

# Taking stock of the Single Resolution Board

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## Banking Union Scrutiny

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### **Abstract**

The Single Resolution Board (SRB) has had a somewhat difficult start but has been able to learn and adapt, and has gained stature following its first bank resolution decisions in 2017-18. It must continue to build up its capabilities, even as the European Union's banking union and its policy regime for unviable banks continue to develop.

Specific areas identified for parliamentary scrutiny include the SRB's authority to determine a bank as failing or likely to fail; its crisis preparedness beyond the ongoing process of resolution planning; and its governance and operational independence.

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## LIST OF ABBREVIATIONS

<b>BRRD</b>	Bank Recovery and Resolution Directive
<b>DG COMP</b>	Directorate-General for Competition, European Commission
<b>DG FISMA</b>	Directorate-General for Financial Stability, Financial Services and Capital Markets Union, European Commission
<b>DGS</b>	Deposit Guarantee Scheme
<b>EBA</b>	European Banking Authority
<b>ECA</b>	European Court of Auditors
<b>ECB</b>	European Central Bank
<b>ECON</b>	European Parliament Committee on Economic and Monetary Affairs
<b>EDIS</b>	European Deposit Guarantee Scheme
<b>ESM</b>	European stability Mechanism
<b>ESMA</b>	European Securities and Markets Authority
<b>FDIC</b>	US Federal Deposit Insurance Corporation
<b>FOLTF</b>	Failing Or Likely To Fail
<b>IMF</b>	International Monetary Fund
<b>MOU</b>	Memorandum of Understanding
<b>MREL</b>	Minimum Requirement for own funds and Eligible Liabilities
<b>NRA</b>	National Resolution Authority
<b>SRB</b>	Single Resolution Board
<b>SREP</b>	Supervisory Review and Evaluation Process
<b>SRF</b>	Single Resolution Fund
<b>SRM</b>	Single Resolution Mechanism
<b>SSM</b>	Single Supervisory Mechanism

## EXECUTIVE SUMMARY

The Single Resolution Board (SRB) was established as a key component of the European banking union initiated in mid-2012 at the height of the euro area crisis. It has had a somewhat delayed and difficult start, largely explained by competing objectives in the legislation that established it. But it has now plausibly passed many of its first few tests, and has displayed an encouraging propensity to learn and adapt.

Further efforts are needed to reach a satisfactory steady state in the next few years, assuming no major crisis in the meantime. This study identifies three areas that might justify specific scrutiny:

- First, and in accordance with its founding legislation, the SRB needs to build an autonomous ability to determine if a bank is failing or likely to fail, while avoiding unnecessary duplication of resources or processes with the Single Supervisory Mechanism. This might be supported as necessary by on-site inspections, which the SRB has the authority to conduct but for which it has not yet established its capability.
- Second, the SRB should take a multi-dimensional approach to crisis preparedness, beyond pursuing its core task of resolution planning. In particular, it should ensure it will be able to concretely draw on the skills and experience needed when confronted with the highly challenging tasks that may come with a major crisis.
- Third, and with a medium-term time horizon in mind, legislators should consider reforming the SRB's governance framework so as to establish it further as an authoritative, operationally independent decision-making entity.

## 1. INTRODUCTION

This study was written in response to a request from the ECON Committee Secretariat, in anticipation of a public hearing of the Chair of the Single Resolution Board (SRB), Ms Elke König, scheduled for 2 April 2019. Given the limited time available for preparation, there is no attempt here at a comprehensive evaluation. Instead, it focuses on a limited number of themes selected by the author for parliamentary scrutiny. The analysis is based on the author's observation of the development of banking union since its inception; a review of selected publicly available written sources; and interviews conducted specifically for this study.

The study is about the SRB, a recently created institution with an important mandate. It is not intended as a holistic review of the European policy regime for handling banks that are deemed unviable (referred to in the text as the "unviable bank regime"). Such a review is being attempted by the author, jointly with Anna Gelper, in a separate forthcoming study also at the ECON Committee's request, which will include lessons from the experience of the US Federal Deposit Insurance Corporation (FDIC). Broader challenges, such as completing the banking union and making the euro area more resilient, are similarly not addressed in this study.

This study includes multiple references to the FDIC, because the US experience of handling unviable banks is unparalleled in terms of historical depth, quantitative significance, and relative policy continuity. It is important to remember, however, that the United States' unviable bank regime, far from being a static point of comparison, has been shaped by decades of policy adjustment, and is still evolving.

The semantics of dealing with unviable banks can be treacherous. The organising concepts are not identical across all jurisdictions, and the same words (e.g. "insolvency", "resolution", "liquidation") can assume different meaning in different jurisdictions. This study generally conforms to recent European practice.

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## 2. THE SRB SO FAR

### 2.1 Origins

The foundational text of Europe's banking union, the euro-area summit statement of 29 June 2012, did not formulate the concept of a Single Resolution Mechanism (SRM), though it did preview the Single Supervisory Mechanism (SSM). Instead, the declaration suggested that, in the immediate near term at least, the financial burden of resolving unviable bank situations should be taken on by the European Stability Mechanism (ESM), which at the time was still in the process of being formally established. This would happen through a new ESM instrument of direct bank recapitalisation, potentially with retroactive effect as the case of Ireland was specifically mentioned<sup>1</sup>. A few weeks earlier, on 6 June 2012, the European Commission had proposed a comprehensive reform of the EU framework for dealing with fragile or unviable banks, known as the Bank Recovery and Resolution Directive (BRRD), following three years of extensive internal debate and external consultations<sup>2</sup>.

At that early stage in mid-2012, the fledgling banking union and BRRD were widely viewed as forming a sequence. The ongoing banking crisis, later labelled "*legacy issues*", would be handled through national and ESM recapitalisations based on the objective assessments provided by the SSM; only later would a harsh principle of bail-in and the corresponding market discipline be introduced as a sounder framework for the treatment of future crises<sup>3</sup>. Correspondingly, the BRRD proposal only envisaged the introduction of bail-in in 2018, which was (plausibly, as it turned out) presumed to be after the proper addressing of most legacy cases<sup>4</sup>.

This understanding, however, did not last long. Partly because of domestic German political dynamics, partly triggered by fast-changing perceptions about the situation of the Spanish banking system<sup>5</sup>, the German government soon backtracked on its late-June commitment to ESM direct recapitalisation. On 25 September 2012, the German federal finance minister, jointly with his colleagues from Finland and the Netherlands, issued a public statement that stated "*the ESM can take direct responsibility of problems that occur under the new [future SSM] supervision, but legacy assets should be under the responsibility of national authorities*", thus negating the approach adopted in late June with the explicit aim "*to break the vicious circle between banks and sovereigns*"<sup>6</sup>. The neat sequence envisaged in late June, under which

<sup>1</sup> The summit statement's famously convoluted language reads: "*When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalise banks directly. This would rely on appropriate conditionality, including compliance with state aid rules, which should be institution-specific, sector-specific or economy-wide and would be formalised in a Memorandum of Understanding.*"

<sup>2</sup> Two key milestones in the preparation of the BRRD were the Commission's communications of October 2009 and October 2010, COM(2009) 561 and COM(2010) 579. A more detailed analysis of the genesis of the BRRD goes beyond the scope of this study.

