The transition from banking supervision to banking resolution. Players, competences, guarantees

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versione provvisoria

1. The banking union launched in 2012 by the European Council and the Euro Zone Summit is based, as is well known, on two pillars: the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), supported by several collateral measures such as the restyling of the powers of the European Bank Authority (EBA), in operation since 2010, and the establishment of the Single Bank Resolution Fund (SRF), through an Agreement among the participating Member States on the transfer and mutualisation of contributions to the SRF.

Moreover, the banking union is underpinned by a comprehensive and detailed single rulebook for financial services for the internal market as a whole. Indeed, the recent moves towards the banking union among the Member States whose currency is the euro have been followed by a new Resolution Framework for credit institutions and investment firms, as a decisive step for harmonisation of bank resolution rules across the whole Union. This Resolution Framework – provided by a new Directive passed in first reading by the European Parliament in April – does not lead to a full centralisation of decision making in the field of resolution, but establishes minimum harmonisation rules.

Both pillars were established in a very short time, almost inconceivable under the usual "meditative" timing of the Union legislators, after sharp discussions

di prossima pubblicazione in ASTRID, *The European Banking Union*, a cura di Marcello Messori e Emilio Barucci, 2014

and difficult trilogues among the Union institutions. The system will operate progressively according to the timetable and conditions provided by the two main Regulations (for the SSM, Regulation no. 1024/2013; for the SRM, Regulation no. 806/2014). The timing for full effectiveness of the SRM, albeit reduced as to the initial proposal, remains too slow and remote. It is undoubtedly inadequate for the needs of the market in this critical period.

2. The second pillar of the banking union, the SRM, has been considered an essential instrument to avoid the damage resulting from bank failures in the past. In the intention of European institutions the SRM will ensure that potential future bank failures are managed efficiently. The resolution procedure only applies in respect of banks whose supervisor is the ECB (at the European level). Like the SSM, also this "mechanism" has original features centred on a body called the Single Resolution Board (SRB) which represents a new kind of agency, after the waves of "European agencies" of recent decades and the three European Supervisory Authorities of 2010. The Single Resolution Mechanism is disciplined by two sets of rules: a) "Regulation 2014" of the European Parliament and of the Council establishing uniform rules and procedure for the resolution of credit institutions and certain investments firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation no. 1093/2010; b) the Intergovernmental Agreement on the Single Resolution Fund. The Mechanism will operate in the framework of "Directive 2014" of the European Parliament and of the Council, establishing a framework for the recovery and resolution of credit institutions and investment firms and amending some Council Directives and Regulation no. 1093/2010.

The expression "banking resolution" is used in European legislative acts in numerous sections, but curiously it is never clearly defined. However, there is general agreement that resolution means "an administrative procedure to manage bank crises out of court so as to protect financial stability, preserve vital systemic functions as well as protect depositors, while minimising any adverse impact on

taxpayers".

It is self-evident and well-established that the two functions of supervision and resolution are strictly inter-connected. The point is expressly reaffirmed in the preamble to Regulation 806/2014, Recital no. 11: "The SRM is interwoven with the process of harmonisation in the field of prudential supervision, brought about by the establishment of EBA, the single rulebook on prudential supervision (Regulation (EU) No 575/2013 of the European Parliament and of the Council and Directive 2013/36/EU of the European Parliament and of the Council), and, in the participating Member States, the establishment of the SSM to which the application of Union prudential supervision rules is entrusted. Supervision and resolution are two complementary aspects of the establishment of the internal market for financial services whose application at the same level is regarded as mutually dependent".

3. The issue considered in this paper from a juridical point of view is the link between the outcomes of the supervisory powers and the beginning of the resolution procedure, when supervision has highlighted some critical situations for banks and financial institutions. The paper examines the initial phases of the resolution procedure, including recovery plans, the "early intervention" procedure in the event of bank failure or imminent failure, and the drafting and adoption of resolution plans and schemes.

The focus herein will be the Europeanization of bank resolution, which is the most innovative part of the SRM. However, it must be stressed once again that the "mechanism" neither concentrates all powers in European institutions and agencies, nor does it operate in two separate parts, namely the national and European, as demonstrated by the involvement of the national competent authorities in most cases.

Though extensively interwoven, supervision and resolution maintain some different features. First, their legal basis is different: Art. 127 TFEU (conferral of specific tasks) for the SSM; Art. 114 TFEU (measures for the approximation of national provisions) for the SRM. Secondly, the supervisory mechanism is

relatively simple, establishing a large number of administrative powers for the ECB (while the regulatory powers are limited). The ECB is a "technical"/specialised institution which ensures a neutral approach in dealing with the supervised banks. By contrast, the assessment and resolution mechanism is much more complex due to the number of bodies involved and the characteristics of each phase of the procedure.

