THE SINGLE BANKING RESOLUTION MECHANISM

Antonio Carrascosa (*)

(*) Antonio Carrascosa is board member of the Single Resolution Board. While this article is based on the Board's public documents, the opinions expressed in it are exclusively the author's and do not represent those of the SRB.

Abstract

The European authority in the field of banking resolution is the Single Resolution Board (SRB), in collaboration with the national resolution authorities. The resolution of a bank involves its restructuring by this Board, through a series of instruments aimed at ensuring the continuity of the institution's critical functions and financial stability in one or several Member States. This article describes the basic characteristics of the Single Banking Resolution Mechanism. Aspects relating to its mission, governance and organisation are first set out. A description that follows of the substantive elements of a resolution plan, namely public interest, critical functions, resolution strategies and instruments, the analysis of a bank's resolvability and the identification of obstacles to resolution. The author also explains the setting of a minimum level of eligible liabilities (MREL) and describes the functioning of the Single Resolution Fund. Lastly, a summary is given of the SRB's activity since it was established in 2015, and the ongoing legislative reforms under the European resolution framework are set out.

1 Introduction

The 2008 financial crisis severely impacted the European banking system, prompting sizeable public aid. In some countries, what began as a banking crisis promptly became a public solvency crisis. The G20, in numerous meetings, backed the initiatives of the Financial Stability Board (FSB) in order to lessen the likelihood of the crisis and its impact affecting global systemic financial institutions. In 2009, the authorities of the most developed countries launched a new paradigm in the management of banking crises. There was a switch back from implicit public guarantees and bail-outs using taxpayers' money towards market discipline, where shareholders and creditors play a predominant role in loss-absorption and in the possible recapitalisation of banks, and where contributions to the banking system as a whole are demanded when banks require external funds.

Against this background, the European Union launched the Banking Union for the 19 euro area countries and approved the regulatory framework for banking resolution: the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR)[1]. The Single Resolution Mechanism (SRM) was established, under the management of the SRB and the national resolution authorities (NRAs), setting in place the second pillar underpinning the Banking Union.

The first pillar is the Single Supervisory Mechanism (SSM), managed by the European central bank (ECB) and the competent national authorities; the third pillar is still under construction and concerns the European Deposit Insurance Scheme (EDIS).

2 Mission, governance and functions of the SRM

The mission of the SRM is to ensure orderly resolution of a failing bank with the least possible impact on the real economy and public finances of the Member States of the Banking Union and of the rest of the countries affected, ensuring overall financial stability.

To fulfil its mission, the SRB cooperates closely with the NRAs. As regards its powers, the SRB is directly responsible for significant banks and cross-border banking groups.

1 Directive 2014/59/UE of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010, and (EU) No. 648/2012, of the European Parliament and of the Council Text. Official Journal of the EU of 12.6.2014.

The NRAs are directly responsible for the other banks and for investment services firms, although the SRB may, in specific circumstances, assume these powers. The SRB likewise performs the function of overseeing the monitoring the NRAs' decisions on less significant institutions, promoting the application of uniform criteria throughout the Banking Union.

The SRM's mission may be specified in terms of its objectives and tasks. In principle, the main objectives of bank resolution (and, therefore, of the SRM) are the following (Article 14 of the SRMR):

- to ensure the continuity of the critical functions performed by the bank under resolution;

- to prevent significant adverse effects on the financial system;

- to protect public funds;

- to protect depositors; and

- to protect customer assets and funds.

The SRM is made up of the SRB and the NRAs. All the NRAs of the member countries of the Banking Union participate in the Plenary Session of the SRB, along with the six permanent SRB members, and with the European Commission and the ECB as permanent observers. The competencies of the Plenary Session are as follows:

- the approval each year of the SRB budget, work programme and accounts;

- in the event of a bank's non-viability, the approval of a resolution scheme if funds from the mechanism of over €5 billion are needed, or if over a 12-month period this amount has been exceeded, with several resolution schemes;

- authorisation to raise extraordinary ex post contributions, loans between SRF compartments and alternative funding with third parties;

- approval of the SRF's investment policy;

- approval of the cooperation framework between the SRB and the NRAs;

- other organisational and internal regime measures stipulated in Article 50 of the SRMR.

The SRB Executive Session comprises the six permanent members and the aforementioned observers. Its main competencies are the approval of the resolution plans of the banks under its responsibility (including the MREL) and its resolution schemes (which require the backing of the European Commission and approval, where appropriate, of the Council). In those decisions requiring an Extended Executive Session, i.e. the participation of the NRAs, when there is no consensus among members, only the permanent members of the SRB vote and the decision is adopted by simple majority.

