



THE APPLICATION OF THE PROPORTIONALITY PRINCIPLE WITHIN THE EU CRISIS MANAGEMENT FRAMEWORK

EBA Workshop on Proportionality
London, 3 July 2015

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OVERVIEW

1. BACKGROUND TO THE CRISIS MANAGEMENT FRAMEWORK
2. ASYMMETRIES AND BLIND SPOTS
3. PROPORTIONALITY IN RECOVERY AND RESOLUTION
4. FROM CASE BY CASE TO STRUCTURAL PROPORTIONALITY
5. DGSD AND BRRD/SRM
6. CONCLUSIONS

The EU response to the crisis: a twofold approach

The crisis unveiled serious shortcomings in the toolkit available to authorities for preventing or tackling failures of systemic banks without recourse to public funds

GLOBAL LEVEL

G20 + FSB standards for recovery and resolution: *Key Attributes of Effective Resolution Regimes for Financial Institutions*

EU LEVEL

SWIFT REACTION

- Commission's Communications on State Aid to the Financial Sector
- Set up of ESRB and ESAs



REGULATORY OVERHAUL

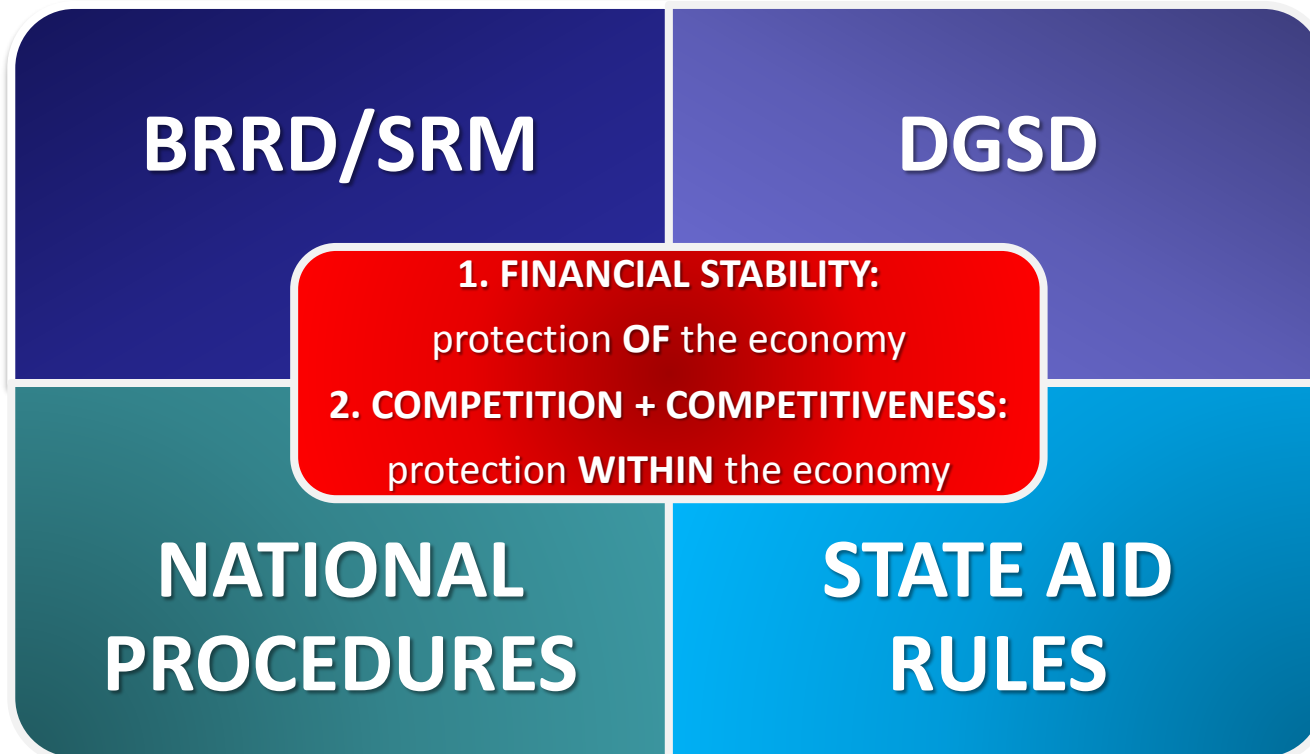
- 1.SSM
- 2.BRRD/SRM
- 3. DGSD
(BANKING UNION)

The EU Crisis Management Framework

DGSD recast was launched before the idea of a Banking Union

Later, however, BRRD and DGSD were adopted as a *package*

Developed jointly, adopted jointly, to be read jointly



A trade-off

COMPETITIVENESS

Less generous safety net. Authorities more likely to let inefficient banks fail. Risk of instability and bank runs.

