Opinion of the European Banking Authority of 3 March 2011 on the Commission’s Services consultation ‘Technical Details of a Possible EU Framework for Bank Recovery and Resolution’

Introduction and legal basis


2. The EBA competence to deliver an opinion is based on Article 34(1) of Regulation No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, as the European Commission’s consultation on a possible EU framework for bank recovery and resolution relates to the EBA’s area of competence.

3. In accordance with Article 14(5) of the Rules of procedure of the EBA, the Board of Supervisors has adopted this opinion.

General comments

4. The EBA welcomes the Commission’s consultation and supports the ambitious package presented in the consultation to provide credible tools for bank recovery and resolution, reduce moral hazard, and to protect financial stability and public funds.

5. The EBA notes that the paper addresses individual credit institutions and cross-border group recovery and resolution. The EBA invites the Commission to consider also the implementation of crisis management tools in the context of a systemic crisis.

6. In line with previous opinions, this opinion will focus on issues of particular relevance to supervisory authorities.

Specific comments

Authorities responsible for resolution

7. The Commission Services argue for a functional separation between supervisory and resolution authorities and suggest that such separation is justified by the dangers of supervisory forbearance.

8. In its comments of November 2010 concerning the Commission Communication on “An EU framework for crisis management in the financial sector”, CEBS noted: “the Communication suggests that resolution authorities should be separate from supervisory authorities, in order to avoid supervisory forbearance. We think this assumption is not sufficiently substantiated and would lead to a reduction of the current responsibilities of (some) supervisory authorities. EU legislation should remain neutral as to the national institutional frameworks.” In the consultation, the Commission Services do not provide new elements to substantiate their assumption. There is no empirical evidence that such separation would achieve a more efficient resolution process.

9. In its 19 January 2010 advice, CEBS argued that “different supervisory frameworks coexist throughout the EU, so it should be left to the Member States to assess which authority is in a better position to use the powers”.

10. In the opinion of the EBA, the choice of the authority or authorities responsible for bank resolution in each Member State should be left to national discretion.

11. According to the Commission Services, the resolution authorities would be responsible for preparing prospective resolution plans. However these authorities would not have any kind of practice in dealing with the credit institutions on an ongoing basis and in crisis situations. Therefore, when a crisis arises their operational capacity could be seriously hindered. Supervisory authorities are in the best position to know the credit institution in depth, particularly after reinforced supervision and recovery plans are implemented. Supervisory authorities have access to information, expertise and operational capacity to assess whether conditions for resolution are met and to tailor resolution measures to the causes of the crisis and to the activities of the credit institution concerned. Speed of intervention requires minimising the need to coordinate the actions of different authorities; in addition, accountability requires clear responsibilities. Unless the future framework allows both functions to take advantage of those synergies, there is a risk that resolution authorities would take measures, which would lead to duplication of work, reduce clarity of responsibility, and engender significant inefficiencies in the system.

12. Moreover, decision-making is likely to take place after consultation and coordination among different authorities, including ministries, central banks, and supervisory authorities, thereby limiting any possible benefits from the suggested separation.

13. The Commission Services also suggest that the resolution authority may be a supervisory authority, "provided that there are arrangements in place to ensure the separation between the resolution and the supervisory functions". The EBA believes that even such a functional separation should be left to national discretion, given the arguments above and the fact that some EU Member States have already made different institutional choices on this matter.
Stress testing

14. Stress tests carried out by banks internally are required and necessary in the context of internal risk and capital management.

15. In contrast, stress tests conducted by supervisory authorities generally target the resilience of the whole sector. Moreover, supervisory stress tests can be constructed to examine specific assets or risk types across all banks.

16. Given the need for an independent, consistent and comparable risk assessment of credit institutions in a banking system, stress tests conducted by supervisory authorities are useful and have already been carried out on a regular basis in some jurisdictions as well as on an EU-wide basis.

