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Bank resolution framework

During the recent financial crisis, a number of governments had to take emergency action to stabilise banks thus avoiding their failure and preventing serious financial meltdown. However, governments acted under their own national laws because no EU framework for managing banking crises existed at EU level. It became obvious during the crisis that the lack of an EU regime hampers the ability of governments to deal with problems in cross-border banks. Putting in place a new bank resolution framework will be a key issue in the coming years. The new Commission will need to decide the most appropriate way forward, and avoid a repetition of the past negative experiences. EBC members were frequently updated on the issues and problems of this file and discussed it in detail.

Against this background, the Commission adopted its Communication **'An EU Framework for Cross-Border Crisis Management in the Banking Sector'** (COM(2009)561) on 20 October 2009 which explores the full range of problems (from early intervention, bank resolution, insolvency framework and including financing of bank resolution), identifies the key issues to be dealt with from the Commission's perspective, and solicits views from all stakeholders. Complex technical issues lay beneath the surface of this topic which are explained in an accompanying staff working paper SEC(2009)1409. An impact assessment SEC(2009)1389 focussing in particular on the problem definition (why a new framework at EU level is needed) completes the approach.

A three month public consultation started on 20 October (until 20 January 2010, see results). In the interim, the Early Intervention Working Group was convened on 20 November to provide some initial feedback to the Communication, and help the Commission services to compile up-to-date information about ongoing changes to national crisis management frameworks.

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Furthermore, on 19 March 2010 the European Commission hosted a high level one-day conference on the construction of a new crisis management framework in the banking sector. The Commission presented the results of the consultation and set out its ideas on how to move forwards in this important policy area. The Conference also provided an opportunity for eminent speakers and panellists from different backgrounds to express their views about what should be done. Information and presentations are available at the website of the conference.

Finally, in the context of its work on cross-border crisis management in the banking sector, the European Commission's Internal Market Directorate General is seeking experts in the field of re-organization, resolution and insolvency law in the banking and financial sector to assist in the preparatory work and development of an EU crisis management regime. A call for expression of interest has been published to establish an 'Insolvency Law Group of Experts (ILEG)' (deadline for submissions was 1 March 2010, see also page 5).

Supervisory arrangements

In September 2009, the Commission adopted proposals for regulations on the European Systemic Risk Board (ESRB) and the European System of Financial Supervisors (ESFS) to establish the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA). The proposals for those regulations govern the institutional functioning of these institutions, and will clearly define their tasks and missions along the lines of the Commission's communication 'European financial supervision' and the conclusions of ECOFIN. The Commission has also adopted in October 2009, a proposal for a so-called 'omnibus' Directive which amends, *inter alia*, the Capital Requirements Directive 2006/48/EC (CRD) to further define areas in which technical standards may be developed and areas in which decisions in case of disagreement between national supervisors may be taken. These texts are being discussed by the European Parliament and the Council.

The EBC will continue its discussion on the robustness of home/host arrangements for the supervision of credit institution with branches established in another Member State, and on the review of supervisory arrangements for banking groups at its next meeting in June in view of the Article 156 report due by end 2011. This strand of work will take into account progress in the field of crisis management and supervision.

International Developments

EBC members were updated on the various work at international level undertaken in the Basel Committee on Banking Supervision (BCBS), the Financial Stability Board (FSB) and G20 in respect of reform of capital, liquidity and systemically important financial institutions (SIFIs). As the BCBS continues to develop its proposals for banking reform, the Commission has now launched a parallel consultation on prudential reforms for credit institutions and investment firms. Furthermore, BCBS launched on 16 March a consultation on a set of principles for enhancing sound corporate governance practices at banking organisations and issued its final *Report and Recommendations of the Cross-border Bank Resolution Group* on 18 March. The BCBS and the Committee of European Banking Supervisors (CEBS) have also launched cumulative impact assessments including an explicit assessment of the macroeconomic impact. The Financial Stability Board (FSB – ex Financial Stability Forum) and G20 continue to monitor progress to develop the necessary reforms, and are due to approve the final package of reforms by the end of 2010.

CRD II: Published in the Official Journal

After the European Parliament and the Council have agreed on the Commission proposal of October 2008 to amend the CRD (on large exposures, colleges, hybrid capital, liquidity risk management, and securitisation), this amendment to the CRD has been published as Directive 2009/111/EC in the Official Journal L 302, p. 97 of 17.11.2009.

CRD III: Under negotiation in EP and Council

The Commission proposal of 13 July 2009 ("CRD III") regarding the trading book, re-securitisation and remuneration is under negotiation in the European Parliament (see draft report of the ECON of 2 March 2010)and the Council (latest available version of Council common position of 28 October 2009).