GENERAL REQUIREMENTS OF A RESOLUTION

BOX 1

The legal framework demands that a resolution meet the following requirements:

- the shareholders of a bank should bear, firstly, the losses;
- the creditors should bear losses after the shareholders and following the priority of creditors that is established for ordinary insolvency proceedings;
- the bank's board of directors and senior management should be replaced, except in justified cases, and duly cooperate towards achieving the objectives of the resolution;
- natural and legal persons shall answer for the responsibilities incurred in the bank's failure;
- the deposits covered shall be fully safeguarded;
- the bank's former shareholders and creditors should incur no more losses than those they might have incurred in the event of liquidation.

The main tasks of the SRM are as follows:

- to draw up the resolution plans of all Banking Union banks;
- to set the minimum level for eligible liabilities (MREL) for these banks;
- to assess banks' resolvability and the removal of the attendant obstacles;
- to approve and apply resolution schemes for failing banks;
- to manage the resolution funds.

3 Basic elements of a resolution: non-viability of a bank, public interest and general requirements

The resolution of a bank involves the intervention by the related resolution authority to ensure the continuity of its critical functions and the financial stability of the Member State where the bank is operating.

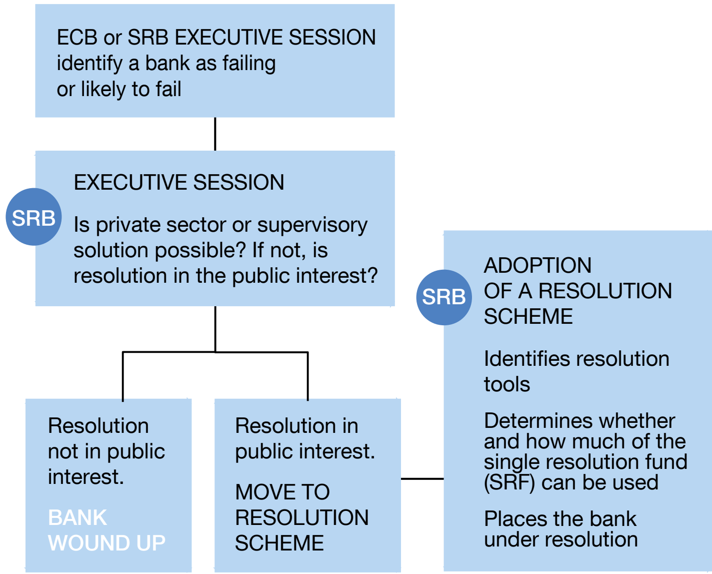
The resolution of a bank is the outcome of a decision by the competent authority, and on condition that three cumulative conditions are given: that the bank is failing, or is likely to fail; that there is no private solution or supervisory action that may restore the bank's viability within a reasonable timeframe; and that the resolution is necessary, owing to public interest.

Both the BRRD and the SRMR stipulate that the resolution of the bank is only fitting if there is public interest in that resolution; that is to say, resolution will proceed if the liquidation of the bank, following national insolvency rules, were to endanger the critical functions it provides and, thereby, financial stability.

Article 18.4 of the SRMR states that a bank is failing or likely to fail (FOLTF) if any of the following circumstances arise: the bank has infringed (or is likely to infringe in the near future) the requirements for retaining its authorisation; the bank's assets are lower than its liabilities (or are likely to be shortly); the bank cannot meet the payment of its debts or

RESOLVING FAILING BANKS

SCHEME 1



SOURCE: SRB.
Note: For simplicity, the role to play by the European Commission and the Council is not included in the scheme.

liabilities on their due date (or is likely to be unable to do so in the near future); and the bank requires extraordinary public aid (except in given situations stipulated by the SRMR in this same article). Scheme 1 sets out SRB decision-making for the resolution of a bank.