17. Stress testing can contribute to evaluating the resilience of credit institutions to high impact shocks, providing relevant information to management, supervisory authorities and even market participants. For these reasons, stress-testing techniques have already been built into the prudential framework and CEBS Guidelines; and also as a power into the Regulation establishing the EBA (the ‘EBA Regulation’):

- As a Pillar II Guideline requirement every EU credit institution should, on a yearly basis, assess its resilience to relevant shocks (ICAAP); discussing its findings with the relevant supervisory authorities (SREP). This firm-related information has to be kept confidential as it is part of the supervisory process;
- According to Articles 21 and 32 of the EBA Regulation, the EBA shall periodically initiate and coordinate EU-wide assessments of the resilience of financial institutions to adverse market developments. To that end, it shall develop common methodologies and common approaches to communication on the outcomes. Practical experience with the EU-wide stress tests conducted over the last few years has shown that a commonly agreed stress test framework can be established, with outcomes published on an individual basis.

18. Given the above, the EBA would advise careful consideration and balancing of the possible duplications of work and the inherent risks to pre-establishing scope and communications, as far as the supervisory process (SREP) is concerned. From that perspective, the publication of individual outcomes should be left to the discretion of the relevant supervisory authorities. From the perspective of EU-wide stress testing exercises conducted by the EBA, common methodologies and approaches to communications shall apply.

Recovery Planning

19. The EBA welcomes the Commission’s proposal to develop recovery plans and agrees that such plans should be developed for all credit institutions.

20. Although a group recovery plan includes the arrangements of the group to restore the viability of the group and all of its entities (which may be located in other Member States or third countries), the EBA believes it may

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3 This is applied as a requirement in the Pillar II Guidelines, in line with Basel Agreements (although not in the CRD).
be beneficial to combine both a top-down and a bottom-up approach to recovery planning, i.e. group recovery planning and individual entity recovery planning.

21. The assessment of a group recovery plan will take place in a going concern situation, to prepare for, and so well before a credit institution faces difficulties. In accordance with Articles 129(1) and 131a of the CRD and existing Guidelines for the operational functioning of supervisory colleges\(^5\), the group recovery plan should be assessed within the supervisory college, by the consolidating supervisor in close cooperation with the relevant host supervisors.

22. The EBA is in favour of a joint decision in accordance with the procedure set out in Article 129 of the CRD by the relevant supervisory authorities for the assessment of the group recovery plan and possible mitigating measures to address identified shortcomings. In case of a failure to reach a joint decision, there would be a need for a mediation procedure by the EBA, in accordance with Article 19 of the EBA Regulation.

23. The approach set out above should also apply to drawing up, maintaining and regularly reviewing, resolution plans.

24. For these purposes, credit institutions should develop a recovery plan incorporating at least the elements proposed by the Commission, to be assessed by the supervisory authorities. In addition to the items suggested by the Commission Services, the EBA thinks that recovery plans should take into account different possible parameters (e.g. institution specific or system wide events, slow deterioration of the situation or a sudden event, etc.). The recovery plan should also identify the potential (legal, operational, regulatory) implementation barriers for each recovery measure and ways to mitigate them. This is important as such parameters and potential obstacles will have a bearing on the feasibility of the recovery measures.

25. Moreover, the EBA thinks that the recovery plan should be embedded in the governance structure of the institutions. This implies that the plan becomes an integral part of the institutions’ risk management framework and that senior management owns – and signs off – the plan. Given the content of recovery plans, institutions should ensure their confidentiality. Recovery plans should be kept under review and updated at least annually.

**Intra-group financial support**

26. The EBA agrees, on balance, with the Commission’s proposal to introduce provisions at EU level on intra-group financial support.

27. The EBA sees it as consistent with the main objective of any crisis management regime for the banking sector, i.e. the preservation of financial stability. The EBA thinks that intra-group financial support should be activated for the exclusive purpose of preserving the stability of the group and/or of one of its components and would represent a useful early intervention tool.

28. However, the EBA thinks that *ex ante* and *ex post* safeguards must be included in the proposed framework.

29. Firstly, the EBA agrees that the support should be organised under an ex ante voluntary agreement to provide loans, guarantees and/or the provision of collateral. The EBA also agrees that it should be left to the agreement of the parties to determine between which entities of the group the support could take place and if it should be up, down and cross-stream. All entities subject to supervision on a consolidated basis should have the opportunity to be part of the agreements. If the purpose of the regime is to safeguard financial stability, those entities that pose systemic risk should be covered, as a minimum.