Recital no. 26 of Regulation 2014 makes it explicit that "the Council and the Commission should cooperate closely and the Council should not duplicate the preparatory work already undertaken by the Commission. The Board should instruct the national resolution authorities which should take all necessary measures to implement the resolution scheme". This co-presence of supranational (Commission) and intergovernmental (Council) institutions and of a technical agency (the Board), acting as an operational independent body, could result in different visions and delays in adopting the resolution schemes, precisely in situations where speed is vital and appropriate measures need to be taken.

The European Parliament has long opposed the Council's role because it gives space to political considerations in a procedure which should be purely technical; in principle and according to Recital no. 12: "the establishment of the SRM will ensure a neutral approach in dealing with failing banks". Inevitably, the Council's involvement in the procedure will make the resolution less independent and more political.

In the compromise which allowed the final approval of "Regulation 2014" the prevailing position was that "since only institutions of the Union may establish the resolution policy of the Union and since a margin of discretion remains in the adoption of each specific resolution scheme, it is necessary to provide for the adequate involvement of the Council and the Commission, as institutions which may exercise implementing powers, in accordance with Article 291 TFEU". (see Recital no. 24). The role of the Council is of particular importance in order to verify whether a resolution action is "necessary in the public interest" (Art. 18

"Regulation 2014").

The issue considered here is a clear example that managing a bank crisis may assume a different importance: after the initial discovery of a crisis by the ECB, the procedure continues with the intervention of the Board and of the Commission, in a permanent dialogue with the ECB (leaving aside, as stated above, the national competent authorities).

The procedure for connecting supervision and resolution is so complex and formally rigid as to raise scepticism with regard to its actual working. Obviously only future implementation and experience will give precise indications, but also when the procedural timing is respected the joint participation of so many bodies involves the juridical importance of different public interests which are far from easily amalgamated. There is also the serious risk that sensitive information on the bank in difficulty is revealed to a large number of competitors and bodies concerned, exacerbating the failure in question.

4. There are three phases in bank crisis management and resolution: bank recovery plans for preventing failure; next, the bank fails or is close to failing; finally, resolution. The first phase is disciplined by Regulation no. 1024/2013 for ECB powers; early intervention and resolution phases by "Regulation 2014".

Let us consider the first phase. ECB supervision of "significant" banks can reveal difficult situations or those of true crisis. In such an event preparation and prevention planning is initiated and the bank concerned is required to draw up recovery plans detailing all the measures to be adopted to restore its viability. It is therefore the bank itself that draws up the recovery plan, under certain conditions provided by the cited Regulation and detailed in BRRD 2014 (the general framework law). That said, the Board can indicate initiatives to be undertaken by the bank or may take over the recovery plan directly, if appropriate. In any event, the Board may also identify impediments to resolvability and adopt measures to facilitate resolvability. The entire phase is "technical" and is entrusted to the banks concerned and to the Board.

When the situation seriously deteriorates, due to the failure of the plan or other reasons, or when no preparation and prevention plans have been adopted, the early prevention phase starts under Art. 13 of "Regulation 2014". This is the legal and material point of contact between the two main functions of the banking union: the shift from supervision and recovery towards resolution.

Let us now examine the main steps of the procedure, focusing firstly on the "early intervention" (Art. 13 "Regulation 2014"). Having assessed the bank's deteriorating situation – whether a credit institution is failing or likely to fail, or whether there is no reasonable forecast that an alternative private sector or supervisory action might prevent its failure within a reasonable time – the ECB informs the Board on the measures to be taken, or alternatively, the initiatives that the ECB itself intends to set in motion under the two cases provided in Art. 16 Regulation no. 1024/2013 and in Art. 23a "Directive 2014" (BRRD). If so, the Board will receive all the relevant information.

In turn, upon receipt of the measures required by the ECB or by the national competent authorities, the Board immediately informs the Commission and may prepare the resolution plan of the institution or group concerned. Then the Board verifies – in cooperation with the ECB and the national competent authorities – the actual situation of the bank concerned and whether the plan fits the case. The Board assesses whether there is a systematic threat (the "public interest" condition) and there is no alternative private solution. The ECB and the national competent authorities may assume additional measures, in which case the Board is informed.

The measures adopted in this phase can be of a different kind and invasive of the bank powers under resolution, such as the appointment of a special manager and the order to contact potential buyers.