4 Resolution plans

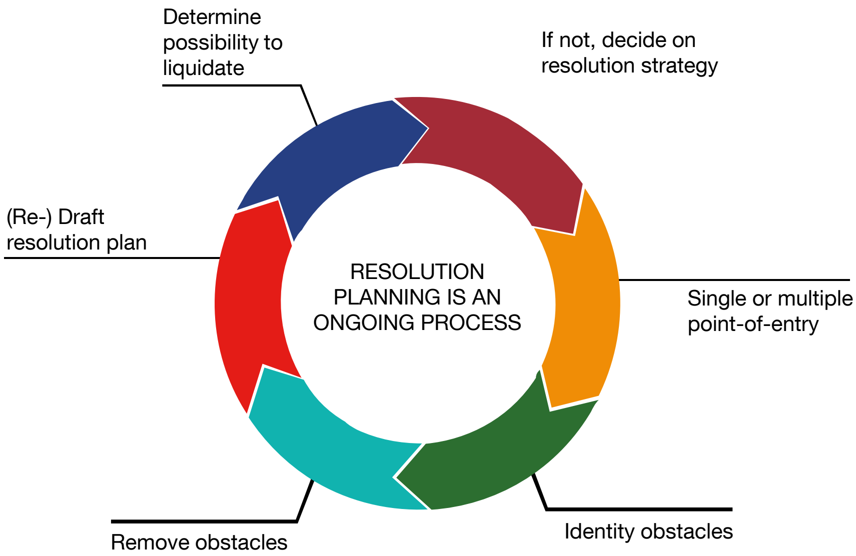
Resolution planning is one of the SRM's main tasks and is a cornerstone of the new bank resolution approach. This planning seeks, on one hand, to understand in detail a bank's operations and, on the other, to identify and manage any obstacle to its resolution. Naturally, this allows the authority to be prepared should resolution be necessary. Resolution plans are drawn up by the resolution authority and should be updated at least once a year (see Scheme 2). The main elements of resolution plans are reviewed below.

4.1 THE CRITICAL FUNCTIONS OF A BANK

Determining the critical functions is an essential step in the preparation of resolution plans (including, also in recovery plans). It affects the establishment of loss absorption capacity, the bank's operating and financial continuity, and also the choice of the preferred resolution strategy, the assessment of resolvability and the identification of obstacles to resolution.

To achieve consistency in this analysis, the SRB, with the cooperation of the ECB and the European Banking Authority (EBA), has developed a template for the identification of critical functions, the completion of which by banks began in the 2017 planning cycle. The template's format and content is standardised, it compiles quantitative information and requires expert evaluation by the resolution authority, which is ultimately responsible for identifying these functions. The indicators used include most notably national market shares and the number of customers, and, in addition to studying the impact of the discontinuity of these functions, it is essential that their substitutability by other providers be analysed.

Preserving financial stability by preventing contagion to other banks is one of the objectives of the resolution of a bank. Financial stability may refer to one or several



SOURCE: SRB.

Member States and to one or several regions. For the SRB, the framework for the analysis of possible adverse effects on financial stability should be one (or several) Member States and should take into account the size and importance of the bank under resolution (volume of assets, market shares in specific functions, significance of the bank's deposits, similarities between its business model and that of other financial institutions, etc.). If there is a risk to financial stability, the bank's resolution would be justified; if there is not, national insolvency rules should be applied (this without considering other resolution objectives).

4.2 VALUATION OF THE BANKS SUBJECT TO RESOLUTION

A common element in all valuations is the need for banks to provide reliable and rapid information. To achieve this, the resolution authority should give priority to this aspect during resolution planning. The lack of appropriate information management systems might be classified, as we will later see, as a material obstacle to a bank's resolution. There are three different types of valuations, aimed at meeting the following objectives:

a) valuation 1: to inform the resolution authority whether the bank meets the conditions for its resolution;

b) valuation 2: to inform the resolution authority on the quantification of losses, and on the resolution strategy and instruments that may be applied;

c) valuation 3: to ensure that the shareholders and creditors do not incur greater losses under resolution than in liquidation.

Valuation 1 must be consistent with the accounting and regulatory rules applicable. Clearly, the focus of this valuation will be different if non-viability or the possibility of non-viability is due to a liquidity crisis or to the non-fulfilment of capital requirements.

Valuation 2 has to determine the bank's economic value, i.e. it has to take into account the present value of expected cash flows and all the factors or contingencies that may affect this value. Based on the resolution instruments to be applied, different valuation criteria shall be used, since it is not the same retaining assets as it is selling or liquidating them. An economic valuation is never absolute. Valuers make specific assumptions; they apply a specific methodology; and they consider more or less adverse scenarios to make adjustments in balance sheet items, which entails obtaining valuation ranges. In any event, valuers should explain in their report the assumptions and methodologies used and how they affect the results of the valuation. If, for reasons of urgency, a provisional valuation 2 is made, this should contain a realistic buffer that allows for full loss absorption.

Valuation 3 requires the classification of the bank's liabilities (including contingent liabilities) according to their creditor ranking in insolvency, in order to determine what result (recovery of their loans) the former shareholders and creditors would have obtained had the bank not been placed under resolution. This should always be done by an independent expert. The lack of uniformity characterising insolvency regimes in the various European countries hampers their consistency.