30. Secondly, the agreements should be approved by the respective shareholders before they are submitted to the supervisory authorities.

31. Thirdly, the EBA agrees that before becoming effective, these agreements should be assessed by the supervisors concerned within the supervisory college, in accordance with the joint decision procedure laid down in Article 129 of the CRD and that, in case of disagreement, the EBA should have a mediation role, in accordance with Article 19 of the EBA Regulation. Furthermore, the EBA thinks that when they approve any such agreements, supervisory authorities need to verify that the arrangement is in line with the specific organisational structure of the group and its internal allocation of liquidity.

32. Fourthly, after the approval and the conclusion of the agreement, ex post safeguards should also apply. The EBA agrees with the Commission that the competent authority responsible for the entity providing the support should be able to restrict or prohibit the financial support when the conditions for the provision of such support are not met or if it jeopardises the financial situation of the entity providing the support. Such a decision should be taken within a certain time limit and after consultation of the supervisory authority responsible for the entity receiving the support. The EBA thinks it should also be communicated without delay to the consolidating supervisory authority and the other supervisory authorities concerned within the supervisory college. If the supervisory authority responsible for the entity receiving the support does not agree with the decision of the supervisory authority responsible for the entity providing the support, it should be able to refer the matter to the EBA for mediation, according to the procedure laid down in Article 19 of the EBA Regulation.

33. Finally, the same safeguards should apply, mutatis mutandis, when a supervisory authority requires a credit institution to request support from another entity within the group.

34. The EBA would not support the introduction of an intra-group financial support regime in EU legislation if adequate ex ante and ex post safeguards, from a supervisory perspective, are not included in the framework. In particular, the Commission should ensure that adequate safeguards are in place for the supervisory authorities in view of preserving financial stability in the host countries.
Resolution Plans

35. The EBA welcomes the Commission’s initiative to align its proposals on resolution plans with those of the Financial Stability Board, and agrees that such plans should be developed for all credit institutions. In accordance with the principle of proportionality, the scope of the plans should be adjusted to the characteristics of the institution (e.g. complexity, size, and degree of interconnection with the financial system). While the focus of resolution plans is primarily on large, financial groups who are most relevant to financial stability, ‘light’ resolution plans can also be a useful tool for the authorities in the supervision and the resolvability of smaller credit institutions.

36. The primary aim of any resolution plan should be to minimize the risk of moral hazard, the risk of spill over to the financial system as a whole, and losses to society resulting from the failure of a credit institution. The EBA agrees that resolution plans are prepared by resolution authorities and supervisory authorities, in close cooperation with the credit institution concerned which would be required to supply the necessary information.

37. The EBA also underlines the need to ensure the confidentiality of resolutions plans, given the sensitivity of their content.

Preparatory and preventative powers

38. In previous comments dated November and December 2010 concerning the Commission Communication on “An EU framework for crisis management in the financial sector”⁶, CEBS expressed the concern that the Commission’s proposals would lead to a reduction of the current powers of supervisory authorities, in particular concerning the preventative powers, if it was proposed that they would be triggered by resolution authorities. According to the Commission Services, if the resolution authorities identify significant impediments to the application of the resolution tools, they should impose on the credit institution a list of measures to tackle those impediments. However, in the EBA’s view, the measures listed by the Commission Services are very similar to the supervisory early intervention tools defined in Article 136(1) of the CRD.

39. The EBA is concerned that under the Commission Services’ proposal the distinction between the responsibilities of the resolution authorities and the supervisory authorities would be blurred, thereby entailing hazardous consequences to the normal functioning of the supervisory process. Furthermore, the EBA has worked under the assumption that the objective of the future framework would be to complete the toolbox with additional tools, not to restrict the existing supervisory tools, or at least to restrict de facto supervisory authorities’ powers.