<sup>3</sup> The precise extent of bail-in that would be associated with the resolution of legacy issues was apparently left ambiguous in the discussion during the summit in late June 2012. It was clear to most or all participants that shareholders and junior creditors of unviable banks would incur losses, as they did under the Spanish programme, but expectations differed as to whether senior creditors, let alone uncovered depositors, would be asked to share the burden as well. It also appears that the modalities under which the ESM direct recapitalisation might be applied with retroactive effect, as was hinted at in the summit statement with reference to Ireland, were left unspecified.

<sup>4</sup> COM(2012) 280, Article 115(1) of the Commission's BRRD proposal of 6 June 2012.

<sup>5</sup> Following the shock of Bankia's precipitous nationalisation in May 2012, the Spanish government requested financial assistance from the European Financial Stabilisation Facility, the predecessor entity to the ESM, on 25 June 2012, and eventually on 20 July 2012 concluded a memorandum of understanding for an assistance programme targeted at restoring the banking sector back to health.

<sup>6</sup> The 'Helsinki declaration' of the three ministers is available at [https://vm.fi/en/article/-/asset\\_publisher/joint-statement-of-the-ministers-of-finance-of-germany-the-netherlands-and-finland](https://vm.fi/en/article/-/asset_publisher/joint-statement-of-the-ministers-of-finance-of-germany-the-netherlands-and-finland). For good measure, the same statement added that "*direct bank recapitalisation by the ESM should take place based on an approach that adheres to the basic order of first using private capital, then national public capital and only as a last resort the ESM*", implying that even in the future, ESM direct recapitalisation would not be aimed at breaking the bank-sovereign vicious circle. The decision was eventually made in 2018 to terminate the ESM direct recapitalisation capability when the ESM's backstop to the Single Resolution Fund is in place. The need for ESM direct recapitalisation of problem banks may be considered again in the future, however, either proactively or under duress in a crisis scenario.



legacy issues would be handled through ESM-supported recapitalisations, and future crises through BRRD-compliant bail-in, could no longer be followed.

The euro-area leaders' response to these changed circumstances was to fast-track the creation of the SRM. The concept had been proposed by the European Commission from the start, e.g. in the *Four Presidents' Report* of 26 June 2012 (Van Rompuy, 2012), as part of a long-term vision for banking union that would also include a European deposit insurance scheme (EDIS). When the Commission proposed the SSM Regulation on 12 September 2012, it simultaneously stated that *"once agreement on the existing DGS [Deposit Guarantee Schemes Directive] and Bank Recovery and Resolution [BRRD] proposals is achieved, the Commission envisages to propose notably a single resolution mechanism to resolve banks and to coordinate the application of resolution tools to banks under the banking union"*. The European Council on 19 October cautiously *"noted the Commission's intention"* to do so<sup>8</sup>. But in its subsequent meeting on 13-14 December, the European Council asked for an acceleration of the legislative work and stated that *"The Commission will submit in the course of 2013 a proposal for a single resolution mechanism for Member States participating in the SSM, to be examined by the co-legislators as a matter of priority with the intention of adopting it during the current parliamentary cycle"*<sup>9</sup>. Meanwhile, the plan to establish an EDIS, already watered down to *"a common system for deposit guarantees"* in the Commission's September communication, was dropped altogether from the agenda until its reappearance at the Commission's initiative in 2015.

The creation of the SRB as the SRM's hub was similarly circuitous. Whereas the *Four Presidents' Report* of June 2012 referred to *"a common resolution authority"*, and Commission discussions in late August still referred to *"a European resolution authority"*<sup>10</sup>, the Commission in its September communication chose to only refer to a *"single resolution mechanism"*. Even as the parallelism with the Single Supervisory Mechanism gave a hint of a central supranational authority, this was not made explicit and remained contested in the course of the ensuing negotiations, not least because of the associated matter of a single (mutualised) resolution fund. As late as May 2013, Germany's federal finance minister argued publicly that *"while today's EU treaties provide adequate foundation for the new supervisor and for a single resolution mechanism, they do not suffice to anchor beyond doubt a new and strong central resolution authority"* and that, since any treaty revision would be lengthy, the SRM should take the form of *"a resolution mechanism based on a network of national authorities as soon as the new [SSM] supervisor is operational, the [BRRD] resolution directive has been adopted and the Basel III capital requirements are in place. Instead of a single European resolution fund – which the industry would take many years to fill – such a model would lean on national funds, which already exist in several member states"* (Schäuble, 2013). Nevertheless, the European Commission's proposal for the SRM Regulation, eventually published on 10 July 2013, did include the SRB and Single Resolution Fund (SRF) on terms broadly similar to those that were eventually enacted<sup>11</sup>.

Meanwhile, later in 2013, the deadline for adoption of the bail-in provisions of the BRRD was brought forward in that directive's legislative discussion, from 1 January 2018 (as mentioned above) to 1 January 2016, and parallel amendments were made to the SRM Regulation. This was consistent with the abandonment of the initial vision of ESM direct recapitalisation of banks, while breaking the bank-

<sup>7</sup> Communication COM(2012) 510 'A Roadmap towards a Banking Union', available at <http://ec.europa.eu/transparency/regdoc/rep/1/2012/EN/1-2012-510-EN-F1-1.Pdf>.

<sup>8</sup> EUCO 156/12, paragraph 11.

<sup>9</sup> EUCO 205/12, paragraph 11.

<sup>10</sup> Minutes of the 2013th meeting of the Commission held in Brussels (Berlaymont) on Wednesday 29 August 2012, PV(2012) 2013, available at <http://ec.europa.eu/transparency/regdoc/rep/10061/2012/EN/10061-2012-2013-EN-F1-1.Pdf>.

<sup>11</sup> COM(2013) 520.

sovereign vicious circle was still viewed as imperative: as the reasoning went, since the cost of addressing “legacy” cases of unviable banks should be borne neither by the ESM nor by national taxpayers, then it must be borne by the banks’ creditors directly. This change of timetable, however, was not based on an observation of the euro-area banks’ balance sheet structures – i.e. the availability, or lack thereof, of subordinated “bail-inable” debt instruments that would prevent the bail-in resulting in losses for senior creditors, which some observers believed (and still believe) might have potentially destabilising systemic impact<sup>12</sup>.

## 2.2 Development and tentative assessment

### 2.1.1. Establishment and initial build-up

The sequence of decisions as outlined above should be kept in mind if the SRB’s somewhat difficult start is to be understood. While in mid-2012 both the SRB and the bail-in instrument were initially planned to be introduced in what was anticipated to be a post-crisis era in 2018, they were ultimately fast-tracked to be available as quickly as possible to help with ongoing crisis management and resolution. This choice helps explaining the fact that the SRB assumed its mandate before being quite ready for it, as was confirmed by the European Court of Auditors (ECA)’s rather harsh early assessment published in December 2017 (ECA, 2017; summarised in Véron, 2018).