4.3 ANALYSIS OF RESOLVABILITY

What elements enable a bank's resolvability to be assessed? Firstly, a strategic analysis of its business model, which involves identifying its critical functions, main business lines and material legal entities. Secondly, an analysis of the credibility and feasibility of the resolution strategy, assessing whether the group's legal structure, and the intra-group interconnections are an obstacle to its resolution. Operational continuity is a further element and requires the bank to have identified and mitigated all material risks to this continuity in the event of resolution, including the maintenance of access to financial market infrastructures (FMIs). The fourth element is financial continuity, which requires the bank to be capable, first, of monitoring and anticipating financial needs under resolution (both loss absorption and liquidity-related) and, further, of identifying and mobilising available liquidity resources to cover these needs. The foregoing includes fulfilment of the MREL target set by the resolution authority.

Another relevant element is governance in communication policy, which involves verifying whether the bank has appropriate governance structure and procedures for timely decision-making in the event of resolution, and a clear communication plan with the various parties concerned, within and outside the bank, particularly with their customers and employees. Lastly, a key element is the information systems and infrastructures that will enable the bank to supply the information needed to implement the resolution strategy.

4.4 RESOLUTION STRATEGY

4.4.1 Resolution tools

In devising a resolution plan, it is essential to determine the resolution strategy. This strategy is two-pronged: the choice of the resolution tool and the point of entry under resolution (single or multiple).

The regulations provide for four resolution tools:

- bail-in,
- sale of business,
- asset separation, and
- bridge bank

With a bail-in, the bank under resolution restores its solvency after the absorption of losses and the recapitalisation of the bank until regulatory requirements are met. Under Article 27 of the SRMR, the bail-in can be applied to recapitalise the bank under resolution until the conditions of the authorisation are met; and to convert into capital or reduce the principal of claims or debt instruments that are transferred to a bridge bank, or following the application of the sale of the business or the separation of assets. This tool can be used if, thereby, there are reasonable expectations the long-term viability of the bank will be restored. In this connection, the plan for the restructuring of the bank's business post-resolution is essential, as is providing the necessary liquidity.

Article 27.3 of the SRMR stipulates the obligatory exclusion from bail-in of a series of liabilities (which would cease to be eligible for loss absorption and recapitalisation) and discretionary exclusion when faced with the exceptional circumstances indicated in Article 27.5 of the SRMR.

The sale of the business should be understood in a broad sense: sale of the bank's shares ("share deal") or sale of all or a portion of its assets, rights and/or liabilities ("asset deal"). Barring exceptional cases of urgency, the sale procedure should be transparent and competitiveEvidently, the price obtained may give rise to a financial imbalance at the bank, which would oblige its shareholders and creditors to bear losses. This principle (the shareholders and creditors of the bank under resolution should be the first to bear losses) is applicable to all the resolution tools.

The third resolution tool is asset separation, which involves separating these assets for their transfer, at a specific price, to a specialised asset management vehicle (AMV) that will administer them long-term. This instrument should be applied along with another of the three set out.

Lastly, the bridge bank allows the transfer of shares or other capital instruments, assets, rights and liabilities of the bank under resolution to this institution. Ownership of the bridge bank shall be fully or partly public; however, in any event, control will be in the resolution authority's hands. The functioning of the bridge bank shall be terminated as soon as possible and, in principle, before two years have elapsed since the last transfer to this bank, although this period may be extended for one or more years in certain circumstances (Article 41.6 of the BRRD).

4.4.2 The point of entry under resolution

When defining the resolution strategy for a bank with subsidiaries in several countries, the point of entry under resolution (i.e. on which bank the resolution tools are to be applied), which can be single (SPE) or multiple (MPE), must be determined.

The choice of point of entry under resolution will depend on the degree of financial and operational interdependence between subsidiaries and parent, and on the existence of a single or several resolution authorities in the countries in which the group operates. Lastly, a very important factor is the legal status of the banks in other jurisdictions (subsidiaries or branches).

In the SPE, there is a point of entry under resolution that is usually the parent company. This means that only one bank would go into resolution (that defined as a point of entry). If a subsidiary is posting significant losses, the group should have pre-established mechanisms for the transfer of losses to the bank that acts as a point of entry, and the latter will recapitalise the subsidiary in question. If it is the bank that acts as a point of entry that has losses, its shareholders and creditors will have to bear the losses and recapitalise the bank.

