality in the medium term;

2. Instrument of last resort;

3. Equivalent treatment across all Member States in the Banking Union; and

4. No costs for non-Banking Union Member States.

For each aspect the legal and regulatory background as well as the economic implications are provided. They significantly influence the common backstop's final design and the choice of an adequate provider for the steady state.

Keywords:

Banking Union | Single Resolution Fund | Single Resolution Mechanism common backstop | risk sharing

## Disclosure statement

No potential conflict of interest was reported by the authors.

# Notes

1. Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225, 30.7.2014.

2. The 2017 contribution data published by the SRB (2017) refers to a total amount of covered deposits of around EUR 5,46 trillion in the Banking Union.

3. See also Howarth and Quaglia (2016) on role of the European Stability Mechanism as a fiscal backstop for sovereigns in the euro area.

4. The role of the central bank as lender of last resort by definition of a monetary system is also acknowledged in Recital 100 SRMR.

5. See also Recital 20 SRMR. The term "Transitional Period" refers to the progressive mutualisation path during the first eight years as of 1 January 2016 until the compartmental structure ceases to exist (Article 1(1)(b) IGA). The term "Initial Period" is often used synonymously but refers to the time required to build up the SRF to its

Target Level which is also envisaged for eight years as from 1 January 2016 (however with a possible extension according to Article 69(3) SRMR). Also Article 3(1)(no. 37) SRMR links the Transitional Period to the time when the SRF will have reached its Target Level, but no later than the 1 January 2024.

6. Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund, ECOFIN 342, 8457/14 of 14 May 2014.

7. The availability of the LFA amounts is subject to the so-called “IGA waterfall”, i.e. the currently available non-mutualised and mutualised means in the respective national compartment. In this respect, the SRB and the European Commission services reached a mutual understanding on the detailed interpretation of Article 5(1) of the IGA in February 2017, which was subsequently endorsed by the signatories of the IGA (Council 2017, Annex).

8. The LFAs of the Banking Union can further be considered a material improvement compared to the sole national framework under Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 (“BRRD”). According to Article 102(1) BRRD, in Member States not participating in the Banking Union, the target level of national resolutions funds (1% of covered deposits of the domestic banking sector) will become fully available only after the end of a ten-year build-up period.

9. The steady state refers to the time as of 1 January 2024, directly after the Transitional Period has ended.

10. Technical discussions of the Economic and Financial Committee (“EFC”) on the common backstop are in part delegated to the Task Force on Coordinated Action (“TFCA”; see, e.g., European Commission 2017a, 13–15). The start of the work was subject only to the full implementation of the BRRD in all Member States and the completion of the signing process of the LFAs (Presidency of the Council of the EU 2016a, 23).

11. See in particular Articles 76(3) and 27 (6)-(12) SRMR on the bail-in requirements and limitations when using the SRF.

12. For comparison, the SRB collected EUR 6.6 billion ex-ante contributions in 2017 (SRB (Single Resolution Board) 2017). Taking into account the yearly maximum of three times the annual ex-ante contributions, this could imply a theoretical maximum amount of up to EUR 19.8 billion.

13. To protect a bank's financial position, Article 71(2) SRMR provides in this respect for individual deferrals of ex-post contributions by 6 months.

14. In accordance with Article 109 BRRD and Article 11(2) of Directive 2014/49/EU on deposit guarantee schemes ("DGSD"), also the respective (national) deposit guarantee scheme shall contribute to resolution actions the amount of the potential net loss it would had suffered in case of winding-up under normal insolvency proceedings. In this respect the actual contributions by the DGS takes into account its preferred claim on the proceeds in accordance with Article 9(2) DGSD) which depends significantly on the respective national insolvency laws. Further, such contribution is capped at a maximum of 50% of the national DGS's target level.

