

Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions. The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

EBF response to the Commission's Communication on "an EU Framework for Cross-Border Crisis Management in the Banking Sector"

Key Points

- In the current political and legal context, realistic solutions to crisis handling at EU level must first **concentrate on ensuring that an adequate and effective supervisory framework is established** to allow increased and enhanced prudential supervision of banks.
- In complement to the supervisory reform, **the tools and powers** available to supervisory authorities to intervene promptly in an institution to reduce the likelihood that a bank's difficulties escalate into a crisis situation and contaminate other banks **should be harmonised across the EU**. Effectively applying those tools cross-border requires that supervisors can have a **common understanding of a problem and jointly decide to act and coordinate their actions**. Such decisions should be made **within colleges of supervisors, under the coordination of the consolidating supervisor** and with the support of the future European Supervisory Authority.
- **The EBF supports the creation of an EU banking resolution framework**, that would apply to the EU financial sector as a whole. An EU resolution framework should prevent resorting to purely national solutions, which act against the integration of the single market. The **assessment of both the stressed situation and the adequacy of the tools should be discussed within colleges of supervisors and Cross-Border Stability Groups** so as to reach a joint decision on what tools to use, and at what level (group level or entity level).
- The idea of creating **an ex-ante, privately funded resolution fund at EU level may have some merits**, such as reducing uncertainty for crisis resolution, being a tool for burden sharing between the private sector and the public sector and helping to preserve the single market integration. Nevertheless, **it is premature for the EBF to support the establishment of an EU resolution fund. The purpose and use of that EU fund should first be clarified**, including how contribution keys would be defined, who would be competent to trigger the use of this fund, and how it would articulate with national level funding sources. The Commission should specify the idea of an EU fund and **assess current practices at national level**, and then where relevant submit a specific proposal for public consultation.
- An **ex-ante burden sharing framework for each cross-border banking group** should help clarifying who would take the lead in the case of a crisis and speeding up the process in the Cross-Border Stability Group; this would then enhance the effectiveness of the resolution tools. It should also leave sufficient room for manoeuvre to adopt case-by-case approaches and solutions. This 'preparatory' burden sharing should be binding and **should contain the elements of the formula on which ex-post burden sharing would then be determined**.

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Related document: [European Commission Communication on "an EU Framework for Cross-Border Crisis Management in the Banking Sector"](#)

General comments

- i. The EBF would like to emphasise the **importance of an enhanced banking resolution framework within the EU**. The financial crisis has clearly shown deficiencies in the way banking resolution is currently foreseen in the EU. There is a strong need to strengthen the internal market for financial services to create a sound and stable financial system, which allows for the failure of insolvent entities while at the same time promoting internal market's integration and cross-border banking.
- ii. **Banking crises cannot be prevented without an effective working relationship between banks and their supervisors**, which allows for an in-depth knowledge of the reality of the supervised entity, **converging supervisory practices across the EU, and enhanced home-host cooperation**. Increased coordination and convergence in supervision should be a primary focus to avoid future bank failures. Banks should also review their (risk) management processes and organisational structure to ensure that they are appropriate to their business model (and risk profile), and comply with the principles of good corporate governance.
- iii. The EBF strongly believes that stronger emphasis should be placed on **harmonising early intervention mechanisms to prevent escalation** of financial distress or its contagion to other banks, thus minimising the risk that a bank's difficulty worsens into a crisis situation and eventually requires public money to resolve. The EBF acknowledges that as a result of widely differing core national laws across Member States, it is not practical to introduce a harmonised EU insolvency regime.
- iv. Consequently the EBF considers that **the short-term priority should be to ensure that supervisory authorities across the EU have harmonised adequate tools and powers to intervene promptly in an institution**. The 'time' element is key; it requires that trigger events for supervisory actions be defined and agreed upon on a fully harmonised basis so that there can be a common understanding of the seriousness of the problem, prompting supervisors to jointly decide and coordinate their actions within colleges of supervisors. **The EBF welcomes in that respect the reaffirmed political support of Member States¹** among others to the Commission to reinforce and align early intervention powers for supervisors as well as to develop a common set of early warning indicators and common means of assessing problems as short-to-medium term priorities.
- v. Considering at this stage the number of political and legal obstacles underpinning the issue of financing of resolution measures, **EBF Members would prefer ensuring that supervisory authorities are sufficiently and adequately funded to fulfil their crisis prevention role** rather than contributing to an "EU resolution fund" whose purpose and use remain to be clearly defined.
- vi. Furthermore, **ex-ante rules on the precise burden sharing among Member States do not seem politically feasible and could in any event not anticipate the true characteristics, scope and type of crisis** for which such precise allocation of costs would be planned. It is also clear that a one-size-fit-all criterion does not exist. A more pragmatic approach to burden sharing would be desirable; in that regard the EBF further welcomes the 2 December 2009 Ecofin Council conclusions whereby the Economic and Financial Committee (EFC) is invited to continue **exploring a framework for Member States' preparedness for ex-post burden sharing**.