An MPE means that the entity considered as a point of entry is independent from the rest of the bank. Consequently, its non-viability does not affect the rest of the group and, therefore, in the event of resolution, it is dealt with autonomously: its shareholders and creditors bear the losses and the bank can continue performing its critical functions normally.

Under the MPE strategy for the resolution of a group, there is scope for an SPE for the resolution of a sub-group. Hence, a bank with two points of entry can have a single point of entry for a group of subsidiaries (which would make up one resolution group) and another point of entry for other subsidiaries (which would make up another resolution group).

4.5 IDENTIFICATION OF OBSTACLES TO RESOLUTION

Once the resolution strategy has been defined, the authority must identify the obstacles to resolution and analyse how they affect the assessment of the bank's resolvability. This assessment will comprise three steps:

1) verifying whether the information provided by the bank is appropriate for identifying the aforementioned obstacles;

2) assessing their impact on the resolution strategy chosen;

3) determining whether these obstacles can be eliminated in the short/medium term, or whether they are likely to persist in the event of resolution.

What have the SRB's priorities been in assessing resolvability in the latest resolution planning cycles? There are five main priorities. First, the legal and financing structure, and loss absorption capacity. The aim here is to identify and eliminate inappropriate elements of complexity in the bank's legal structure, and to ensure there is a sufficient amount of loss-absorption instruments and that they are in the appropriate place in the case of a group.

Second, technological and operational capacity to provide the necessary information to enable implementation, if necessary, of resolution measures. This priority takes the specific form of the provision by the bank of full and correct information for the drawing up of resolution plans, the valuation of the bank and the identification of unencumbered assets. It is also necessary to examine the procedural and operational steps needed for the use of the resolution tools and, especially, for the reduction in value and conversion of liabilities.

The third priority has been business continuity under resolution and maintenance of access to FMIs. The necessary services for critical functions and business lines are identified and mapped; repositories of contracts with critical services suppliers are established, assessing their suitability in the event of resolution; and critical services supplied by FMIs are identified and mapped.

Liquidity under resolution has been a further priority, with the aim of improving the bank's liquidity management during resolution.

Lastly, priority has been given to communication with authorities and main counterparties. A full communication plan has been developed, ensuring a clear governance structure and laying down detailed internal procedures.

The interaction with the banks in this process is ongoing. The SRB communicates its priorities to the banks by letter; the banks make a self-assessment of their resolvability and discuss it with the internal resolution teams (IRTs); the banks propose measures to eliminate material obstacles to resolvability, which will be analysed by the authority; and the banks regularly report to the authority on progress made. This means that the resolvability of a bank is a joint responsibility of the authorities and the banks.

Among the potential obstacles to resolvability mentioned in the plans relating to the 2018 cycle were the complexity of group structures, the systems and infrastructures for the supply of information, and insufficient loss-absorption capacity. Key among the priorities for 2019 is the management of the aforementioned potential obstacles, and progress on the operationalisation of resolution tools, including separability in the event of the sale of the business, separation of assets and a bridge bank, and ensuring business and financial continuity under resolution.

The communication of material obstacles to resolution should be in conformity with Article 10 of the SRMR.

By definition, resolution planning is an ongoing process; accordingly, after identifying the obstacles to resolution and their removal, a new cycle of work starts and the bank's resolution plan should be updated.

5 MREL policy

One of the guiding principles of the new regulatory framework is to demand that banks have sufficient loss absorption capacity and have, in the event of going into resolution, a sufficient amount of liabilities that will enable the bank to be recapitalised with the minimum possible impact on critical functions, on financial stability and on public funds.

Article 45 of the BRRD requires that all European banks should have an adequate level of MREL to comply with the above-mentioned principle. The resolution authority shall annually communicate to banks their minimum MREL requirement. As regards eligible liabilities for the MREL, the BRRD and the SRMR consider the following as excluded: liabilities excluded from bail-in (liabilities that could not absorb losses or be of use for recapitalisation), and those instruments which, while not excluded from bail-in, are excluded from the MREL, since they are unable to absorb losses, are relatively unstable or for which it is difficult to conduct a bail-in (liabilities that are not fully paid-up, liabilities that are backed or financed by the same bank, liabilities that mature in at less than one year, liabilities arising from derivatives and liabilities considered preferential according to the national insolvency hierarchy). That is to say, the typical instruments for meeting the requirement are own funds, subordinated debt and senior debt issued at over one year.