EMPHASIS

FINANCIAL STABILITY

Authorities less incline to let banks fail. A number of inefficient institutions may be kept in the market and this may result in an incentive for moral hazard.

THE RIGHT BALANCE?

1. a division of task between authorities and private safety nets;
2. a credible bank resolution framework for systemic institutions.

Risk of Asymmetrical Treatment

the SRM resolution procedure entails **3 key elements**:

1. conditions for resolution;
2. a public interest not achievable to the same extent by a normal insolvency proceeding;
3. the process and the decision (Board > Commission > Council).

Where conditions are met, following the resolvability assessment, the decision to apply resolution or give way to insolvency procedures may result in an asymmetrical treatment:

- **SMALL BANKS**: more likely to be left to fail, full emphasis is put on **competitiveness**
- **LARGE BANKS**: investors are bailed-in, but the bank is not dismantled, competitiveness adjusted by the **stability concern**

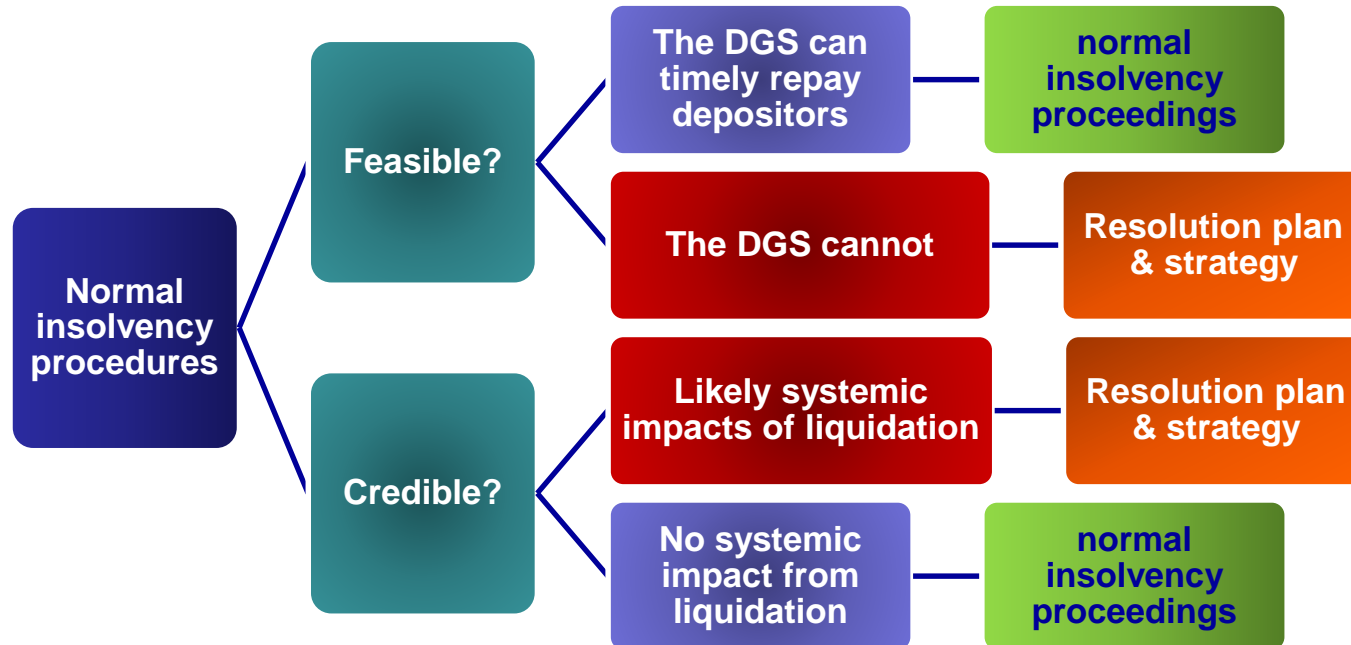
the trade-off may thus result as differently dealt with...