The legislation summarised herein is in line with the principle of delegation of powers to agencies, as interpreted by the Court of Justice in the famous Meroni case (13.6.1958, case 9/56) and now reconsidered in a new perspective by the ESMA case (22.1.2014, C-270/12). In brief, as stated in the opinion of the

Council's legal service of 7.10.2013, no delegation can be presumed and thus an explicit decision to delegate must be taken; a delegation of powers cannot be excluded even in the absence of a specific basis for it in the Treaty; any delegation of powers where the conferred powers are broader than those of the delegating authorities is unlawful; a delegation involving discretionary powers implying a wide margin of discretion would entail an illegal transfer of responsibility, altering the balance of powers; the delegation should be subjected to precise rules.

5. After analysis of the new regulations, let us make some general remarks on the Single Resolution Mechanism governance. According to the initial proposal by the Commission, the whole resolution procedure was to be centred on the Board, operating in coordination with the Commission and under EBA rules. The Board has consequently been designed in a new way, vis-à-vis the general model of the European agencies and also the three European Supervisory Authorities established in 2010 (European Banking Authority; European Securities and Markets Authority; European Insurance and Occupational Pensions Authority).

"Regulation 2014" provides that the Board shall be the body responsible for the effective and consistent functioning of the SRM. Legally, "a Union agency with a specific structure corresponding to its tasks" (Art. 42, para. 1). "It should have the capacity to deal with large groups and to act swiftly and impartially. The Board should ensure that appropriate account is taken of national financial stability, financial stability of the Union and the internal market" (Recital no. 39). As a collegiate body, the Board is composed by a full time Chair and four further full-time independent members, plus a member appointed by each participating Member State, representing the national competent authorities. The Board will act in plenary and executive sessions (the Chair and the four independent members). As a rule, the Board adopts decisions in plenary session, but the crucial decisions requiring expertise and independence are assumed in executive session. If a possible comparison is possible, the only body with some similarities with the Board is the ECB.

The institutional choice of the SRM confirms that the European Union shapes the administrative bodies according to the nature of the conferred functions. A second general remark concerns the nature of the resolution procedure. The legislative acts which now discipline the SRM provide such a rigid and detailed procedure as to become in itself a factor of complexity. Obviously, only the next implementing experience will show whether this view is correct, but undoubtedly the wording and length of "Regulation 2014" and of "BRRD 2014" (the latter alone is more than 500 pages long) is barely compatible with the need for a "market-compatible" law, easy to understand and to manage.

It is hoped that if the next implementing experience confirms the risk of rigidity it will be possible to amending and to simplify the discipline considered herein. Wisely, "Regulation 2014" provides this opportunity saying that the Commission is empowered to review the application of the Regulation in order to assess its impact and to establish whether any modifications or further developments are needed in order to improve the efficiency and effectiveness of the SRM.

A third and final remark relates to the risk that a discipline which is so complex and difficult to manage may cause unacceptable legal and economic breaches to the rights of the banks involved and of their shareholders. The resolution mechanism is per se a procedure which renders European a function traditionally falling within the sovereignty of the States and of their laws. Furthermore, it impinges on many issues of private law beyond (or perhaps in contrast with) the limits of the competences conferred upon the Union. The "intrusion" of the resolution procedure may become unbearable if the many players involved in the mechanism overlap with possible delays and inconsistencies; especially in the event of leaks of sensitive information/data on the bank, increasing its difficulties.

An appropriate balance with some of these risks is now the provision – assumed after much debate – that all the measures undertaken in the procedure

could be reviewed by the Court of Justice (to be here considered as the EU Judiciary, including the General Court, under Art. 19 TEU). The principle implies that also the acts related to the phases considered herein may therefore be subject to judicial control, albeit very technical.

Pursuant to Recital no 120 of "Regulation 2014", "the Court of Justice has jurisdiction to review the legality of decisions adopted by the Board, the Council and the Commission, in accordance with Article 263 TFEU, as well as for determining their non-contractual liability. Furthermore, the Court of Justice has, in accordance with Article 267 TFEU, competence to give preliminary rulings upon request of national judicial authorities on the validity and interpretation of acts of the institutions, bodies or agencies of the Union" (seem also Art. 87 ibid). The framework of the legal guarantees is completed by an interesting system of " administrative justice" – peculiar to the SRM – provided by Art. 86 para. 1 of "Regulation 2014", according to which the interested party (as a rule the bank under resolution, but also the resolution authorities) may appeal against a decision of the Board which is addressed to that person or which is of direct and individual concern to that party. The appeal shall be considered by the Appeal Panel, a quasi-judicial body (not a court) composed by five persons of high reputation.

Finally, it may be stated that the European legislators on banking union have been fully consistent in providing a legal discipline for the connection between supervision and resolution. Centralised supervision, as is now in operation, without a link to a new resolution mechanism at European level would have been a function devoid of any effectiveness, dissolving the banking union itself. However, the legislation here is very complex as a result of an institutional compromise; it can only operate if the players act in mutual trust and a spirit of cooperation.