CRD IV Review: New public consultation

EBC continued discussion of further changes to the CRD ("CRD IV"). These discussions fed into the launch of a public consultation regarding further possible changes to the Capital Requirements Directive (CRD; deadline 16 April 2010) aimed at strengthening the resilience of the banking sector and the financial system as a whole. The proposed changes, known as 'CRD IV', relate to seven specific policy areas, most of which also reflect commitments made by G20 leaders at summits in London and Pittsburgh during 2009. These commitments included building high-quality capital, strengthening risk coverage, mitigating pro-cyclicality and discouraging leverage, as well as strengthening liquidity risk requirements and forward-looking provisioning for credit losses. All interested stakeholders are invited to reply to the consultation by 16 April 2010, indicating what impact the potential changes would have on their activities. The results will feed into a legislative proposal scheduled for the second half of 2010.

The seven areas of potential action are as follows:

- **Liquidity standards**: Introducing liquidity standards that include a liquidity coverage ratio requirement underpinned by a longer-term structural liquidity ratio.
- **Definition of capital**: Raising the quality, consistency and transparency of the capital base.
- **Leverage ratio**: Introducing a leverage ratio as a supplementary measure to the Basel II risk-based framework based on appropriate review and calibration.
- **Counterparty credit risk**: Strengthening the capital requirements for counterparty credit risk exposures arising from derivatives, repos and securities financing activities.
- **Countercyclical measures**: A countercyclical capital framework will contribute to a more stable banking system, which will help dampen, instead of amplify, economic and financial shocks.
- **Systemically important financial institutions**: The Commission is consulting on appropriate measures to deal with the risk posed by such institutions.
- **Single rule book in banking**: The Commission is consulting on areas where more stringent requirements might be necessary. In addition, the Commission is consulting on the appropriate prudential treatment of real estate lending. This is part of the Commission's commitment to create a single rule book in Europe.

In order to achieve the dual objective of improving the resilience of the global financial system and ensuring a level playing field, it will be essential that a more robust and consistent set of prudential capital requirements is applied across the world. Consequently, the possible changes set out in the consultation document are closely aligned with the forthcoming amendments to the Basel II framework and the introduction of a global liquidity standard that are currently being drawn up by the Basel Committee on Banking Supervision (BCBS, http://www.bis.org). In this context, as part of the countercyclical measures, the Commission puts greater emphasis on dynamic 'through-the-cycle' provisioning.

Next steps: In the second half of 2010 the Commission intends to adopt and publish a legislative proposal dealing with some or all of the areas discussed in this and previous consultations. Any such proposal will be developed in the light of both responses to the consultations and an impact assessment examining the anticipated effects of options for achieving the outlined policy objectives. In this respect, the Commission has also invited the Committee of the European Banking Supervisors (CEBS) to carry out a European Quantitative Impact Study to aid the assessment of the aggregate effect of the proposed revisions.

State of play of comitology amendment to the CRD

The Commission's services also presented a **draft comitology measure** in view of a change of Article 2 CRD in order to include the Slovenian SID bank in the list of credit institutions excluded from the scope of the CRD. As the scrutiny period has expired without comments, the formal procedure for adoption by the new Commission has started and was completed by the publication of the Commission Directive 2010/16/EU of 9 March 2010 amending Directive 2006/48/EC of the European Parliament and of the Council as regards the exclusion of a certain institution from the scope of application in the Official Journal L 60 (p. 15) of 10 March 2010.

Deposit Guarantee Schemes: State of play

The Commission is required to prepare a report on a variety of issues such as the increase of the coverage level to €100 000, the harmonisation of funding mechanisms, and operational issues and to submit legislative proposals, if appropriate. The services are now finalising the impact assessment that must precede any Commission action. The new Commission will decide on how to go forward with this important dossier – as part of a package with work on the Investor Compensation Directive and on Insurance Guarantee Schemes before the summer break.

Currently, there are about 40 DGS in 27 Member States. They are very different as regards the number of member banks (ranging between 6 and 1209 in 2008), their human and financial resources (between 0 and 168 permanent staff), their administrative setup (16 schemes are private, 13 schemes are public, 10 schemes are characterised by both public and private elements) and the available ex-ante financial resources (between 0 and €6.5 billion). The Commission services have assessed the various options identified under the main objectives of the Directives on Deposit Guarantee Schemes (DGS): protecting a portion of depositors' wealth and consequently minimising the risk of bank runs in order to ensuring financial stability. Further overarching principles applied when identifying preferred options were simplification and harmonisation. This mitigates the fragmentation of schemes referred to above, enables a level playing field for banks, ensures that consumers can choose the best product and leads to a protection that is easily understandable for consumers.