The final version of the SRM Regulation<sup>13</sup> stipulated that the SRB “shall become fully operational by 1 January 2015” and that, with some exceptions, the Regulation itself would apply (i.e. the SRB shall acquire its mandatory authority) from 1 January 2016. The SRB Chair, Ms König, was duly appointed in December 2014. But as the 2017 ECA report made plain, a number of critical functions, including proper resolution planning, were not yet in place by the end of the auditing period in mid-2017. Even though the ECA report questioned some prioritisation choices made by the SRB early on, most of this lag must be attributed to unrealistic deadlines set by the SRM Regulation, which was only enacted in July 2014. The ostensible lesson is that for a brand-new EU agency, the time buffer between the legislation’s entry into force and the assumption of full authority may need to be significantly longer than it was in the SRB’s case<sup>14</sup>.

Another complicating factor was the above-mentioned decision in late 2013 to bring forward the applicability of bail-in under BRRD by two years, from early 2018 in the European Commission’s June 2012 proposal to early 2016 in the final version<sup>15</sup>. All things being equal, that decision materially reduced the time for banks to adapt the structure of their balance sheets to the new requirements, and especially to ensure that a sufficient buffer of liabilities deemed comparatively easy to bail-in (or “bail-inable”) would be present to make it very unlikely that senior debt, let alone uninsured deposits, would

<sup>12</sup> The US experience is somewhat ambiguous in this respect. There were hundreds of bank failures managed by the Federal Deposit Insurance Corporation between 2008 and 2013, with a very large one (Washington Mutual) at the start of that period in which senior creditors incurred significant losses. But many of these were small banks with little or no outstanding senior debt, and deposits were protected beyond the minimum coverage threshold, which itself was raised from \$100,000 to \$250,000 in 2008 (FDIC, 2017).

<sup>13</sup> Regulation (EU) 806/2014 of 15 July 2014. The provisions for build-up of the SRF were eventually placed in a separate inter-governmental agreement, signed on 21 May 2014 and available at <https://www.consilium.europa.eu/en/policies/banking-union/single-resolution-mechanism/>.

<sup>14</sup> To be sure, the SSM Regulation was enacted in October 2013, and the SSM assumed its full supervisory authority on 4 November 2014. But the SSM was incubated in-house by the European Central Bank, and that saved considerable time in comparison to the establishment of a new agency. The European Commission played a supportive role in the creation of the SRB, but its capabilities in this area are evidently not comparable to those of the ECB.

<sup>15</sup> Directive 2014/59/EU of 15 May 2014.

have to be bailed-in in the event of the bank being deemed unviable<sup>16</sup>. BRRD Article 45 enjoins resolution authorities (i.e. the SRB for significant euro-area banks) to set Minimum Requirements for own funds and Eligible Liabilities (MREL) that would establish such a buffer<sup>17</sup>.

In practice, the SRB gradually added to its staff, with some difficulty caused by the relatively slow pace of the initial build-up (ECA, 2017; IMF, 2018). Headcount rose from 35 in March 2015 to 116 at end-2015, 182 at end-2016, and 276 at end-2017<sup>18</sup>. The number at end-2018 does not appear to have been published yet, but can be presumed to be close to the envisaged permanent level of slightly above 400. The SRB moved to its current office uphill from Brussels' Cathedral in April 2016, after about a year in a temporary location.

Resolution planning was developed gradually, so that by the end of 2019 for the first time, all banks under the SRB's direct watch will be covered by a resolution plan (König, 2018), and these resolution plans will be developed to become fully-fledged by 2020 (IMF, 2018)<sup>19</sup>. The SRB moved in 2017-18 from setting 'informative' MREL targets to binding consolidated targets for the largest and more complex banking groups under its watch, even as its MREL-setting policy continued to evolve (Deslandes and Magnus, 2018b). It intends to set binding targets for all banking groups within its remit by 2020<sup>20</sup>, and to gradually tighten up its targets for the subordination (or loss-absorbing capacity) of MREL. The Single Resolution Fund had grown to €25 billion by mid-2018, and is expected to reach €33 billion in 2019 (König, 2018). Overall, the non-crisis functions of the SRB can be expected to reach something close to an operational steady state by late 2020 or 2021, well ahead of the SRF's full mutualisation in 2024<sup>21</sup>.

The SRB participates in resolution colleges and crisis management groups for banking groups which have operations in both the euro area and other jurisdictions inside and outside the European Union, and in related coordination exercises or crisis simulations<sup>22</sup>. From 2013 to 2017, SRB Chair Elke König chaired the Financial Stability Board's Resolution Steering Group for two successive two-year terms, thus contributing to knowledge and recognition of the SRB at the global level.

### 2.1.2. Cases of unviable banks involving the SRB

Under Article 7 of the SRM Regulation, the SRB is directly responsible for resolution planning and resolution decisions relating to all banks directly supervised by the ECB (e.g. Significant Institutions under the SSM Regulation), and also to "other cross-border groups" as defined in Article 3(24) of the Regulation<sup>23</sup>. All other (generally smaller) banks in the banking union area are under the watch of national resolution authorities, with some oversight by the SRB.

<sup>16</sup> BRRD Article 44(5)(a) sets a threshold of 8 percent of total liabilities including own funds to be bailed-in before any use of what the BRRD refers to as resolution financing arrangements, such as the SRF.

<sup>17</sup> While resolution planning and the MREL process are very important, however, there can be no certainty that in a real-world crisis there will be no need to bail-in senior creditors or uninsured depositors, depending on the circumstances of the case and the scale of the unviable bank's revealed losses.

<sup>18</sup> Including seconded national experts and Board members. Source: SRB annual reports.

<sup>19</sup> An update as of mid-2018 is provided in both IMF (2018) and Deslandes and Magnus (2018b).

<sup>20</sup> Slide 4 of SRB presentation at the 7<sup>th</sup> SRB-Banking Industry Dialogue Meeting in Brussels, 10 December 2018, available at [https://srb.europa.eu/sites/srbsite/files/7th\\_industry\\_dialogue\\_-\\_mrel.pdf](https://srb.europa.eu/sites/srbsite/files/7th_industry_dialogue_-_mrel.pdf).

<sup>21</sup> For comparative purposes it may be noted that the Bank of England has stated that "the major UK banks are on course to being fully resolvable by 2022" (BoE IEO, 2018).

<sup>22</sup> See e.g. SRB press release on a planned coordination exercise together with the FDIC and other US authorities, UK authorities, the ECB and the European Commission, 5 October 2016, available at <https://srb.europa.eu/en/node/166>; and SRB statement regarding Nordic-Baltic financial crisis simulation, 31 January 2019, available at <https://srb.europa.eu/en/node/722>.

<sup>23</sup> The SRB maintains a public list, counting 13 such groups by the latest update: SRB List of other cross-border groups, Brussels, 1 February 2018, available at [https://srb.europa.eu/sites/srbsite/files/5\\_for\\_publication\\_srb\\_website\\_list\\_of\\_other\\_cross\\_border\\_groups\\_1februar.pdf](https://srb.europa.eu/sites/srbsite/files/5_for_publication_srb_website_list_of_other_cross_border_groups_1februar.pdf).

As of mid-March 2019, the SRB had made public decisions on the following four cases of banks determined to be failing or likely to fail (FOLTF) by the European Central Bank:

- Banco Popular Español (7 June 2017): resolution scheme (sale of business) resulting in the transfer of all shares to the Santander Group;
- Banca Popolare di Vicenza (23 June 2017), Veneto Banca (23 June 2017), ABLV (24 February 2018): decision not to take resolution action<sup>24</sup>.