HOWEVER

all banks must comply with BRRD/SRM provisions:
rec&res plans, loss absorbing liabilities and contributions to the SRF.

A possible blind spot

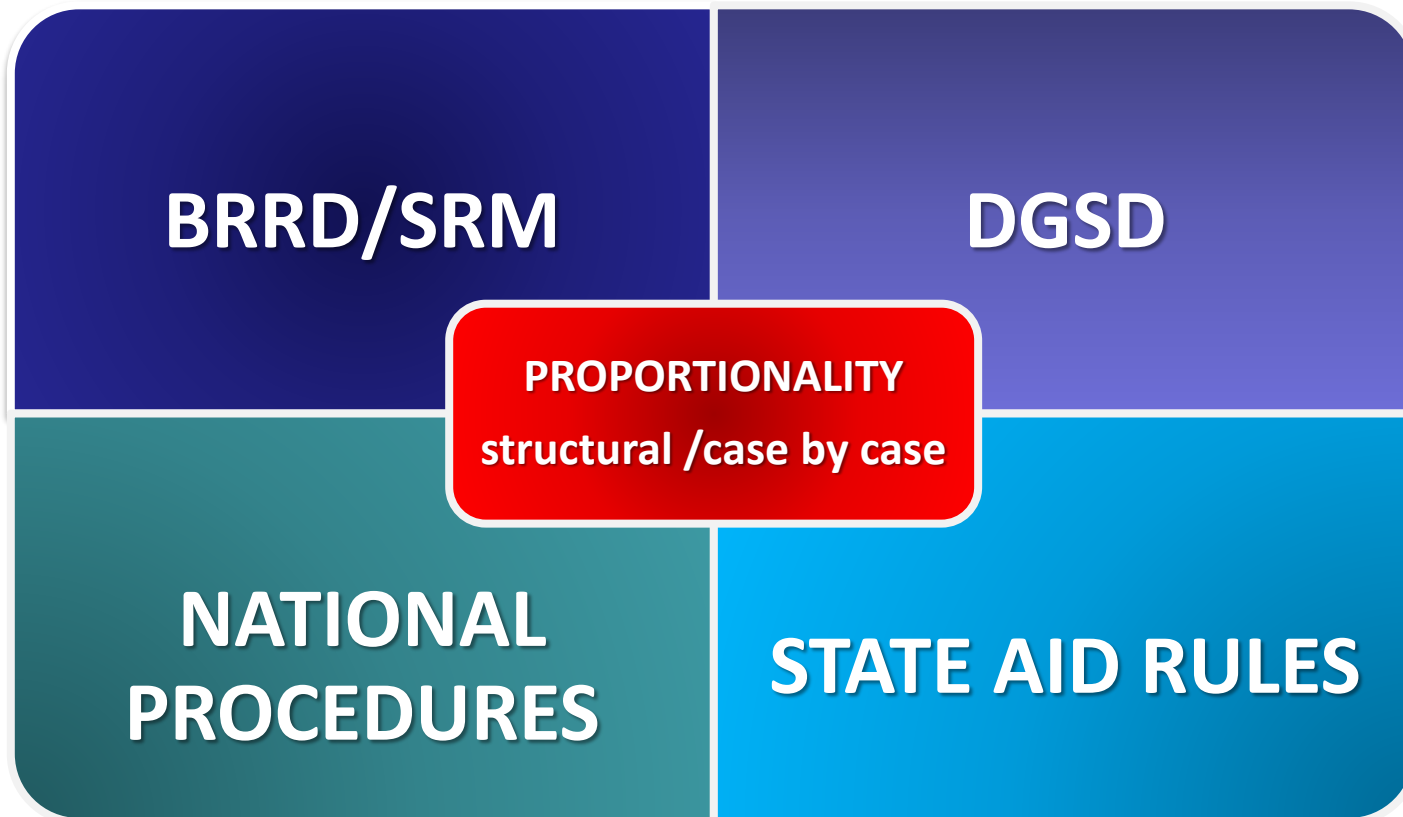
- EBA draft RTS on resolvability assessment, a stage approach on the public interest;
- it may suggest that when normal insolvency procedures are both feasible and credible, they should be preferred to resolution.