¹ Cf. 2 December 2009 Ecofin Council conclusions on financial stability arrangements and crisis management

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- vii. In addition to the responses presented in this Paper, the EBF would like to underline the importance of **more work on enhanced contingency planning**. The EBF has set up a separate working group to develop principles on how banks could improve their processes in this area. It is essential that the discussions on enhanced contingency planning are organised in close cooperation between banks and supervisory authorities. To ensure convergence in the work undertaken by different organisations, EBF Members would therefore welcome **a close dialogue between the banking industry and the Committee of European Banking Supervisors (CEBS)**. Banks' enhanced contingency planning could furthermore be tested within, and be an important part of, supervisors' regular crisis simulation exercises.
- viii. Last but not least it is of utmost importance that regulatory activities by the EU are undertaken in close cooperation with the recommendations that will be issued by the Basel Committee on cross-border bank resolution just as where regulation on capital, liquidity and risk management are concerned.

1. *Which additional tools should supervisors have in order to address developing problems?*
2. *How should their use be triggered?*
3. *How important are wind-down plans ("living wills") as a tool for crisis management?*

1. The EBF believes that the cross-border financial crisis which occurred over the last year has stressed the importance of and need for strengthening early intervention powers to national supervisors across the EU, not least by providing **more harmonisation of the early intervention objectives and tools available to Member States' supervisory authorities**. In particular, key supervisory intervention measures could be capital-related, e.g. to prohibit or limit principal or interest payments on subordinated debt; require conversion of subordinated debt; to limit or prohibit any major capital expenditure.
2. Furthermore, **the "trigger events" (i.e. events that legitimate the supervisors' early intervention) should also be put on a level playing field**. Further examination is necessary to determine which events should fall within a common set of trigger events for supervisors, and whether these should be quantitative (e.g. solvency triggers such as under the US Prompt Corrective Action²), qualitative or both.
3. Such harmonisation (both of powers and of trigger events) is necessary to reach the following **aims: (i) avoid any possibility for regulatory arbitrage; (ii) eliminate national discretions; and therefore (iii) provide legal certainty. Harmonisation would enhance trust amongst supervisors and create incentives for supervisors to coordinate their actions in cross-border intervention**. Harmonisation should furthermore be implemented based on best practices in supervision. **The right balance should nevertheless be stroked between the need to ensure flexibility and case-by-case approaches of new situations, and the need to allow coordinating supervisory actions across borders using common indicators, tools and powers**. Progress at EU level towards harmonisation should furthermore enhance coordination at international level and not come at the expense of the competitive position of EU banks vis-à-vis their non-EU counterparts.

² A PCA scheme requires action to be taken in the early stages of financial distress to try to stop the problem from escalating and, eventually, to take away a bank's charter while the economic value of its capital is still positive. The US system is based on the CAMELS supervisory ratings of a bank's overall condition (Capital adequacy; Asset quality; Management; Earnings; Liquidity; Sensitivity to market risk).

4. Beyond harmonisation, further questions need to be addressed, namely: **who would trigger the intervention mechanism and who would be responsible for it?**

For EBF Members, the decision to trigger intervention mechanisms should be made jointly within the college of supervisors upon the proposal of the relevant member. Ensuing decisions on cross-border supervisory activities/measures in the early intervention phase should be jointly made by the members of the college of supervisors, together with the senior management of the bank's concerned (**Pillar II dialogue**), **under the coordination of the consolidating supervisor**³ and with the support of the European Supervisory Authority (Article 131a of CRD2; Article 10(1) of the draft ESA Regulation).