In all four cases, the decisions made by the SRB were in line with the objective of financial stability. It is improbable that a court-ordered insolvency of Popular would have been fully orderly given the bank's size (nearly €150 billion in total assets by end-2016), notwithstanding multiple ongoing lawsuits arguing that creditors would have ended up better off had the SRB not taken resolution action. In the latter three cases, the lack of resolution action did not result in disorderly developments, even though there is no unanimity in the policy community as to whether a positive public interest assessment by the SRB might have been justified<sup>25</sup>.

Of course, decisions on other bank cases might have been prepared and considered by the SRB, e.g. for banks that came close to being determined FOLTF but eventually were not.

It may also be recorded that a number of other cases of fragile or unviable banks have generated headlines and debate in recent years but have not directly involved the SRB:

- Several cases of bank restructuring that started before the BRRD became applicable (e.g. HSH Nordbank, started September 2011; Cyprus Cooperative Bank, started February 2014; Banco Espírito Santo/Novo Banco, started August 2014) or before the SRB assumed authority (HETA, started March 2015<sup>26</sup>);
- Three cases of precautionary recapitalisation (National Bank of Greece in December 2015, Piraeus Bank in December 2015, Monte dei Paschi di Siena in July 2017): in these, the banks were not determined to be FOLTF;
- Multiple cases of smaller banks which are outside of the direct remit of the SRB, even though the SRB has an oversight role as mentioned above. While a full list of such cases is not publicly maintained, known ones include: Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, and Cassa di Risparmio della Provincia di Chieti (Italy, resolved in November 2015); Cooperative Bank of Peloponnese (Greece, resolved in December 2015); Trasta Komercbanka (Latvia, license withdrawn by the ECB in March 2016); Nemea Bank (Malta, put under public administration in April 2016); a number of Lithuanian credit unions in 2017-18; Versobank (Estonia, license withdrawn by the ECB in March 2018); Banca Sviluppo Economico (Italy, liquidated in April 2018); and Pilatus Bank (Malta, license withdrawn by the ECB in November 2018)<sup>27</sup>.

### 2.1.3. Lessons learned

As previously argued, the bad news for the SRB is that it was granted full authority in early 2016 before being ready for it, with potentially awkward consequences under some crisis scenarios at the time. The good news, however, is that it has displayed a commendable capacity to learn and adapt. This was

<sup>24</sup> In SRB parlance, the Public Interest Assessment was positive in the case of Popular, and negative in the three other cases.

<sup>25</sup> For the two Veneto banks, it must be noted that significant state aid was provided by the Italian authorities, as detailed in Section 3. As for the ABLV case, events did not play out as ostensibly anticipated at the outset. On 9 March 2018 the Luxembourg Commercial Court refused to place ABLV's subsidiary in that country in liquidation, refusing a request from the Luxembourg supervisor as the bank's temporary administrator (ABLV's statement is available at <https://www.ablv.com/en/press/2018-03-09-the-court-recognises-the-soundness-of-ablv-bank-luxembourg-s-a-which-can-now-be-sold-to-new-investors>). On 16 January 2019, ABLV Luxembourg announced its proposed acquisition by the Duet Group, a privately held investment company (statement at <https://www.ablv.com/en/press/2019-01-16-duet-group-acquires-ablv-bank-luxembourg-s-a>), pending regulatory approval.

<sup>26</sup> The applicability of the BRRD to the case of HETA was initially disputed in court, but the corresponding referrals to the EU Court of Justice were withdrawn in 2016 following a financial settlement.

<sup>27</sup> Sources: EBA website (<https://eba.europa.eu/regulation-and-policy/recovery-and-resolution/notifications-on-resolution-cases-and-use-of-dgs-funds>) and media reports.

already evident in its response to the ECA's critical report, sent in December 2017 and published together with the rest of the report that same month (ECA, 2017). Instead of reacting defensively, the SRB acknowledged most of the shortcomings exposed by the auditors, accepted most of the ECA's recommendations and constructively described its past actions and ongoing plans to address them.

The context of this study does not allow for a comprehensive analysis of all challenges and SRB's responses. A few may be highlighted, however.

- First, the SRB has demonstrated its ability to make decisions under time pressure in situations of bank unviability, particularly in the case of Popular (the other decisions, of negative public interest assessment, were comparatively simpler). When the SRB was first established, there were entirely legitimate concerns that the complexity of its formal arrangements for decision-making would be paralysing in crisis situations. In January 2014 during the legislative discussion on the SRM Regulation, one MEP published an SRM decision-making flow chart that became an instant classic in the expert community<sup>28</sup>. On Popular, however, the SRB was able to make and publish a complex decision, not even during the proverbial crisis weekend, but in the middle of a working week. To be sure, the process was not perfect. In the period immediately before the bank was determined by the ECB to be FOLTF because of insurmountable liquidity challenges, SRB communication might have had an impact on developments<sup>29</sup>. The deposit flight was almost certainly accelerated by public reporting of resolution preparations a few days later<sup>30</sup>. The source of that leak remains uncertain, as the SSM and SRM processes involve sharing sensitive information with multiple participants, including representatives of authorities from all euro-area member states and the European Commission. The SRB has now built a dedicated infrastructure for sensitive information-sharing with the aim of reducing the scope for future breaches of confidentiality.
- Second, the SRB has dramatically expanded its communication and cooperation with the SSM, the deficiencies of which were central to the ECA analysis. The symbolic moment for this improvement was the revision on 30 May 2018 of the memorandum of understanding (MoU) between the two institutions (SRB and ECB), the initial version of which was concluded on 22 December 2015<sup>31</sup>. The revised version includes much more granular specification of the information to be shared by the two institutions, and especially information to be automatically provided by the ECB/SSM to the SRB (and by the SRB to the ECB), which is detailed in a new annex. This ensures that the SRB has access to a considerable amount of confidential supervisory information, not least for banks designated as "*priority entities*". This category, also introduced in the 2018 MoU revision and roughly equivalent to the US Federal Deposit Insurance Corporation (FDIC)'s "*problem banks*", is defined in paragraph 3.2(g) of the revised MoU as "*(i) an Entity in a distressed situation in respect of which the ECB has triggered its internal crisis management arrangements; or (ii) an Entity with a Supervisory Review and Evaluation Process (SREP) score of 4 or a SREP score of 3 in combination with a sub-score of 4*"<sup>32</sup>. As of mid-2018, the IMF assessment team concluded that "*information exchange*

<sup>28</sup> Available at [https://sven-giegold.de/wp-content/uploads/2014/01/SRM\\_Machine\\_DE.jpg](https://sven-giegold.de/wp-content/uploads/2014/01/SRM_Machine_DE.jpg); English version at <https://sven-giegold.de/single-resolution-board-commits-to-report-about-obstacles-to-resolution-in-national-and-eu-legislation/>. The International Monetary Fund has a less explicitly sarcastic but still daunting version (IMF, 2018, Box 6).

<sup>29</sup> Interview of the SRB Chair on Bloomberg TV, 23 May 2017, available at <https://www.bloomberg.com/news/videos/2017-05-23/single-resolution-eu-shouldn-t-be-bailing-banks-video>.