40. Therefore, the proposed preventative powers listed in the consultation must be included in Article 136(1) of the CRD. These preparatory and preventative powers should be exclusively imposed by the supervisory authorities, on their own initiative and in consultation with resolution authorities, or upon proposal from the resolution authorities. The Ecofin

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⁶ See footnote 2.
conclusions of 7 December 2010, page 4 point c, third bullet confirm this view.

41. Furthermore, one measure that, arguably, does not fall under usual supervisory early intervention measures would be the power to require changes to the legal or operational structure of a banking group (even though some supervisory authorities would consider that they have such a power today). In the consultation, it remains unclear how the Commission intends to ensure that the Single Market paradigm would not be harmed by the exercise of such power. An appropriate balance between the effective resolution of credit institutions and groups and the correct functioning of the Single Market should be found.

42. The EBA agrees that authorities should satisfy themselves that there are no significant impediments to effective resolution of a financial institution, and that authorities should have the powers to remove any such barriers. However, a measure to require ex ante changes to legal or operational structures of a credit institution should only be implemented after the impact of this measure on the stability of the group as a whole and of its businesses has been explicitly taken into account. The group-wide risk management and the effective consolidated supervision should not be undermined. The restructuring of a large and complex banking group is a measure that can have profound effects: considerable assessment will be needed to ensure that the restructuring measure is workable and strikes the right balance between safeguarding financial stability and the ability to resolve an institution effectively. Although authorities should have appropriate discretion in pressing institutions to make structural changes to improve the effectiveness of resolution plans, such measures must remain in line with the EU Single Market legislation.

43. Finally, regarding the possible impact of preparatory and preventative powers on affiliated entities located in other Member States, defining objective criteria for assessing resolvability is desirable. Such criteria should include the following:

- all the supervisory authorities involved have the necessary powers;
- no legal obstacles prevent the use of the powers in a domestic and cross-border context;
- the exercise of the powers is necessary to achieve the resolution objectives in the other Member States;
- the exercise of the powers does not impinge on the credit institution’s freedom of establishment under EU law (a.o. no forced ‘subsidiarisation’);
- the adequate safeguards for shareholders and creditors are in place (since the powers would be used in a preparatory and preventative stage, the exercise of the powers cannot interfere with property rights);
- the exercise of the powers does not have an adverse impact on the financial stability in other Member States (a.o. no contagion risk).

The EBA could define technical standards in this respect; coordination with the ongoing FSB work on SIFIs resolvability would also be needed. Given the preparatory and preventative stage in which such powers could be

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7 Council conclusions on crisis prevention, management and resolution, 7 December 2010: “Agrees that strengthened preparatory and preventative powers identified should be exercised by the competent authorities following proper consultation with resolution authorities...”
used, and given their supervisory nature, the EBA would expect to play a mediation role under Article 19 of the EBA Regulation in case of disagreement.

**Special Management**

44. The EBA supports the proposal to grant supervisory authorities the power to appoint a special manager as an early intervention measure. In EBA’s view, special management is a measure aimed at restoring the conditions for sound and prudent management of a credit institution. The appointment of a special manager who takes over the management of a credit institution appears to be useful in specific situations, where the institution’s problems have already become quite severe. The EBA agrees that the “special manager” instrument is, in itself, not meant to override property rights of shareholders and creditors, even if this is in the public interest. However, this should not exclude the possibility to combine the appointment of one or more special managers with other crisis management measures that do allow interference with property rights. Furthermore, such a measure is without prejudice to the power of the general meeting to replace one or more board members in other circumstances.

45. The Commission Services suggest that the special manager can either replace, or assist, the management board of a group. In the latter case, there could be merit in giving the special manager the power to put the management board under legal restraint. Under a legal restraint, the management board can act only after approval by, or in compliance with, the directions of the special manager. In this way, the special manager can also be used to assist the existing board, instead of replacing it, which can be more suitable in specific circumstances. However, in such a case, the powers of the special manager would be limited and may, therefore, be less effective. So the power to appoint a special manager to replace the existing management board should be part of the toolbox.