On 23 May 2016, the Commission Delegated Regulation completing the BRRD in respect of MREL[2] was published. This legislation established a calibration by default which basically duplicates the capital requirements demanded by the supervisor, since its objective would be the recapitalisation of the bank, along with loss absorption. Hence, the amount the bank should have will be the sum of the amount needed to absorb losses (by default, that

2 Commission Delegated Regulation (EU) 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities (Official Journal of 3.9.2016).

demanded by the supervisor as capital requirements, including the combined capital buffer), that needed to recapitalise the bank (by default, the same amount needed to continue with the banking licence after having absorbed the losses resulting from the crisis) and an additional amount to restore market confidence in the bank after the resolution process.

In 2017 and 2018, the SRB published its criteria for determining the MREL in those years, the resolution plans, opting for a bail-in and for transfer strategies as the preferred resolution tools, broadly following the calibration by default established in the above-mentioned Regulation. However, the SRB understands that it is possible that the bank, after suffering the effects of the crisis and as a result of the losses incurred, may have seen its risk-weighted assets (RWAs) diminish; or that certain assets of the bank that reduce these RWAs can be easily sold; or that, as a result of a restructuring plan approved by the supervisory authorities, there is a clear expectation that RWAs will decline in a short period of time. In these specific cases, the SRB might reduce the amount stipulated by default for recapitalisation, in such a way that the MREL requirement would be reduced.

Regarding the quality of the MREL, it is expected for globally systemic institutions that a portion of the requirement equivalent (at least) to 16% of RWAs (plus the capital buffers) be met by own funds or subordinated debt. In the case of systemic institutions at the national level, the expectation is that at least 14% of RWAs (plus buffers) are subordinated. In both cases, the required level of subordination may be increased if the resolution authority considers that, in the event of having to execute the bail-in, there is some risk of non-compliance with the NCWO ("no creditor worse off") principle whereby no creditors should incur greater losses than they would have done under liquidation. For the remaining institutions, the SRB will set subordination levels on a case-by-case basis. This analysis will take into account similar-ranked (pari passu) liabilities in the order of insolvency. Hence, derivatives, liabilities needed for the continuity of the institution and corporate deposits or senior bonds usually share the same rank in the order of insolvency. Were it necessary to exclude liabilities needed for business continuity from the bail-in, the share to be borne by the remaining creditors in the bail-in would be greater. As a result, in the event of resolution, the SRB (through the SRF) might have to compensate holders of converted liabilities who have incurred more losses than they would have done under liquidation.

In terms of quality, it is worth noting that the SRB clarifies that the following liabilities are not eligible: those issued under legal regimes outside the EU or by banks established outside the EU, unless the banks can demonstrate the effectiveness of the bail-in in the country of issue; non-preferential deposits and deposits not covered by the Deposit Guarantee Scheme in the long term, but where the holder can withdraw the money in a term of less than one year; and, in principle, structured bonds and those issued by special-purpose vehicles (SPVs).

To date, the SRB has been setting the MREL at the consolidated level. But SRB policy as from 2019 intends to set individual MREL requirements, adhering, in principle, to criteria similar to those explained.

Finally, once the requirement is set, a term over which institutions must comply with it is needed. This term will be determined by the level required (amount) and the quality required (subordination), and it will take into account other specific factors of the institution and of the markets in which it operates.

The basic aim of the SRF is to ensure the efficient application of resolution tools and the exercise of the resolution powers conferred on the SRB by the European banking resolution authority. Under the new paradigm, a bank crisis should be financed by shareholders and creditors and, where necessary, by the SRF, which is financed by financial institutions. Only exceptionally, after the use of the SRF, may national public funds be used.

The SRF is financed by ex-ante contributions from credit institutions and some investment companies. If one (or several) resolution case(s) consume(s) all the resources available in the SRF and more financing is needed, ex post contributions – by the same financial institutions – will be raised. Normally, these ex-post contributions are not available or not immediately accessible; in that case, the SRF will resort to debt (whether private or public) operations. The target amount for the SRF in 2024 is to reach at least 1% of the deposits covered in the euro area (currently estimated at around €60 billion).

Article 76 of the SRMR stipulates the potential uses of the SRF: to guarantee the assets or the liabilities of the institution under resolution; to make loans to the institution under resolution, its subsidiaries, a bridge bank or an AMV; to purchase whatsoever assets of the institution under resolution; to make contributions, in a broad sense, to a bridge bank and to an AMV; to pay compensation to shareholders and creditors for having borne greater losses under resolution than under liquidation; and to make contributions to the absorption of losses and recapitalisation of an institution, replacing specific creditors following their exclusion from a bail-in (Articles 27.5 and 18.7 of the SRMR).