<sup>30</sup> Francesco Guarascio, "EU warned of wind-down risk for Spain's Banco Popular – Source", *Reuters*, 31 May 2017, available at <https://uk.reuters.com/article/uk-banco-popular-m-a-eu-idUKKBN18R25M>. The SRB published a statement on the same day in response to the Reuters article, available at <https://srb.europa.eu/en/node/312>.

<sup>31</sup> The 2015 version is available on the SRB's website at

[https://srb.europa.eu/sites/srbsite/files/en\\_mou\\_ecb\\_srb\\_cooperation\\_information\\_exchange\\_f\\_sign\\_.pdf](https://srb.europa.eu/sites/srbsite/files/en_mou_ecb_srb_cooperation_information_exchange_f_sign_.pdf), and the 2018 version at [https://srb.europa.eu/sites/srbsite/files/mou\\_with\\_the\\_single\\_resolution\\_board\\_on\\_cooperation\\_and\\_information\\_exchange\\_2018\\_.pdf](https://srb.europa.eu/sites/srbsite/files/mou_with_the_single_resolution_board_on_cooperation_and_information_exchange_2018_.pdf).

<sup>32</sup> The SSM's SREP scores are functionally comparable to CAMELS ratings in the United States (CAMELS stands for Capital adequacy, Assets, Management capability, Earnings, Liquidity, Sensitivity). The SREP methodology includes four elements: (1) business model assessment; (2) governance and risk management assessment; (3) assessment of risks to capital; and (4) assessment of risks to liquidity and funding.



*between the ECB and the SRB has worked well in normal times*" (IMF, 2018, paragraph 64). The ECB also has observer status in SRB meetings<sup>33</sup>.

- Third, The SRB has ramped up its capacity to respond to litigation and claims. This is partly a response to the developments arising from the Popular case, in the wake of which the SRB has been the target of dozens of lawsuits<sup>34</sup>. ABLV also sued the SRB in 2018<sup>35</sup>. The SRB has built up its own infrastructure to enable stakeholders to express their views in accordance with their "right to be heard"<sup>36</sup>, through which it had received around 12,000 expressions of interest by late 2018 (König, 2018).

With all this in mind, many of the challenges the SRM could face, and the SRB's ability to address them satisfactorily, remain untested. The SRB has issued only four decisions in concrete unviable bank cases, of which three were simple and the fourth (Popular) was itself not the most complex possible (despite the quite large size of the bank), since no senior liabilities required bail-in, there was no apparent difference of views between the SRB and the home-country national authorities, and there was a ready buyer<sup>37</sup>.

In future cases, the SRB might have to bail in senior debt as part of a resolution scheme, an action for which there are few precedents in the euro area and none in the context of the BRRD. It might have to manage severe tensions with national authorities, possibly including national resolution authorities in home and potentially also host countries. It might have to spend money from its Single Resolution Fund, which until now has remained pristine. It may have to manage assets and activities inherited from a resolution process for an extended period of time, a situation which inherently generates potential for controversy. And it might need to manage multiple unviable bank situations simultaneously<sup>38</sup>. The SRB's learning journey has barely started.

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<sup>33</sup> The SSM Supervisory Board's observer to the SRB has been Sabine Lautenschläger in 2015-16, then Ignazio Angeloni up to early 2019.

<sup>34</sup> Francesco Guarascio, 'Investors file 51 lawsuits against EU for shutting Banco Popular', *Reuters*, 30 August 2017, available at <https://www.reuters.com/article/bancopopular-ma-investors/investors-file-51-lawsuits-against-eu-for-shutting-banco-popular-idUSL8N1LF3BA>.

<sup>35</sup> See LSM.lv Public Broadcasting of Latvia, 'ABLV bank wants European court ruling on legality of shutdown', 7 May 2018, available at <https://eng.lsm.lv/article/economy/banks/ablv-bank-wants-european-court-ruling-on-legality-of-shutdown.a277433/>.

<sup>36</sup> A dedicated section of the SRB website is available in English and Spanish at <https://srb.europa.eu/en/content/banco-popular-right-be-heard>.

<sup>37</sup> In the months preceding its failure, Banco Popular explored the possibility of its sale to another banking group and opened a data room for due diligence by several potential acquirers, including Santander.

<sup>38</sup> A detailed picture of the complexity of decisions involved in large-scale resolution activity is provided in FDIC (2017).

## 3. SELECTED AREAS FOR SCRUTINY

### 3.1 Context

Scrutiny of the SRB takes place in a fast-moving environment. The banking union's unviable bank regime, which the SRB was created to serve, is in flux<sup>39</sup>.

- First, as Section 2 made clear, many pieces of the comprehensive reform adopted at EU level in 2012-14 are still falling into place. The initial build-up of MREL is underway but far from complete with implications for SRB choices in future unviable bank situations. The SRF is being gradually built up and mutualised up to 2024. The ESM backstop to the SRF, agreed in principle in 2013<sup>40</sup> and specified in more detail in 2018<sup>41</sup>, might not be in force before 2024 – and even then will remain constrained and limited in size. The challenge of ensuring sufficient liquidity for banks in resolution is being actively discussed but has not yet received a satisfactory policy response (e.g. IMF, 2018; Deslandes and Magnus, 2018a; Demertzis *et al*, 2018). The legislative banking package adopted in early 2019 also alters some aspects of the regime as it includes revisions of both the BRRD and the SRM Regulation, which will become applicable only gradually.
- Second, the regime for unviable banks is not only a matter of legislation and regulation, but also of practice and jurisprudence. The SRB's future decisions in response to unviable bank cases will be partly shaped by the still-ongoing judicial review of the decisions it has made so far, particularly those on Popular. Future SRB decisions will also depend on policy decisions made by individual member states, not least on the provision of state aid to banks<sup>42</sup>. And of course, they will depend on the behaviour of banks themselves and supervisory decisions taken by the ECB, determining the future occurrence of unviable bank cases about which the SRB will have to take decisions.
- Third, the context for future SRB activity will be materially affected by the development of EU state aid control in the banking sector. Even though state aid decisions are made on a case-by-case basis<sup>43</sup>, the European Commission's stance on this has been signposted in successive banking communications. The most recent of these, from summer 2013<sup>44</sup>, specifies (paragraph 5) that: *"the persistence of tensions in sovereign debt markets forcefully illustrates the continued volatility in financial markets. The high level of interconnectedness and interdependence within the financial sector in the Union continues to give rise to market concerns about contagion. The high volatility of financial markets and the uncertainty in the economic outlook and the resulting persistent risk of a serious disturbance in the economy of Member States justifies maintaining, as a safety net, the possibility for Member States to grant crisis-related support measures on the basis of Article 107(3)(b) of the Treaty in respect of the financial sector."* This description was certainly apt in mid-2013, but whether it applies to current and future market conditions is debatable, with potentially significant implications for future state aid decisions. This could affect, among others, decisions on state guarantees on bank liabilities (as mentioned in the previous point), or liquidation aid such as that provided in the

<sup>39</sup> This analysis, and corresponding policy recommendations, will be further developed in the forthcoming study on the unviable bank regime, referred to in the Introduction. Of course, the banking union is a subset of the regime in the European Union and European Economic Area more broadly. The consequences of Brexit, in particular, while potentially significant, are left out of this discussion given the uncertainty about the UK's future situation at the time of writing. The intricacies of the potential geographical expansion of the banking union beyond the euro area through close cooperation are also left aside.