46. Regarding the trigger for the appointment of a special manager, the EBA supports using the same trigger as for the other supervisory measures under Article 136 of the CRD. Adding an additional trigger (as proposed under option 1 or option 2) poses an additional burden of proof for the supervisory authorities on very subjective topics such as “the likelihood that the credit institution will not prepare or implement the specific recovery plan (...)” or that “the management of the credit institution is not willing or not able to take the required measures”. It is not clear that there is any benefit arising from the inclusion of an additional trigger. Furthermore, using the same trigger as for the other supervisory measures provides additional incentives for the management to comply with other – less intrusive – requirements from the supervisory authorities. The mandate of the special manager (which will of necessity be situation-specific) should not be limited to the implementation of the measures provided for in the restoration plan, but should be to take all the necessary measures to restore the situation of the credit institution concerned.

47. The EBA thinks that the special manager should be appointed for an appropriate period of time to be reviewed at regular intervals. The duration of the measure should primarily depend on whether or not the credit institution continues to meet the criteria for intervention and appointment of the special manager. Therefore, reporting requirements to the
supervisory authority should not be limited to the beginning and the end of mandate, but should be regular, as specified when the special manager is appointed. The EBA also suggests specifying that the special manager is accountable to the relevant supervisory authority for achieving the objectives of his mandate. However, regarding the special manager’s liability, legal challenge before a court against the special manager for acts performed in the conduct of its duties should be limited to gross negligence and serious misconduct. Finally, the framework should also specify that the appointment of a special manager does not imply any State guarantee or financial support to the credit institution.

**Group treatment (Group recovery plans, appointment of special manager and coordination of measures under Article 136(1) CRD) and assessment of recovery plans**

48. The EBA agrees that an agreement on a group recovery plan proposed by the consolidating supervisory authority should be reached within the supervisory college. A joint decision would be appropriate to ensure the feasibility and effectiveness of the plan. The potential room for conflicts among supervisors should be greatly reduced by the EBA’s power to put in place technical standards on recovery plans and to participate in the preparation of the plan (according to Article 25 of the EBA Regulation). When there are residual disagreements between the different competent authorities, involvement of the EBA would be appropriate in its role of binding mediation under Article 19 of the EBA Regulation.

49. With regard to the implementation of a recovery plan, or any other measure under Article 136(1) of the CRD aimed at restoring the health of a distressed cross-border credit institution, prompt and ex ante coordination among supervisory authorities is needed within the supervisory college, under the coordination of the consolidating supervisory authority. Indeed, certain early intervention measures may have cross-border effects which require a coordinated approach. As proposed for the assessment of a group recovery plan, supervisory authorities should strive for a joint decision on the implementation of a group recovery plan or on the implementation of a measure under Article 136(1) of the CRD. In case of disagreement, supervisory authorities should be able to refer the matter to the EBA, which could exercise a mediation role under Article 19 of the EBA Regulation.

**Resolution conditions**

50. The EBA remains of the opinion that the conditions for resolution should be based on the supervisory assessment that ‘a credit institution no longer fulfils, or is likely to fail to fulfil, the ongoing conditions for its authorisations’, and that ‘there are no suitable alternatives other than the use of the resolution powers’.
**Bridge bank tool**

51. A bridge bank taking over the systemically relevant parts of a failing institution operates on a temporary basis as a fully licensed credit institution with the function of a legal successor for the creditors of the failing institution in so far as their contracts have been transferred. Having this in mind, a time limit for the operation of a bridge bank may be counterproductive: creditors and investors could be led to withdraw their assets or authorities could be forced to undertake fire sales. Furthermore, the time needed to sell the business of the bridge bank to a private sector purchaser is not foreseeable *ex ante*. Therefore, the EBA is not in favour of the specification of a time limit for the operations of a bridge bank. However, the EBA does recognise that a bridge bank’s existence should be brought to an end as soon as is possible, given the potential impact on competition of having such an entity active in the banking market: authorities should, therefore, regularly review the situation.