The first two tools seek to strengthen the liquidity of an institution under resolution, and the following aim to shore up its solvency. When capital-strengthening measures are involved, compliance is necessary with the legal requirement whereby the shareholders and creditors of the bank under resolution must first absorb losses for a minimum amount of 8% of the institution's total liabilities, with the SRF's maximum contribution at 5% of these total liabilities.

To make the SRF operational, the Member States have signed an Intergovernmental Agreement (IGA). Under the IGA, the SRF will, for a transitory period from 2016 to 2023, comprise different compartments corresponding to each of the Member States: the use of these compartments will be progressively mutualised until, by 2024, the SRF will be mutualised in its entirety (pursuant to Article 5 of the IGA). Thus, during the transitory period, the following order would have to be followed in the event of a resolution: first, use would necessarily be made of the "national" portion of the compartment of the country where the bank under resolution is domiciled (with the percentage to be defined by the IGA); second, if these resources are not sufficient to accomplish the SRB's mission, resort may be had to the mutualised portion of each of the other compartments; if the resources continue to fall short and more funds are needed, resort will be had to the remaining portion of the compartment of the country of resolution; finally, if, after the three foregoing steps, the resources were still to prove insufficient to finance the resolution arrangements, extraordinary (ex-post) contributions would be requested of the credit institutions authorised in the same country where the resolution case is unfolding.

Since the above-mentioned extraordinary contributions are not immediately accessible, each Member State has entered into a Loan Facility Agreement (LFA) for the estimated amount of its compartment as at end-2023. Importantly, LFAs will only be used as a last resort, and they will be fiscally neutral for each country in the medium term. This is because it is credit institutions that will have to return the funds used.

In addition, the SRF, on the request of the country where the resolution is unfolding and contingent on the approval of the other euro area member countries, may use loans between compartments. Lastly, provided that a resolution ensues, the SRF may under Article 73 of the SRMR seek alternative sources of financing with third parties.

To conclude, the SRB has made significant progress this year in determining the criteria for setting the MREL. However, much work remains to be done. The priorities here are: to set clear criteria to determine the MREL for those banks in which the resolution tool is not a bail-in; to make internal MREL operative (for institutions with an SPE); to set the MREL at the individual level; and to make headway in terms of reporting for the effective monitoring of MREL compliance.

6 SRB activity: 2015-2019

Firstly, the SRB has taken numerous steps to implement the regulatory framework. It has drawn up policies and methodologies (MREL, identification of functions and critical services, access to FMIs, operational continuity, liquidity in resolution, etc.). Further, it has developed templates, enabling it to obtain and analyse information on liabilities (LDR – liability data reporting), FMIs and critical functions. Finally, the total amount collected by the SRF will be around €33 billion as at end-June 2019.

Secondly, the SRB has made progress in drawing up resolution plans for banks under its jurisdiction. In particular, it has set obligatory MREL objectives for larger, more complex banks, and reporting objectives for the remaining banks. In devising these plans there has been ongoing interaction with the euro area NRAs (in IRTs, in various committees organised by the SRB and in the SRB plenary session), with the ECB (information exchange, consultation of resolution plans and observer-status participation in the executive and plenary sessions), with the European commission (also with an observer role in the executive and plenary sessions), with the EBA, and with the resolution authorities from countries outside the Banking Union.

Thirdly, it has participated and contributed actively in international fora on resolution, coordinating various groups within the EBA and the FSB, promoting best practices and improving reference texts.

The SRB priorities for 2019 are: to further refine those policies already approved (MREL, access to MFIs, operational continuity, operationalisation of resolution tools and assessment of the public interest); to approve new policies and guidelines (valuation, aimed at valuers and banks); to increase the scope of binding MREL decisions; to identify material obstacles to the resolution of banks; to review decisions on less significant institutions that are the responsibility of the NRAs; to develop an efficient framework for the management of bank crises; and to complete the SRF's investment policy.

It is worth highlighting one last priority, linked in this case to the United Kingdom's withdrawal from the European Union. Brexit may prompt various effects on the resolvability of European banks. The SRB is focusing on some of these effects, e.g. the eligibility of financial instruments which, in principle, might be MREL-eligible, but which on being issued in the United Kingdom would be considered as third country-issued instruments. This means that new UK issues should include a contractual clause acknowledging the capacity of the European resolution authorities to execute a bail-in on these instruments, although the legal uncertainty would only be removed if the issue were made under the laws of one of the EU Member States. Regarding outstanding issues, these will be analysed on a case-by-case basis to evaluate their eligibility.