<sup>40</sup> Statement of Eurogroup and ECOFIN Ministers on the SRM backstop, 18 December 2013, available at <https://www.consilium.europa.eu/media/21899/20131218-srm-backstop-statement.pdf>.

<sup>41</sup> Terms of reference of the common backstop to the Single Resolution Fund, 4 December 2018, available at [https://www.consilium.europa.eu/media/37268/tor-backstop\\_041218\\_final\\_clean.pdf](https://www.consilium.europa.eu/media/37268/tor-backstop_041218_final_clean.pdf).

<sup>42</sup> For example, and to state the obvious, the fact that Italy in 2017 had a policy of providing guarantees on new bank liabilities, which Spain did not have, made a very significant difference between the respective treatments of the failures of the two Veneto banks on the one hand and of Popular on the other hand. The Italian bank guarantee scheme was approved by the European Commission on 26 June 2016 (state aid decision C(2016) 4095, available at [http://ec.europa.eu/competition/state\\_aid/cases/264903/264903\\_1952481\\_84\\_2.pdf](http://ec.europa.eu/competition/state_aid/cases/264903/264903_1952481_84_2.pdf)).

<sup>43</sup> As confirmed by the Court of Justice of the European Union's judgment in Case C-526/14: press release No. 80/16, Luxembourg, 19 July 2016, available at <https://curia.europa.eu/jcms/upload/docs/application/pdf/2016-07/cp160080en.pdf>.

<sup>44</sup> 2013/C 216/01, available at [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013XC0730\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013XC0730(01)&from=EN).

insolvency of the two Veneto banks and as approved by the European Commission<sup>45</sup>. One of the SRB board members observed that a lesson learned in the Veneto experience is that currently “*state aid is possible in liquidation but not in resolution*”<sup>46</sup>. Whether and how this changes in the future is a critically important space to watch.

- Fourth, the unviable bank regime could potentially be subject to more comprehensive reform in the not-necessarily-distant future. The granting to the SRB of administrative authority to liquidate banks beyond the existing BRRD resolution framework, in place of the current “*normal insolvency proceedings*” defined in national law, has been advocated by the IMF (2018), and the SRB chair has called for “*an EU [bank] liquidation regime alongside an EU resolution regime*” (Deslandes *et al*, 2019). Such a reform might be considered on the basis that the outcomes of unviable bank cases since 2015 do not necessarily correspond to the original intent of the BRRD legislators. Furthermore, in November 2015 the European Commission made a legislative proposal for EDIS, which suggests that the European scheme should be operated by the SRB, but the corresponding legislative discussion has not yet delivered a positive outcome.

### 3.2 Ongoing developments

Continued scrutiny is desirable, by the European Parliament and other stakeholders, to ensure that the SRB keeps learning and improving its practice on its ongoing tasks. Echoing the observations made in Section 2, relevant aspects include:

- Resolution planning, which still has to lead to fully-fledged plan under the SRB’s staged process, and has to ensure effective resolvability of all banks within the SRB’s remit;
- MREL setting, incorporating the latest legislative changes to the BRRD, to ensure that there is sufficient loss-absorbing capacity in the banks’ balance sheet structures to ensure credibility of bail-in scenarios;
- Oversight of national authorities’ planning and resolution activity on smaller banks not directly within the SRB’s remit;
- The SRB’s interaction with the SSM, under which the ECB needs to provide information of sufficient extent and quality to ensure that the SRB can duly fulfil its mandate;
- Further development of the SRB’s cooperative relationships and joint work in resolution colleges and crisis management groups for banks with activities beyond the euro area, in accordance with relevant global standards and best practices;
- Development of greater transparency, in line with best practices such as those observed e.g. in the UK and United States where generally more information is publicly available on banks’ resolution arrangements than is the case in the euro area, and incorporating the full lessons of successive developments in the Popular case<sup>47</sup>.

### 3.3 FOLTF Determination Mandate

The SRB, as set out in Article 18(1) of the SRM Regulation, may determine a bank to be FOLTF “*on its own initiative*”, i.e. in the absence of such a determination by the ECB. This is a key competence of the SRB. It is substantially comparable to the US Federal Insurance Deposit Corporation’s “self-appointment authority”, which is rarely used<sup>48</sup> but whose possibility is occasionally leveraged by the FDIC in its

<sup>45</sup> European Commission press release, Brussels, 25 June 2017, available at [http://europa.eu/rapid/press-release\\_IP-17-1791\\_en.htm](http://europa.eu/rapid/press-release_IP-17-1791_en.htm).

<sup>46</sup> Mauro Grande, ‘Lessons learnt from first bank crisis cases in the Banking Union (2016-2018)’, presentation at the Wolpertinger Conference 2018, 27 August 2018, available at [http://www.wolpertinger2018.unimore.it/wp-content/uploads/2018/09/Mauro\\_Grande\\_SRB\\_30082018Modena.pdf](http://www.wolpertinger2018.unimore.it/wp-content/uploads/2018/09/Mauro_Grande_SRB_30082018Modena.pdf). Any use of the SRF, however, is also subject to state aid control.

<sup>47</sup> In June 2018, the SRB was led to disclose additional documents related to Popular following decisions by its Appeal Panel: see statement at <https://srb.europa.eu/en/node/574>. Transparency requirements will also be modified by the latest legislative changes to the BRRD. Unfortunately, the limited time available for this study has not allowed for an in-depth analysis of the cross-jurisdictional differences in transparency practices.

<sup>48</sup> One example is the case of Meridien Trust and Safe Deposit Company in Connecticut, closed by the FDIC in July 1999: press release available at <https://www.fdic.gov/news/news/press/1994/pr9441.html>.



interaction with other supervisors. At least partly to support the SRB's FOLTF determination mandate, Article 36 of the SRM Regulation grants the SRB authority to conduct on-site inspections of individual banks, comparable to the FDIC's "special examination authority" under which (in the FDIC's own description) "*the FDIC regularly monitors the potential risks at all insured institutions, including those for which it is not the primary federal supervisor*". In the FDIC's case, that authority in supplement to the primary supervisor is often referred to as being the banking system's "backup supervisor"<sup>49</sup>.

The SRB has not yet made any such FOLTF determination by itself, and nor is there any indication it has conducted any on-site inspections. The extent to which it has developed the capability to do so is hard to assess on the basis of public information<sup>50</sup>. The ECA (2017, paragraph 141) stated that "*the SRB has not yet established a framework for assessing whether a bank is failing or likely to fail*." In its December 2017 response included in the ECA report, the SRB stated that "*it is actively preparing its policy in this area*" and noted that "*the SRB's role with regard to the declaration of FOLTF is important as a safeguard within the system to minimise supervisory forbearance*". Simultaneously, however, the SRB sent a mixed message about the importance it assigns to this aspect of its authority, mentioning "*the need to avoid developing overlapping assessments which would lead to it acting as a shadow supervisor*" and the fact that "*the primary responsibility to undertake such assessment lies with the supervisor, who has best access to all relevant information*"<sup>51</sup>.