Setting the level of coverage at a fixed level of € 100 000 from the end of 2010 onwards as required by current legislation would bring many advantages, such as creating a level playing field and making obsolete the complex arrangements between countries with a different coverage level. 95% of deposits would be fully protected. Excluding debt certificates and structured products with investment character from coverage would simplify the system, avoid unquantifiable risks for DGS, be in line with the requirements of prudential supervision and reduce the payout delay. SMEs should be covered to the same extent as individual depositors. However, only about 1% of enterprises are not covered under the current Directive. A time-consuming verification to identify these enterprises would lead to high administrative costs and delay the payout for all depositors.

Currently, in 21 MS bank contributions are paid in advance on a regular basis (ex-ante) while in 6 MS banks only contribute after a failure (ex-post) but some of them plan to move towards ex-ante financing. Some schemes would not seem capable to cope even with small or medium-sized bank failures. If DGS have insufficient funds, depositors might be paid out after a long delay or not be paid out at all. Moreover, mere ex-post funding seems to be pro-cyclical: it drains liquidity from banks in times of stress which might have negative consequences for the economy (limiting credit supply by banks). Introducing a strong ex-ante financing element and requiring a target level for DGS would tackle these problems. If the contributions from banks on the basis of which DGS are financed took into account the individual risk of banks, this would create incentives for better risk management in banks and limit adverse selection. Developing a set of core indicators and another set of optional supplementary indicators could be a useful element.

The payout delay is to be reduced to 4-6 weeks by the end of 2010. This payout delay is still too long. Depositors would suffer financial difficulties already after a few days without access to their bank accounts. The Commission services strongly believe that the payout delay needs to be substantially reduced – preferably to one week (after a transition period). Depositors would have quick access to their money after a bank failure and, in turn, they would likely refrain from running on their banks. Discontinuing the set-off of claims against liabilities of the same depositor would also contribute to reducing the payout delay and avoid a situation where depositors, e.g. with a mortgage credit, could receive nothing in case of a bank failure. Furthermore, depositors should to be properly informed about all key aspects of deposit protection. The most effective option would be to do this by a harmonised template to be countersigned by a depositor before depositing money in a bank. A reference to DGS in account statements and advertisements, if a product is covered, would also be effective to clarify to depositors whether their deposits are covered.

DGS and crisis management are separate workstreams. Work on crisis management and bank resolution concerns all creditors of a bank while DGS concern depositors who are eligible and whose deposits are covered by DGS. If DGS were to be involved in bank resolution measures (in some Member States this is the case), it should be ensured that such schemes have sufficient funds available to fulfil this role. It should also be prevented that DGS funds are used for purposes other than directly ensuring access of depositors to their funds.

Some suggest that a single pan-EU DGS could be an effective way forward and cost-efficient in the long run (about € 40 million administrative costs could be saved each year). However, some legal issues remain to be examined. Therefore, another possibility and first step to mitigate fragmentation after a full harmonisation of coverage and financing could be to establish a network of DGS ('EU system of DGS') and to introduce some form of solidarity between them by, for instance, allowing a scheme with insufficient or depleted financial capacities (due to a number of payouts) to borrow some money from the other schemes. However, any pan-EU scheme should comprise all banks to avoid competitive distortions and a depletion of 'remainder DGS' on national level which would otherwise seem likely.

Two new groups of experts

- Insolvency Law Group of Experts (ILEG) – see also above "Bank resolution framework"

In the context of its work on cross-border crisis management in the banking sector, the European Commission's Internal Market Directorate General was seeking experts in the field of re-organization, resolution and insolvency law in the banking and financial sector to assist in the preparatory work and development of an EU crisis management regime. The call for expression of interest was prolonged and expired on 1 March 2010.

- Group of Experts in Banking Issues (GEBI)

In order to facilitate direct communication between the banking industry, consumers and the European Commission, Internal Market Directorate General is setting up a Group of Experts in Banking Issues (GEBI). The Group will have two major tasks. Firstly it will advise the Commission on policies and possible legislative proposals concerning banking regulation. Secondly it will provide information, forecasts and analysis concerning the possible impact of banking policies and possible legislative proposals on various stakeholders. The call for expression of interest expired on 28 February.

Information on the work of these two experts groups are available at their respective websites:

http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm#Call_for_expression_of_interest

http://ec.europa.eu/internal_market/bank/group_of_experts/index_en.htm

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