7 Reforms pending in the resolution regulatory framework

Regarding the operationalisation of the SRF, one initial measure to pursue is the creation of a common backstop to the SRF. This must be available at the very latest in 2024, and it must work as a last resort and be neutral, from a fiscal standpoint, in the medium term (i.e. be financed, after its use, by financial institutions). Access to the backstop will require complying with the rules for the use of the SRF, without it, appearing necessary to add more requirements, which might entail excessive complexity of use. It is essential that the loans obtained by the SRF through the backstop can be mobilised immediately. Following the latest political agreements in December 2018, it appears the provider of the backstop will be the European Stability Mechanism (ESM) and the amount that will be made available

It was clear from the resolution of Banco Popular en 2017 that liquidity in resolution, including the availability of sufficient collateral, is a priority matter. In the resolution of a major bank, credibility (with respect to size and speed) in the provision of liquidity is only possible with the intervention of a central bank. The SRF, even with an operational backstop, might suffice to tackle a crisis at a medium-sized or small bank; but its limited capacity is a handicap when it comes to managing a crisis at a systemic bank. In some countries, such as the United States and the United Kingdom, the central bank provides liquidity in resolution with a public guarantee. And this is the alternative that should be explored in the Banking Union.

The SRB is monitoring the level of encumbered assets in order to assess banks' capacity to gain access to funding on the market or at the central bank. The SRB is also cooperating with the ECB on the design of stressed liquidity scenarios, so as to be able to estimate potential liquidity needs and to design the measures to be taken.

to the SRB will reflect the size of the SRF. Hence, if the SRF target is €60 billion (an estimated 1% of covered deposits in 2023), the ESM will provide a further €60 billion through a revolving credit line. That means that the total financial capacity of the SRF will be around €120 billion.

A second group of measures would involve the revision of the BRRD and SRMR, and of capital requirements rules, with the aim of reducing risks in the financial system. A political agreement was likewise reached on this in December 2018. Focusing on the reform of the resolution legal framework, the SRB's position can be summarised as follows: banks with a similar presence in the Banking Union should have similar MREL requirements (Pillar 1 of MREL); the resolution authorities need flexibility to set an MREL target in accordance with the resolvability characteristics of each bank; the degree of subordination of the eligible instruments for MREL should be decided by the authorities in the context of the assessment of the resolvability of institutions and of the analysis of possible non-compliance with the NCWO principle; regarding the transitory period for meeting the MREL target, the authorities should set this having due consideration to the circumstances of each institution; the legal framework for the internal MREL should be clarified by the legislator and, in particular, so too should the different types of internal loss absorption capacity; the authorities should have more discretionality to react to a failure to meet the MREL target; the contractual clauses governing recognition of the resolution authorities' actions should focus on the eligible liabilities for MREL and bail-in; and the requirement of an intermediate parent undertaking (IPU) for third-country institutions operating in several European Union countries may enhance their resolvability.

The third major reform is to establish a European Deposit Insurance Scheme (EDIS), the third pillar of the Banking Union. Headway in this reform is linked to the approval of banking risk-reduction measures, which is progressing more slowly. Clearly, too, a solution must be found for the non-performing loans (NPLs) problem in some countries, so that the EDIS may be brought back to the negotiating table. The SRB resolutely supports the EDIS, as it does the harmonisation of national insolvency rules. As to the calculation of the contributions for the EDIS, the core criteria for the SRB should be simplicity, transparency and feasibility. The contributions should be calculated by the SRB and raised and transferred by the national deposit guarantee schemes. This is because the management of the European scheme by the SRB would have synergies with the resolution strategies and management of the SRF. Also, the SRB considers that the EDIS should be able to make use of alternative measures (e.g. the transfer of deposits to another institution, subject to certain requirements).

8 Conclusions

The new European resolution framework has been operating for just over four years. Much progress has been made in this period in the organisational area (start-up of the SRB and of the national resolution authorities) and the operational area (approval of policies and internal procedures by the SRB and national authorities).

The quality of resolution plans has improved substantially over the period, with binding MREL objectives being set for a significant group of institutions. Following the first resolution case, the model has been seen to work.

However, we have seen throughout this article that the authorities still have progress to make on aspects such as identifying material obstacles to the resolution of institutions and finalising MREL policy. To conclude, it should be borne in mind that the resolvability of institutions is a shared task between authorities and banks. Accordingly banks, too, should adopt all the necessary measures to enhance their resolvability.