15. Paragraphs (8) and (9) of Article 27 SRMR distinguish between alternative funding means in accordance with Articles 73 and 74 SRMR in order to finance the 5% contributions by the Fund and alternative financing sources after that Fund's contribution. The use of the latter is conditional on a full conversion and write-down of all unsecured, non-preferred liabilities (except for eligible deposits). However, in the corresponding Article 44(6) and (7) of the BRRD seems less consistent in that distinction.

16. See also Recital 17 IGA linking the principles for the use of the SRF to the general principles governing resolution.

17. With regard to the LFAs, the ECOFIN statement 2015 defines last resort as "after having exhausted all other financing sources, including bail-in requirements under BRRD as well as […] the SRB's external borrowing capacity".

18. A Member State is theoretically not excluded from the concept of a "third party". However, it can be assumed that Article 73 SRMR relates primarily to private borrowings either in the form of loans or issuance of debt instruments in markets.

19. Hence, Article 74 SRMR does not rank per se as a funding source of last resort in the SRMR.

20. The scope of the SRMR (Article 4 SRMR) refers to the one of the SSM and ensures consistency of participating Member States in both pillars of the Banking Union.

21. A related aspect was also dealt with by the Economic and Financial Committee in December 2014 regarding equivalent treatment of euro area and non-euro area

Member States in the context of national bridge financing to the SRF. With respect to the availability of the ESM for Member States in difficulties it was concluded that “non-euro area Member States participating in the Banking Union will have access to the EU’s medium-term facility for Balance of Payment (BoP) assistance” (Council 2014, 2).

22. If the guarantee would be used to back the issuance of debt instruments in markets, such design could in principle be comparable with the European Financial Stability Facility (“EFSF”), which issued securities in the market guaranteed by the euro area Member States.

23. The SRB’s attractiveness further depends on the regulatory treatment of its exposures under the standardised approach in accordance with Regulation (EU) 575/2013 (CRR) and the eligibility of its debt according to the Eurosystem collateral framework.

24. See also Article 76(1)(a) and (b) SRMR, Article 50(1)(c) SRMR and Recital 33 SRMR.

25. The lack of a clear definition of liquidity support by the Fund (i.e. duration and collateral requirements) leaves room for interpretation when using the Fund. De Groen and Gros (2015) state that during the last crisis liquidity support was provided to banks in the euro area in an amount of ca. EUR 1.4 trillion loans, partly in the form of ELA. Against that background they consider this a task for monetary authorities and governments. Also Schoenmaker (2016) recommends the European Central Bank as provider of emergency liquidity as a last resort for “properly resolved banks”.

26. Cf. Euro Area Loan Facility Act 2010.

27. Such bargaining could further be complicated depending on the impact of the Brexit on the future EU budget.

28. While the decision on the resolution scheme including bail-in and the use of the SRF is taken by the SRB, only the ESM Member can request direct recapitalisation from the ESM.

29. The proposal of the European Commission for a Council Regulation is based on Article 352 TFEU, requiring unanimity among all Member States in the Council and consent from the European Parliament.

30. The main risk reduction measures foreseen are the implementation of the Total Loss Absorbing Capacity (TLAC) standard into EU law and an according review of the

Minimum Requirement for Own Funds and Eligible Liabilities (MREL), a common approach to the bank creditor hierarchy and subordination, introduction of a leverage ratio of at least 3% and the Net Stable Funding Ratio (NFSR) into the CRR/CRDIV-framework as well as proposals for a minimum harmonisation in national insolvency laws also addressing the reduction of non-performing loans in the banking sectors (Council of the European Union 2016). The Commission has made according legislative proposals in 2016 for amendments of the capital requirements and resolution framework (cf. European Commission 2017a).

31. In October 2017 the Commission (2017a) presented a compromise suggestion on its November 2015 legislative proposal on a European Deposit Insurance System (EDIS). The compromise provides for a more gradual mutualisation than originally envisaged. Such step was deemed necessary to revive the process since the negotiations among the EU co-legislators got stuck due to significantly diverging views and no further progress was expected.

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