Similarly, the IMF (2018) recommended "*operationalising its [the SRB's] FOL[T]F powers*" (recommendation 26(i), page 8) and referred (paragraph 47) to a future moment "*when the SRB actively starts fulfilling its FOL[T]F back-up authority*", noting that "*it will require additional staffing*" to that end. The IMF also drily noted (paragraph 54) that "*the parameters for SRB on-site inspections should be clarified*."

The experience of the FDIC backup supervisory authority suggests that the SRB could establish an effective capability for FOLTF determination without harmful or wasteful duplication. The SRB's apparent concern to avoid unnecessarily replicating the work of the ECB in this area is commendable, and there is no need for the SRB to develop a parallel and equivalent process to the existing SREP. As previously noted, the SRB now has access to extensive SREP information. But it is also important that, on the basis of the information available from the SREP and other sources, the SRB is able and willing to form its own independent judgment on whether a bank is FOLTF. In the case of the Veneto banks, for example, it is an open question whether the ECB waited too long before making its FOLTF determination in late June 2017. An independent view from the SRB early on might have led to a better outcome. To be sure, a more active stance on FOLTF determination would potentially create scope for legal challenges to the SRB's decisions, and might also entail the occasional difference of views with the ECB. None of this, however, would justify the SRB not fulfilling its significant responsibility in this area, as established by the SRM Regulation.

<sup>49</sup> Description of the FDIC's Supervision Program, available at <https://www.fdic.gov/about/strategic/strategic/supervision.html>. Further granular description of the FDIC's backup supervisory activity is in FDIC (2017). Unlike the SRB, the FDIC also directly supervises a number of US banks, but these represent a relatively small share of the US banking system's total assets.

<sup>50</sup> The SRB's Work Programme for 2019 includes a paragraph on on-site inspections (OSIs): "*In 2019 the SRB will start putting in place an operational guidance for the OSIs for resolution purposes with a view to building over time an in-house capacity while cooperating at the same time with the ECB to reap potential synergies in this domain. OSIs can be used not only for resolution action but also in relation to resolution planning*." (SRB, 2018)

<sup>51</sup> It is not clear that the SRB's references to avoiding the role of "shadow supervisor" and of the "primary responsibility" of the supervisor for FOLTF determinations refer to any particular specifications of EU law. Article 34 of the SRM Regulation only mentions a requirement of "making full use of all of the information available to the ECB or to the national competent authorities".

### 3.4 Crisis Preparedness

As noted in Section 2, the SRB has so far taken resolution action in only one case, that of Popular. Meanwhile, a lot of SRB work goes into resolution planning, and rightly so. But for all its critical importance, resolution planning may be viewed as being to resolution action broadly what military planning is to military operations. As Prussia's (later Germany's) Field Marshal von Moltke famously observed in his 1871 treatise *On Strategy*, "no plan of operations extends with any certainty beyond the first contact with the main enemy force." The ongoing resolution planning effort, accordingly, should not be the only dimension of SRB preparedness for future unviable bank cases.

It is critical for the SRB to constantly hone the skills it might need to mobilise without advance notice in future crisis situations. This is particularly true of legal, financial ("deal-making") and asset-management capabilities, which can be outsourced only to some extent. The experience of the FDIC, in particular, with all due awareness of the differences between the contexts in Europe and America, offers valuable lessons on the balance to be kept between cost control in non-crisis times and availability of skills when needed, and how to manage this inherently difficult trade-off (FDIC, 2017).

One important and difficult challenge is for the SRB to have some advance understanding of potential buyers of bank businesses and assets so it does not miss an opportunity to attract the best/highest bidder in a future time-constrained sale process, while of course ensuring a level-playing field and avoiding any undue special treatment. The universe of potential buyers includes European and non-European banking groups and investment funds. Given the absence of prior experience, it is probably inevitable that for the SRB to get this task right, some learning by doing will be involved, but the SRB should do all it can to ensure it learns quickly.<sup>52</sup>

Another potential challenge is to ensure that the SRB and the European Commission's state aid enforcement (led by the Directorate-General for Competition Policy, or DG COMP) are highly coordinated in future cases of unviable banks that might involve state aid. The IMF (2018, paragraph 67) mentions that "The SRB appears to have a close working relationship with the Commission (DG FISMA and DG COMP), which is reinforced by the Commission having a permanent observer on the SRB's Executive Session and Plenary. Nevertheless, the SRB and the Commission have been working on their MOU for several years and are encouraged to sign the arrangement as soon as possible." All these challenges would be compounded in the event of a systemic crisis involving multiple simultaneous or near-simultaneous cases of unviable banks. It is not evident that the SRB is prepared for the potentially dramatic expansion of activity that this could entail, including the possibility of having to directly manage sizeable banks for an extended period of time, with all the difficult and occasionally controversial operational decisions this would entail. Furthermore, in some systemic crisis scenarios there could be a greater need for resolution action on unviable banks which in normal times might have been left to normal insolvency proceedings, e.g. smaller banks within the SRB remit.

At the FDIC, the full-time staff of the Division of Resolutions and Receiverships expanded from about 250 at the time of Lehman Brothers' bankruptcy to more than 2,000 two years later, over four-fifths of which were on temporary contracts. The FDIC observed that "it took time to search for, hire, and train new staff while also abiding by the various procedures and mandates related to hiring federal employees (...) one can see that more-robust pre-crisis readiness planning may help reduce such delays in the future" (FDIC, 2017, page 204 and Figure 6.4.). Similarly, while it is obviously impossible to make specific advance hiring plans, the SRB should ensure that no unnecessary obstacles will stand in the way if it needs to unexpectedly mobilise new resources in a future crisis episode.

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<sup>52</sup> Here too there is a lot to be learned from the FDIC experience. The FDIC maintains a permanent web page to market troubled institutions, at <https://www.fdic.gov/buying/franchisemarketing/index.html>.

### 3.5 Governance

The SRB's governance framework has strengths, not least its compact Executive Session format which appears well-suited for an independent financial authority. But it also has potential shortcomings, which can only be addressed by future changes in the SRM Regulation.

As noted in Section 2, the SRB decision-making process is complex and involves vetting of individual decisions on resolution schemes by the European Commission (in addition to its above-mentioned observer status), and potentially also the Council, if the Commission does not endorse the SRB's stance. This complexity did not prevent it from acting quickly in the case of Popular, even though the multiplicity of participants involved might have been an enabler of the leak that contributed to the chain of events that led to that bank's FOLTF determination. But the SRB's decision-making dependence on third parties for individual resolution decisions, as established by the SRM Regulation, is not satisfactory.<sup>53</sup> The IMF (2018, paragraph 34) wrote that "*structures for resolution decision-making are inconsistent with the SRB's full operational independence and are complex and potentially lengthy*", implying that such structures might put the SRM in breach of the Financial Stability Board's 'Key attributes of effective resolution regimes'<sup>54</sup>.