**Resolution tools, powers, mechanisms and ancillary provisions, scope of rights to challenge resolution’**

52. The EBA agrees with the Commission Services proposals. As stated in previous advice, when using a tool from the common toolbox, authorities must state their reasons and the legal basis for their decision. This is a prerequisite in order for stakeholders to exercise their right to judicial review and to challenge the authorities’ decisions before a Court. However, the role of the Court should only be to review *ex post* the legality of the authorities’ decisions, and, in circumstances where this is appropriate, to set compensation.8

**Resolution colleges**

53. The EBA notes the Commission’s proposal to establish resolution colleges, and understands that resolution colleges would play the role of the cross-border stability groups as defined under the 2008 Memorandum of Understanding, and that it is not the intention of the Commission Services to duplicate such groups, nor crisis management groups as defined by the FSB.

54. The EBA is of the view that the operational functioning of resolution colleges should be in line with the CEBS Guidelines for the operational functioning of supervisory colleges. This would facilitate the cooperation among all authorities involved in the planning and coordination of activities in preparation for and during emergency situations. Indeed, in accordance with Articles 129(1)(c) and 131a (1)(f), supervisory colleges provide the framework for the planning and coordination of supervisory activities in preparation for and during emergency situations, in cooperation with the other competent authorities involved.

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8 See CEBS’s Advice on the EU Framework for Cross-Border Crisis Management in the Banking Sector (CEBS 2010 84 rev1), June 2010.

Group resolution

55. The EBA agrees with the Commission that there is an urgent need to promote cross-border cooperation during emergency situations with cross-border credit institutions, and to prevent fragmented national responses. As such, the Commission’s proposal that resolution colleges should develop and sign off a group resolution scheme, setting out how a group resolution might be carried out taking into account the responsibilities of national authorities involved and the different resolution tools at their disposal, is both understandable and justified. However, regarding the decision process proposed by the Commission Services for group resolution, the EBA wonders whether this cooperation framework will really favour cross-border resolution in practice, as individual national resolution authorities retain the power not to comply with the resolution scheme for reasons of national financial stability. Furthermore, as long as there is no EU solution to burden sharing, Member States will of necessity act within their respective national mandates and responsibilities in the next crisis. Hence, any step forward must entail very strong political commitment to open the route to cross-border burden sharing agreements.

56. Until this is achieved, the EBA supports a framework where resolution authorities in the resolution college strive for a voluntary joint decision as to the activation of a previously agreed group resolution plan.

57. Where authorities, in accordance with their mandates and responsibilities, take their own decisions as to the application of a resolution, they should consider the impact of that action not only on national financial stability, but also on financial stability in other Member States. The EBA could define relevant uniform and objective criteria and parameters for taking such decisions, and offer a non-binding mediation to the authorities concerned.

58. Also, as suggested by the Commission Services, the EBA agrees that these authorities should – before taking individual action – give their reasons to the resolution college and, where feasible, discuss those reasons with the other members of the college before taking individual action.

59. Moreover, in order to facilitate group resolution, the EBA would support the harmonisation of the resolution tools so to enable the effects of their implementation to be equal across the EU.

Debt write down

60. The EBA understands that the economic rationale for a debt write down (‘bail-in’) is very strong. Notwithstanding this, triggering a bail-in instrument could potentially have a destabilising effect on other financial institutions and the financial stability as a whole. In order to mitigate these risks, the instrument and its trigger should be properly designed. In the EBA’s view, both the “targeted approach” and the “comprehensive approach” have their merits. In this respect, the EBA would like to highlight the following aspects:

- The design of the trigger: In order to avoid negative impacts on market behaviour and arbitrage opportunities it is necessary to reduce uncertainty surrounding the activation of triggers for debt write-down. The trigger for bail-in debt should be the same as for the other resolution tools. The recent crisis has taught that that trigger cannot be defined by a single metric, ratio or market based measure as it depends on the combination of firm-specific and market circumstances. It currently is, and should remain, the discretion of the competent
authority to determine whether a credit institution has reached the conditions for resolution. In addition, triggering the bail-in procedure requires that all existing going concern loss absorbing capital is wiped out and convertible instruments are converted into equity;

