Brussels, 6 May 2014
9510/14
(OR. en)
PRESSE 266

Council adopts rules on bank recovery and resolution

The Council today[1] adopted a directive harmonising national rules on bank recovery and resolution (PE-CONS 14/14).

The directive provides national authorities with common powers and instruments to pre-empt bank crises and resolve any financial institution in an orderly manner in the event of failure, whilst preserving essential bank operations and minimising taxpayers' exposure to losses.

EU financial markets have become increasingly integrated, to the extent that domestic shocks in one member state can rapidly spread to other member states. Because of this risk and the important economic functions that banks provide, normal insolvency proceedings may not be appropriate in some cases. Since the onset of the financial crisis in 2007-08, the absence of effective instruments for the resolution of banks has often led to the use of public funds to restore trust in even relatively small banking institutions, so as to prevent a domino effect of failing institutions from causing real damage to the economy.

The directive accordingly establishes a policy framework for managing bank failures in an orderly manner and to avoid such contagion, without resorting to taxpayers' money.

It establishes a range of instruments to tackle potential bank crises at three stages: preparatory and preventative, early intervention, and resolution. Member states will be required, as a general rule, to set up *ex-ante* resolution funds to ensure that the resolution tools can be applied effectively.

[1] At a meeting of the Economic and Financial Affairs Council.

Banks will have to draw up recovery plans, and update them annually, setting out the measures they would take to restore their financial position in the event of significant deterioration. Resolution authorities will have to prepare resolution plans for each bank, laying out the actions they might take if it were to meet the conditions for resolution.

Authorities will also have the power to appoint "temporary administrators" or special managers to an institution if its financial situation were to deteriorate significantly or if there were serious violations of the law.

The main resolution measures include:

– the sale of (part of a) business;

– establishment of a bridge institution (the temporary transfer of good bank assets to a publicly controlled entity);

– asset separation (the transfer of impaired assets to an asset management vehicle)

– bail-in measures (the imposition of losses, with an order of seniority, on shareholders and unsecured creditors).

Adoption of the directive follows an agreement reached with the European Parliament at first reading in December 2013.

Member states have until 31 December 2014 to transpose it into national law.

Bail-in

Bail-in provisions, which enter into force in January 2016, will enable resolution authorities to write down or convert into equity the claims of the shareholders and creditors of banks that are failing or likely to fail. Certain types of liabilities will be permanently excluded from bail-in. A minimum level of losses equal to 8% of total liabilities including own funds will have to be imposed on an institution's shareholders and creditors before access can be granted to the resolution fund. Eligible deposits from natural persons and micro-, small and medium-sized enterprises will have preference over the claims of ordinary unsecured, non-preferred creditors and depositors from large corporations. The deposit guarantee scheme, which will always step in for covered deposits (i.e. deposits below €100,000), will have a higher ranking than eligible deposits.

Exclusions from bail-in

Certain types of liabilities will be permanently excluded from bail-in:

– covered deposits (i.e. deposits below €100,000);

– secured liabilities, including covered bonds;

– liabilities to employees of failing institutions, such as fixed salary and pension benefits;

– commercial claims relating to goods and services critical for the daily functioning of the institution;

– liabilities arising from a participation in payment systems that have a remaining maturity of less than seven days;

– inter-bank liabilities with an original maturity of less than seven days.

National resolution authorities will also have the power to exclude, or partially exclude, liabilities on a discretionary basis for the following reasons:

(1) if they cannot be bailed in within a reasonable time;

(2) to ensure continuity of critical functions;

(3) to avoid contagion;

(4) to avoid value destruction that would raise losses borne by other creditors.

Resolution authorities will be able to compensate for the discretionary exclusion of some liabilities by passing these losses on to other creditors, as long as no creditor is worse off than under normal insolvency proceedings, or through a contribution by the resolution fund.

<u>*Resolution fund*</u>

The directive requires member states, as a general rule, to set up *ex-ante* resolution funds to ensure that the resolution tools can be applied effectively. These national funds will have to reach, by 2025, a target level of at least 1% of covered deposits of all the credit institutions authorised in their country. To reach the target level, banks will have to make annual contributions based on their liabilities, excluding own funds and covered deposits, and adjusted for risk.

An exemption to this rule allows member states to establish their national financing arrangement through mandatory contributions without setting up a separate fund. However, in doing so they must raise at least the same amount of financing and make it available to their resolution authority immediately upon its request.

Resolution funds will be available to provide temporary support to banks under resolution via loans, guarantees, asset purchases, or capital for bridge banks. They can also be drawn on to compensate shareholders or creditors if and to the extent that their losses under bail-in exceed the losses they would have undergone under normal insolvency proceedings, in line with a "no creditor worse off" principle.

National resolution authorities will be able in exceptional cases to exclude some liabilities and use the resolution fund to absorb losses or recapitalise a bank. However, such flexibility will only be available after a minimum level of losses equal to 8% of total liabilities including own funds has been imposed on an institution's shareholders and creditors, or under special circumstances 20% of an institution's risk-weighted assets where the resolution financing arrangement has at its disposal *ex-ante* contributions that amount to at least 3% of covered deposits.

The contribution of the resolution fund is capped at 5% of a bank's total liabilities. In extraordinary circumstances, where this limit has been reached, and after all unsecured, non-preferred liabilities other than eligible deposits have been bailed in, the resolution authority may seek funding from alternative financing sources.

Exceptional measures

The directive offers the possibility, under exceptional circumstances and subject to EU state aid rules, to temporarily inject capital into solvent banks that cannot access private funds. However, this precautionary measure is limited to injections necessary to address capital shortfalls revealed during stress tests, asset quality reviews or equivalent exercises conducted by the European Central Bank, the European Banking Authority (EBA) or national authorities.

Moreover, a stabilisation tool will allow for public capital injections in emergency situations where an extensive bail-in of creditors could endanger financial stability. However, this is subject to the 8% bail-in requirement and conditional on approval by the Commission under state aid rules.

Minimum loss absorbing capacity

To ensure that banks always have sufficient loss-absorbing capacity, the directive provides for national resolution authorities to set minimum requirements for own funds and eligible liabilities (MREL) for each institution, based on its size, risk and business model. A review in 2016 will enable the Commission, based on recommendations by the EBA, to introduce a harmonised MREL applicable to all banks.