In cases of disagreement, a mediation procedure at the level of the European Supervisory Authority could be initiated as provided in Article 11 of the draft ESA Regulation, and possibly after having consulted the Cross-border Stability Group (see below § 25).

5. **Communication to the public** when difficulties are publicly known will also be very important in the early intervention phase. The bank concerned and its competent national authorities should be co-responsible for the communication. To avoid communicating any misleading information, clear guidelines should be introduced and applied for communication to all parties, including the media. It should be clear who is responsible for communication at what stage so that there always is only one party (the ailing institution or the authority) communicating.
6. The objective to develop adequate early intervention measures which follow a going concern approach should not be confused, in the EBF opinion, with the objective to facilitate Member States' agreements for the resolution of cross-border crises. In particular **the concept of 'living wills' as proposed by the Commission unnecessarily takes discontinuity and the dismantling of the organisation as a starting point**. This is not how EBF Members would see this work in practice. Instead, **the EBF prefers referring to 'enhanced contingency plans'**, which would be regularly updated and reviewed, and take into account different kinds of stresses.

The EBF suggests deepening the concept and content of 'living wills' / enhanced contingency plans but cautions at the same time that **'enhanced contingency plans' are not, in themselves, a tool that guarantees either the possibility of early intervention or the proper management of a banking crisis**.

In connection with the debate surrounding 'living wills' / enhanced contingency plans EBF Members consider that there is a bias developing in the regulatory community for a particular style of group structure. This is unfortunate as, of course, the greater the extent to which banks share the same structures the greater the risk that systemic weaknesses may develop from that source. **Diversity of structures is important for the financial sector as a whole**. All structures, whether through a complex use of branch structures or through national subsidiaries have strengths and weaknesses. **The important test is whether the bank has thought through the potential weaknesses and has viable strategies in place to deal with adverse outcomes should they arise**. In the EBF view, concerns about ease of resolution, while extremely important, are not as significant as concerns that the ongoing risk

³ As provided in the Memorandum of Understanding (MoU) on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union on cross-border financial stability. June 2008, point 4.4, p. 8.

<http://www.ecb.int/pub/pdf/other/mou-financialstability2008en.pdf>

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management environment of a bank, and the good overall management oversight of banks, should be as strong as possible.

- Enhanced contingency plans should not be seen as a way to force cross-border banks and banking groups to adapt their corporate structure to a (national) resolution-friendly organisation.** On the contrary, at least at EU level, enhanced contingency plans should be drafted in a way that preserves the unity, albeit operational, of banks and banking groups operating under a common crisis management framework. Furthermore the purpose of enhanced contingency plans should be to demonstrate that the bank would be able to respond effectively, by e.g. defining **procedures to raise contingency capital**; a good starting point could be the procedures embodied in the Memorandum of Understanding signed in June 2008⁴ ("the 2008 MoU").

As stated in the general remarks above, the EBF has started reflecting about enhanced contingency plans. **EBF Members are now working on principles that should guide enhanced contingency planning** and what such contingency plans should contain.

Among these principles are the following:

- The enhanced contingency plans should be prepared at the level of the entire financial group;
- The requirement to draft and maintain enhanced contingency plans should apply to all financial institutions, albeit in a proportionate manner;
- Authorities should ensure that access to commercially sensitive data is strictly controlled and confidentiality maintained;
- Every bank should prove to itself and its supervisors that it has robust information management system in place allowing it to deliver all the information required in a period of severe stress.

4. Is the development of a framework for asset transfer feasible? If so, what challenges would need to be addressed?

5. What safeguards for shareholders and creditors are needed?

- The EBF supports the initiative of the European Commission to address the problem of ring fencing in crisis situations and related inefficiencies and costs**, resulting from hindering the free movement of capital in the internal market (for instance: large exposures rules and limitations to liquidity transfers due to legal settings protecting shareholders' minority interests) and undermining economies of scale and scope (due for instance to limits in information exchange in relation to clients' creditworthiness). The EBF stresses that current regulatory limitations to cross-border asset transfer become even more burdensome **under stressed financial situations where, pending the appropriate safeguards are respected, internal capital and liquidity transfer may prove to be of vital importance** to preserve the solvency of the group or of a subsidiary in a country where a crisis is developing.
- The EBF believes that **asset transfer (AT) among the entities of a same group is one of the tools to be considered in the context of early remedial intervention** (i.e. before an insolvency is declared) for four main reasons:

⁴ Ibid.