- for small institutions, normal insolvency procedures may thus become a 'standard';
- **BLIND SPOT:** even for small-sized co-operative banks, an "atomistic liquidation" can be insidious;
- they have so far been resolved following a model similar to the "**Purchase and Assumption**" of FDIC.

How to work it out?

Proportionality should be achieved in a cross-sector fashion, in order to result:
EFFECTIVE + NON COMPETITION-DISTORTIVE + APPROPRIATE



Recovery and Resolution

REC.

Art. 5 BRRD:

all institutions - not part of a group subject to consolidated supervision – shall draw up and maintain recovery plans, setting out actions to restore the financial position following a significant deterioration of it.

- EBA recommendation on the development of recovery plans
- EBA RTS on the content of recovery plans
- EBA RTS on the assessment of recovery plans
- EBA GLs on the range of scenarios to be used in recovery plans
- EBA GLs on recovery plans indicators

RES.

Art. 10 (4 & 7) BRRD: contents of resolution plans (Art. 12.3 for groups);

Art. 11 BRRD: information for resolution plans;

Art. 15 BRRD: resolvability assessment;

- EBA RTS on resolution planning
- EBA RTS on resolvability assessment
- EBA GLs on measures to reduce or remove impediments to resolvability
- EBA GLs on treatment of liabilities in bail-in
- EBA RTS on contractual recognition of bail-in
- EBA RTS on minimum requirement for own funds and eligible liabilities (MREL)
- EBA ITS on procedures, forms and templates for resolution planning [...]

Proportionality in Recovery & Resolution

GENERAL

LEVEL 1

Art. 4 SIMPLIFIED OBLIGATIONS:

on rec & res plans and when using their powers/tools Authorities should take into account:

- ✓ institutions' business' nature, shareholding structure, legal form/status, risk profile, size;
- ✓ interconnectedness with other institutions or the market, scope and complexity of its activities;
- ✓ membership to an IPS or other coop mutual solidarity systems as of Art. 113.7 CRR;
- ✓ whether failure + winding up under insolvency proceedings may damage significantly markets, other institutions, funding conditions, or the wider economy

RECITAL 14

and should make sure that the regime is applied in an appropriate and proportionate way and that the administrative burden for rec & res plan preparation obligations is minimised.

CASE BY CASE

LEVEL 1

Art. 4. 8 and Art. 4.9

- **WAIVER** on Rec & Res Plans for institutions falling within Art. 10 CRR
- **WAIVER** on Recovery Plans for members to an IPS

LEVEL 2

- EBA GLs on Simplified Obligations
- EBA ITS on Simplified Obligations

Present approach: General/Case by Case

GENERAL PROPORTIONALITY

- a wide range of elements should be taken into account by Authorities when deciding on the application of common rules to all institutions

CASE BY CASE PROPORTIONALITY

- some specific issues are treated differently – but not always enough – when deemed worthy of consideration or enhancement

- Proportionality in the BRRD is mainly sought after on a case-by-case basis, leaving the width and depth of application to the assessment of authorities;
- this would be acceptable if all institutions were more or less similar;
- it usually results in a non satisfactory, too discretionary application only for some cases or only in portions of some cases (IPS, good, but good enough? Contributions to SRF?);
- at level 2, the EBA draft GLs on simplified obligations focus on the assessment of institutions for eligibility, nothing material is said on the contents of simplified obligations.

A different approach: Structural/Case by Case

STRUCTURAL PROPORTIONALITY

- should be able to identify and combine core or basic objectives, suitable processes and tools and the category of eligible institutions.

CASE BY CASE PROPORTIONALITY

- should then single out - within such category - specific cases deserving specific treatment for the best achievement of legislation' goals according to the rationale.

- Art. 4 BRRD suggests that there may room for **STRUCTURAL PROPORTIONALITY**;
- this should result in better identification *ab origine* (thresholds) of a **CATEGORY OF INSTITUTIONS** eligible for simplified obligations according to a set of features;
- “case by case” approach would remain applicable for specific cases;
- examples within EU legislation: SSM criteria for dividing significant institutions from less significant ones, BSR proposal;
- EBA’s task - and that of the Authorities - could be easier, more certain and more effective.

