Council of the European Union

PRESS

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PRESS RELEASE
ST 11814/14
PRESSE 397
Brussels, 14 July 2014

Council adopts rules setting up single resolution mechanism

The Council today[1] adopted a regulation establishing a single resolution mechanism for failing banks (PE-CONS 88/14).

The creation of a single resolution mechanism (SRM) – with a central decision-making board and a single resolution fund – ensures that resolution decisions across participating member states will be taken in a coordinated and effective manner, minimising negative impacts on financial stability and reducing the dependence of banks on the creditworthiness of sovereigns.

The aim is to ensure the orderly resolution of failing banks without recourse to taxpayers' money. This will involve both a systematic recourse to the bail-in of shareholders and creditors, in line with the bank recovery and resolution directive adopted in May[2], and the possible recourse to a single fund fully financed by banks.

"*We have established another important pillar of Europe's banking union, which will contribute to safeguarding the single market and the prosperity of all European citizens heavily hit by the global financial crisis*", said Pier Carlo Padoan, minister for economic affairs and finance of Italy. "*With the single resolution mechanism, the European Union is radically improving the regulatory framework of the banking sector, which will increasingly be at the service of Europe's economic development, without shifting private risks onto public budgets.*"

The SRM will form one of the key elements of Europe's banking union, along with the single supervisory mechanism (SSM) that entered into force in November[3]. It will cover all banks established in the euro area and in other member states that choose to participate.

Adoption of the regulation follows an agreement reached with the European Parliament at first reading in early April.

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1 At a meeting of the Agriculture and Fisheries Council, without discussion.
2 See press release 9510/14.
3 See press release 14044/13.

Resolution board

The regulation establishes a single resolution board with broad powers in cases of bank resolution.

Upon notification by the European Central Bank (as supervisor) that a bank is failing or likely to fail, or on its own initiative after having previously informed the ECB, the board will adopt a resolution scheme placing the bank into resolution. It will determine the application of resolution tools and the use of the single resolution fund (SRF).

The resolution scheme will enter into force within 24 hours of its approval by the board, unless the Council, acting by simple majority on a proposal by the Commission, objects. Within 12 hours of approval of the resolution scheme by the board, the Commission may propose to the Council to object to the resolution scheme on the grounds that it is not necessary in the public interest, or to approve or object to a material modification of the amount of funds provided for in the resolution scheme.

The board will be responsible for the planning and resolution phases of cross-border banks and those directly supervised by the ECB, while national resolution authorities will be responsible for all other banks. However, the board will always be responsible if the resolution of a bank requires access to the SRF.

For cross-border banks and for banks directly supervised by the ECB which are under the responsibility of the single resolution board, national resolution authorities will be responsible for executing bank resolution schemes under the board's instructions. Should a national authority not comply with a decision of the board, the latter will be able to address executive orders directly to the troubled bank.

The regulation also calls on the board, in cooperation with the participating member states, to develop ways to enhance the borrowing capacity of the SRF.

To guarantee member states' budgetary sovereignty, the regulation prohibits decisions requiring a member state to provide extraordinary public support or impinging on its budgetary sovereignty and fiscal responsibilities.

Decision-making on the board

The board will consist of a chairperson, four full-time appointed members and the representatives of the national resolution authorities of all the participating member states[4]. The ECB and the Commission will each designate a representative as a permanent observer. The board will exercise its tasks in either a plenary or executive format. Most draft resolution decisions will be prepared in the executive session, composed of the chairperson and the appointed members, with the representatives of member states concerned by a particular resolution decision.

However, the plenary session will be responsible for individual resolution decisions requiring more than €5bn in capital, or twice that amount in liquidity support, from the SRF. Moreover, once the accumulated use of funds over any 12-month period reaches €5bn, the plenary will be responsible for evaluating the application of resolution tools, in particular the use of the SRF, and for giving guidance to the executive session for subsequent resolution decisions.

Decisions involving the use of funds available in the SRF above these thresholds will always require a simple majority of board members in the plenary session representing at least 30% of contributions to the SRF.

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[4] The selection procedure for these key posts was launched on 10 July with the publication (in the Official Journal and in the press) of public vacancy notices.

The plenary session will also always be responsible for decisions authorising the SRF to borrow and to raise extraordinary ex-post contributions, and on financing arrangements in the event of the resolution of a group with institutions in both SRM-participating and non-participating EU countries. These types of decisions will during an initial eight-year transition phase (until the SRF is fully mutualised) require approval by a 2/3 majority of board members representing at least 50% of contributions. However, in the so-called steady state (once the SRF is fully mutualised) these decisions will be taken by a 2/3 majority of board members representing 30% of contributions.

Single resolution fund

The SRF will be built up over a period of eight years to reach a target level of at least 1% of the amount of covered deposits of all credit institutions authorised in all the participating member states. It is estimated that this will amount to about €55bn.

The individual contribution of each bank will be calculated pro-rata to the amount of its liabilities (excluding own funds and covered deposits) with respect to the aggregate liabilities (excluding own funds and covered deposits) of all the institutions authorised in the participating member states. Contributions will be adjusted in proportion to the risk profile of each institution.

On 21 May, member states participating in the SSM and the SRM also signed an intergovernmental agreement on the transfer and mutualisation of contributions to the single resolution fund (see press release *10088/14*).

Under this agreement, contributions by banks raised at national level will be transferred to the SRF, which will initially consist of national compartments. These will be gradually merged over an eight-year transitional phase. This mutualisation of paid-in funds will be front-loaded, starting with 40% in the first year and a further 20% in the second year, and continuously increasing by equal amounts over the subsequent six years until the SRF is fully mutualised.

The Council decided in December to include these provisions in an intergovernmental agreement in order to provide maximum legal certainty, given legal and constitutional concerns in certain member states.

At the same meeting, ministers also adopted a statement specifying that during the initial build-up phase of the SRF, bridge financing will be available from national sources, backed by bank levies, or from the European Stability Mechanism in accordance with existing procedures. Temporary transfers between national compartments will also be possible. During the transitional phase a common backstop will be developed. It will facilitate borrowings by the SRF and will ultimately be reimbursed by contributions from the banking sector.

A statement accompanied the intergovernmental agreement, confirming the commitment of the contracting parties to be bound by bail-in rules and principles as outlined in the bank recovery and resolution directive adopted in May. This will be a precondition for accessing the fund: the cost of bank failures should be borne by the financial industry and not by taxpayers.

Entry into force

The SRM will be applicable as follows:

– Provisions on the preparation of resolution planning, the collection of information and cooperation with national resolution authorities will apply from 1 January 2015.

– Provisions relating to resolution planning, early intervention, resolution actions and resolution instruments, including the bail-in of shareholders and creditors, will apply from 1 January 2016, provided that the conditions for the transfer of contributions to the SRF have been met.

The intergovernmental agreement will enter into force once ratified by member states participating in the SSM/SRM that represent 90% of the aggregate of the weighted votes of all participating member states.