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- i. AT can be an important means to fix situations where a prompt solution is fundamental to avoid a banking crisis, thus maintaining financial markets' confidence in the banking system and preventing "bank-runs";
- ii. in the event of a crisis, AT may help to reduce the (final) fiscal burden required to repair it;
- iii. in good times, AT allows a centralized management of a banking group, in line with cross-border banking groups' business model;
- iv. AT is an extended practice for the funding of banks with a global business model, as much of the interbanking funding is on a collateral basis. Global funding models allow responding quickly to as well as avoid and prevent a crisis; limitation or restrictions in relation to movement of assets or liquidity could thus have destabilising rather than stabilising effects.

10. The current principle of **transfer at arm's length (i.e. market price) between entities of the group** should be maintained and the decision for a group's entity to transfer its assets to another one should remain under the **sole and entire discretion of the management**. In cases of immediate threat of insolvency, where the management refuses to take appropriate measures, the college of supervisors should however take position.

11. To exploit all the AT possibilities, it is necessary to further examine the possibility to provide a definition of "group interest" and of "group" at EU level. Such notion, however, must be non-binding, i.e. the recognition of the group cannot be automatic, but only by means of a specific application to the competent EU authorities. A pre-requisite to that work will be to carry a thorough analysis of the possible legal regimes and approaches across Member States applying to the "Group" (notably in the field of transfer of assets, including in times of liquidity stress or solvency crisis, as well as in tax law and criminal law). Rather than proposing additional or new criteria, the "group" notion could be based on existing EU and international instruments in the field of accounting. As a matter of fact, the definition given in Article 12(1) of the Seventh Council Directive 83/349 EC on consolidated accounts which is also referred to by the Conglomerates Directive (2002/87/EC) could be an interesting basis for discussion. The International Accounting Standards 27 also provide definitions of the term "group" and its relating terms which might not be as precise as the ones of Directive 87/349 but could still be worth considering.

Finally any such group regime must also fully take into account the situation of global banks headquartered outside the EU, but with substantial business operations within the EU.

12. The EBF **in principle** agrees with the Commission's proposal to build a limited "group" notion on the concepts of interdependence and mutual assistance. It should nonetheless be ensured that the rights of **the transferor's creditors should be preserved and clarified that within such notion each single entity of a group would:**

- (i) retain its own legal status, i.e. branch or subsidiary;
- (ii) be liable for its own obligations only with its own capital i.e. the burden on individual subsidiaries may never exceed its capacity to pay or jeopardise its soundness, even in the pursuit of the group interest as a whole;

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- (iii) Potential losses related to an intra-group AT could be justified through "compensatory group advantages" i.e. benefits created by other transactions or group relationship, whether past or future.

13. Any commitment from a mother company to its subsidiaries should:

- (i) serve the mother company's corporate interest;
- (ii) be proportionate to its financial means;
- (iii) be in line with the requirements of an efficient capital allocation; and
- (iv) not lead to a situation whereby the resolution of a subsidiary could endanger the existence of the mother company or vice versa.

14. At the same time, the EBF underlines that **safeguards are required to preserve the rights of shareholders and especially creditors from which assets have been transferred**. In this regard, there are three main considerations to bear in mind:

- (i) it is of fundamental importance that insolvency regimes do not favour the interests of the shareholders over those of the creditors; therefore there is some merit in reforming creditors' ranking legal discipline in insolvency procedures, expressly **putting the transferor's creditors in a better position than the transferee's ordinary shareholders**;
- (ii) the depositors of the group legal entities must be placed on an equal footing;
- (iii) with regard to the "suspect" period in which the AT may be retroactively invalidated, it is necessary to strike a proper balance between the need for legal certainty for AT exploiters in a crisis context (which will lead to an unduly short "suspect" period) and the opposite need of the transferor's creditors not to be worse off (which will lead to an excessively long period).