BRRD: a possible way forward

Authorities should **TRULY** make sure that the administrative burden of recovery and resolution planning for such institutions is minimised, EBA should lead and supervise.

- The application of simplified obligations is mandatory, not be left to discretion;
- waivers are an option and represent a possible good examples, but they are not enough,
- the role of IPSs in early intervention actions should be enhanced, not only when resolution is being considered (art. 32.1 BRRD)

RECOVERY & RESOLUTION PLANS. Small banks are more likely to fail due to misapplication of concentration rules, governance shortcomings or macroeconomic conditions: they should be allowed to apply simplified scenarios (see the UK example for building societies).

The new DGSD within the wider framework

DGSs serve two main goals:

1. protecting savers against loss of deposits in case of their bank's insolvency
2. maintaining the stability of the financial system while avoiding systemic risk

According to the 1994 Directive, EU DGSs resulted as:

- differently organized (one or more per Member State);
- differently funded (*ex ante* or *ex post*, or both);
- different in terms of pay-out procedures;
- multi-functional (pay box, risk manager, risk minimizer)

DGSD recast + BRRD + State Aid + 5 Presidents 'Report:

- DGSs mainly cover the pay-box function;
- the financial means of a DGSs shall be used to finance resolution (art. 109 BRRD);
- DGSs shall be used for measures alternative to deposits' reimbursement (art. 11.6 DGSD);
- early intervention measures are provided, but limited (art. 11.3 DGSD);
- in any case, rules on State Aid must be complied with;
- forthcoming proposal on pan-European DGS (the 5 Presidents' report as of June 22).

DGSD & BRRD – going concern

DGSD Art. 11 (3)

Early interventions & recovery – going concern

DGS available financial resources may be used for alternative measures in order to prevent the failure of a credit institution

No mention of any involvement of the DGS in recovery actions and early interventions by the competent authority

- The implementation of proportionality for small institutions in the recovery and early interventions framework should benefit from Art. 11.3 DGSD, in order to prove less costly;
- recovery options relatively limited for a small and local bank.

DGSD & BRRD – gone concern

DGSD Art. 11 (6)

Gone concern – alternative measures to depositors reimbursement

The available financial means may also be used to finance measures to preserve the access of depositors to covered deposits

BRRD on the same topic

It looks like reimbursement is a necessary part of normal insolvency proceedings (no mention of the role the DGS similar to art. 11.6 DGSD)

- **BLIND SPOT:** even for a small institution, “atomistic liquidation” can be insidious;
- even if the DGS can timely repay depositors, an alternative may be favoured according to Art. 11.6 DGSD as long as the **LEAST COST** criterion is met;
- that may prove consistent with the “costs minimizing” criterion stated in Art. 31.2 BRRD (Objectives of Resolution);
- Art. 11.6 DGSD does not jeopardize market discipline: a failed institution is not kept alive. Its market exit, however, does not imply depositors reimbursement.

Traditional Small Banks Resolution Approach

Italian BCCs: when losses require full wipe out of capital and reserves, the DGS steps in to bring back net assets value to zero.

The remaining assets and liabilities are transferred (sale of business tool) to another institution (**COST SHARING**).

How to preserve a good practice?

The stepping in of the DGS is activated only where less onerous than the payout of depositors (**LEAST COST**).

Even if financial stability is not at risk, concerns are directed to preserving access to financial services, protection for small retail investors, etc.

Conclusions

A nuclear power plant and a windmill farm do not apply identical rules just because they both produce energy.

Their decommissioning procedures, likewise, follow different criteria.

PROPORTIONALITY

Decommissioning smaller banks, especially when gifted with mechanisms serving the same rationale of the legislation – *i.e.*, preventing crises and, when unavoidable, minimizing their negative effects– should therefore imply specific rules.

Such rules already exist in some cases (*e.g.*, IPSs), but due to a **CASE BY CASE** approach, they do not fully tackle the issue. Schemes like IPSs, or DGSs under the right conditions, could be fostered as a solution to re-align asymmetries and sort out blind spots.

A **STRUCTURAL** approach, albeit **WITHOUT** national discretion and **WITHIN** the single rulebook, may better capture the diversity of the banking sector and further secure the righteous goals of the EU crisis management framework. Single rule book + case by case may not indeed fully dismantle the “one size fits all” risk.

Thank you for your attention

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