It is a matter of debate among legal experts what scope there is for enhancing the SRB's decision-making independence, i.e. reducing or entirely phasing out the involvement of the European Commission and/or Council for decisions on individual cases, within the current EU Treaties' framework. For this study's purposes, suffice to say that the EU Court of Justice's revision of the *Meroni* jurisprudence in 2014<sup>55</sup> is viewed by many scholars as having clarified the extent of the powers EU agencies (such as the SRB) have to make binding decisions that do not amount to general policy-setting. On a policy level, there is a certain chicken-and-egg quality to this issue. The more the SRB asserts itself as a competent and independent agency, the more scope there could be for relaxing the external checks on its decision-making that were enshrined in the SRM Regulation; but its ability to act independently also depends on its current legal decision-making framework, and could be impaired by these same checks.

A separate governance challenge is the SRB's current reliance on National Resolution Authorities (NRAs). To a certain extent, this mirrors the organisation of the SSM (though importantly not for decisions on individual bank cases, which the SRB makes in executive session), which is also paralleled in the SRM's operational arrangements, for which Internal Resolution Teams have been set up along similar lines to the SSM's Joint Supervisory Teams<sup>56</sup>. But the comparison might not be apt, because the SRB's activity of dealing with unviable banks is much more episodic than prudential supervision (which is a near-permanent process) and thus entails a different trade-off between the various requirements for specialised expertise, resource effectiveness and embeddedness in local environments. The diversity of national legal frameworks for bank resolution is not a compelling argument for the current

<sup>53</sup> By contrast, the FDIC makes its decisions autonomously in cases of bank resolution. Only when exercising its Orderly Liquidation Authority, established by Title II of the Dodd-Frank Act of 2010, is FDIC decision-making subject to a 'three keys' approval process also involving the Treasury Department and Federal Reserve System. This authority is only for cases of very systemically important entities, and has never been used yet, suggesting that its intended remit is more limited than that of resolution action by the SRB under the BRRD. See for example Reuters Credit Markets, 'Factbox: How Dodd-Frank's orderly liquidation regime works', 28 February 2011, available at <https://www.reuters.com/article/us-finance-summit-liquidate-factbox-idUSTRE71O6EQ20110228>.

<sup>54</sup> FSB (2014), paragraph 2.5: "*The resolution authority should have operational independence consistent with its statutory responsibilities, transparent processes, sound governance and adequate resources*".

<sup>55</sup> Judgment of 22 January 2014 in the Case C-270/12, often referred to as 'ESMA short selling': available at [https://eur-lex.europa.eu/legal-content/en/TXT/PDF/?uri=uriserv%3A0J.C\\_.2014.085.01.0004.01.ENG](https://eur-lex.europa.eu/legal-content/en/TXT/PDF/?uri=uriserv%3A0J.C_.2014.085.01.0004.01.ENG).

<sup>56</sup> Described on the ECB's website at <https://www.bankingsupervision.europa.eu/banking/approach/jst/html/index.en.html>.

architecture, since there are precedents of EU agencies making decisions on the basis of non-converged national law including in the financial services area<sup>57</sup>.

Nor is it evident that the current division of authority, under which the SRB decides on a resolution scheme but its execution is entrusted to the NRAs under monitoring by the SRB (Article 28 of the SRM Regulation) will be conducive to optimal resolution outcomes<sup>58</sup>. In the case of Popular, the Spanish NRA and the SRB appeared broadly aligned in their decision-making, but it is not difficult to imagine cases in which a NRA would not agree with the SRB's stance. Moreover, the cases so far, including those of the two Veneto banks and of ABLV, suggest that BRRD resolution might only ever be applied to banks above a certain threshold of significance at the European level, which is somewhat higher than that for Significant Institutions under the SSM Regulation, and such banks are to be found only in a subset of member states. Finally, the maintenance of a network of NRAs is costly for individual member states and for the banking union as a whole.

As the SRB further builds its profile and credibility, the role of NRAs in resolution decision-making, and in the governance of the SRB itself, may be beneficially curtailed or entirely phased out in future reviews of the SRM regulation and of the broader unviable bank regime. In the medium term, a consolidation of the functions currently carried out by NRAs within the SRB itself, i.e. substituting them with national offices of the SRB, might be envisaged<sup>59</sup>.

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<sup>57</sup> For example, the ECB's supervisory decisions on so-called fit-and-proper executives and on early intervention.

<sup>58</sup> The ambiguity of this arrangement is reflected in the wording of Recital 11 of the SRM Regulation, whose first sentence reads: *"For participating Member States, in the context of the Single Resolution Mechanism (SRM), a centralised power of resolution is established and entrusted to the Single Resolution Board established in accordance with this Regulation ('the Board') and to the national resolution authorities."* There is an apparent tension between the claim of "a centralized power" and the fact that it is simultaneously "entrusted" to multiple authorities.

<sup>59</sup> This point is obviously related to the debate on bank insolvency law harmonisation, and will be further developed in the forthcoming study of the unviable bank regime referred to in the Introduction.

## 4. CONCLUSION

The conclusion of this study is that the SRB's trajectory is still at a very early stage, and that the journey so far has been challenging but encouraging. The general architecture of the system, including the SRB's establishment as an authority separate from the prudential supervisor, has withstood its first few tests despite widespread initial scepticism. The SRB had a difficult start in 2015-16 and has not yet completed its initial build-up, as attested by still-unfinished work on resolution planning and MREL-setting. But it has displayed an ability to learn and adapt, and has considerably gained in stature following its first decisions on individual cases of unviable banks in 2017 and 2018.

Evidently, the SRB's future cannot be separated from that of Europe's banking union and of its broader unviable bank regime. As analysed in Section 2 of this study, the two are related but distinct: the BRRD was proposed before banking union started. But they are interrelated, and both are still works in progress. Completing the banking union entails breaking the bank-sovereign vicious circle, which in turn requires reducing concentrated home-country sovereign exposures in banks' balance sheets, creating an EDIS that insures all euro-area deposits identically, and removing the current obstacles to the free allocation of capital and liquidity by banking groups across intra-euro-area borders. Meanwhile, the dependence of the unviable bank regime on divergent national insolvency proceedings, with a lower observed occurrence of BRRD resolution than might have been the legislators' intent, could lead to an in-depth reconsideration. And to the extent that the current regime leaves ample scope for expending national public financial resources in future unviable bank cases, it also contributes to perpetuating the bank-sovereign vicious circle.

In the meantime, the SRB should continue to build up its capabilities, and keep a sense of urgency about fulfilling the full extent of its mandate so that it is not caught unprepared in the event of a future crisis. If the SRB is able to properly handle the next cases of unviable banks in the banking union, whatever and whenever these may be, and to use its existing authority to the extent made necessary by the circumstances, it has the potential to become a credible, globally-respected authority on a par with the US FDIC. That would be no mean achievement.

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The Single Resolution Board (SRB) has had a somewhat difficult start but has been able to learn and adapt, and has gained stature following its first bank resolution decisions in 2017-18. It must continue to build up its capabilities, even as the European Union's banking union and its policy regime for unviable banks continue to develop. Specific areas identified for parliamentary scrutiny include the SRB's authority to determine a bank as failing or likely to fail; its crisis preparedness beyond the ongoing process of resolution planning; and its governance and operational independence. This document was provided by the Economic Governance Support Unit at the request of the ECON Committee.

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