- A two-stage approach: Newly issued debt instruments containing a contractual bail-in clause should be converted first, once their agreed trigger is met or at the latest once the resolution conditions are met and other loss absorbing techniques have been applied (see above). A relevant question is what to do if the amount of debt containing such an explicit bail-in clause is insufficient to restructure the credit institution and mitigate the risk that a failure of this credit institution may endanger financial stability. In that case, the EBA thinks that, in a second stage, and as a complement to the contractual bail-in, competent authorities, in order to prevent the use of public funds, should be able to trigger (fully or proportionally) the bail-in of additional debt that does not contain such a clause. Giving competent authorities such a power to trigger additional bail-in provides debt investors with a strong incentive to make sure that credit institutions hold sufficient bail-in debt with a contractual trigger.

- The scope of "bail-inable debt": The combination of a contractual trigger (targeted approach) and, if insufficient and in the interest of financial stability, a statutory trigger (comprehensive approach) in a second stage could potentially hit all creditors. In order to prevent this, certain categories of debt should explicitly be excluded from the bail-in. The EBA preliminary view is that the exclusion of secured debt, and repos should be considered. Also, the interests of the depositors, up to the insured amount, must be safeguarded;

- The marketability and amount: It is crucial that there is a market for "bail-inable debt". In order to boost the supply of bail-ins, there seems to be merit in requiring credit institutions to issue and hold a minimum percentage of their liabilities as "bail-inable” debt. Large market volumes will provide market participants with an incentive to standardise bail-in debt contracts, and rating agencies with the incentive to focus properly on the rating of such debt instruments. By reducing market inefficiencies, the pricing of such instruments should better reflect the actual risk of senior bank debt than current senior debt. Another advantage of a minimum issuance and holding of “bail-inable” debt is that this would limit the risk of substitution by issuing debt that is excluded from having a “bail-inable debt clause”. This liability arbitrage could undermine the potential benefits of “bail-inable” debt. Requiring banks to hold a minimum amount of bail-in debt automatically raises the question of the amount of bail-in debt that a credit institution should be required to hold. This would require further consideration.

61. If the measure proves effective in restoring the credit institution to a sound position, warrants or other mechanisms should apply to provide compensation to non-converted creditors to benefit from any upside on their positions. Such compensation could also be considered with regard to 'pre-resolution' shareholders. Policy options that are worth considering to make bail in instruments more attractive, without undermining the objectives of the tool, could be either allowing for temporary-write-down
(but further work is needed to assess accounting implications) or requiring conversion.

62. The general framework would provide a mechanism for compensation in the event that creditors are left worse off than in insolvency as a result of the use of the resolution tools.

63. The EBA notes that the FSB has work in train in this area. The EBA urges the Commission actively to contribute to internationally coordinated proposals on bail-in.

Role of the EBA in the framework

64. In the consultation, the Commission Services raise the issue of the role of the EBA in the future framework. The EBA notes that the EBA Regulation provides the EBA with a number of powers that are of particular relevance for the future framework. These powers relate notably to action in emergency situation (Article 18), settlement of disagreements (Article 19), stress testing exercises (Article 21 and 32), and recovery and resolution plans (Article 25). In particular, Article 18 of the EBA Regulation enables the EBA to take action and decisions in emergency situation but does not further specify the type of action and decisions that can be taken in such a context. For the sake of consistency and efficiency of the future framework, the EBA should be able to use the same tools as those that will be available to supervisory authorities.

65. With regard to resolution powers available to resolution authorities and the resolution process as described in Part 4 and 5 of the consultation, the EBA could at least offer a non-binding mediation to the authorities concerned.

66. As indicated in a number of instances in this opinion, the EBA thinks it can usefully provide a mediation role to supervisory authorities under Article 19 of the EBA Regulation.

67. In addition, the EBA expects to provide further advice to the Commission and to develop, as proposed in this opinion, further criteria or standards, where deemed appropriate.

This opinion will be published on the EBA’s website.

Done at London, 3 March 2011.

[signed]

Andrea Enria
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For the Board of Supervisors