6. What should be the key objectives and priorities for an EU bank resolution framework?

15. **The key objectives of an EU bank resolution framework should include:**

- (i) **Strengthening the internal market for financial services;**
- (ii) **Ensuring a level playing field among European Economic Area (EEA) entities;**
- (iii) **Creating a sound financial system, allowing for the failure of insolvent entities;**
- (iv) **Promoting cross-border European groups to compete with non-European actors;**
- (v) **Strive towards globally accepted objectives, guidelines or recommendations developed by the Basel Committee, Financial Stability Board and IOSCO.**

The new framework would have to prevent resorting to purely national solutions to banking crises to the extent that such solutions result in competition distortion between European banks and act against the integration of the single market for financial services.

16. In the Commission's view, a bank-specific European crisis resolution framework's objective should be primarily focused on maintaining financial stability, besides the usual aim of most existing insolvency regimes which consists in achieving the best possible treatment for creditors and shareholders. Moreover, another primary objective should, according to the

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Commission, be to rather impose losses on shareholders, junior and unsecured creditors than public funds.

17. **The EBF agrees that financial stability is a key objective, but also invites the Commission to duly take into account shareholders' rights** in drafting a new EU banking crisis resolution framework. Indeed, even if certain limitations to shareholders' rights are acceptable, such limitations should be strictly and only justified on the grounds of emergency purposes and should provide for compensatory group advantages.
18. In other words, authorities that will be elected as competent to manage a crisis resolution process should take into account the **need to compensate shareholders with advantages that could reduce the final loss**. For example, if competent authorities decide to assist a merger to bail out an ailing bank, the operation should not be detrimental to the interests of the shareholders.
19. **The EBF agrees in principle that shareholders' rights should not become an obstacle to action by the authorities to prevent or manage a crisis**, considering the need to ensure the stability of the banking system and the general interests involved. Nevertheless, before shareholders' rights are removed or limited, shareholders should be offered the opportunity to collaborate with the supervisors on the resolution measures that are being considered. In this way, the removal or limitation of shareholders' rights would be subsidiary, and only apply in exceptional cases where the lack of such collaboration makes the prevention or management of the crisis difficult.
20. Furthermore **any decision to limit or deprive shareholders' from their rights should be reasoned, justified and in accordance with the law**, in order to allow for a proper control by the Courts. Finally, regardless of the existence of sufficient financial compensation for the removal or limitation of shareholders' rights, there is a need for legal systems to ensure that supervisory decisions can be swift and effective and to offer proper guarantees of due process.

7. What are the key tools for an EU resolution regime?

8. What are the appropriate thresholds for the use of resolution tools?

21. The main problem underlined in these questions is to find tools that may give the resolution authorities the possibility to deal with a banking crisis without having to resort to public funds. Moreover, these tools must be sufficiently flexible so that they can be applied in a crisis promptly and effectively.

The Commission takes into consideration **three possible resolution tools**:

- (i) acquisition of the ailing bank by a private sector purchaser;
- (ii) a "bridge bank" (i.e. a bank temporarily licensed, to which competent authorities may transfer assets and liabilities, in order to take over and preserve as a going concern the remaining viable business of the bank);
- (iii) a "bad bank" (i.e. to deploy the "bad" assets of the troubled bank to a special asset management company, in order to "clean" the bank's balance sheets and therefore help restoring the viability or find a private sector solution to the crisis).

22. **The issue of the pricing of the assets transferred from an ailing bank to a "bridge bank", a "bad bank" or a third party needs to be addressed.** Two elements should be taken into account:

- (i) the measurement method applied to the assets of the bank and the extent to which this measurement method contributed to the problems of the ailing bank (the use of illiquid market prices in measuring bank assets may have and still can aggravate the financial situation of that bank without affecting the underlying value of the assets); and
- (ii) the transaction price to sell the assets of the ailing bank to a bridge bank / bad bank or a third party.

To take both elements into account, it might be necessary to define a special procedure in the resolution framework to define the transfer price (not the transfer in itself), while preserving the shareholders' right to property as provided in the European Convention of Human Rights (cf. Commission Staff Working Document accompanying the Commission Communication, §§ 123-126).

23. The Commission considers the possibility to combine the above described resolution measures with a "**special administration**", which would be granted together with all the relevant powers necessary to fix a crisis, without any procedural burden.

24. **The EBF largely agrees with the Commission's proposal.** The difficulty, however, will be to design the right set of instruments which enable an application of these tools individually or jointly in an efficient and effective manner and without unwanted repercussions for third parties. Therefore, prior to introducing any specific instruments, it will be of paramount importance to carefully analyse the potential impact these may have. In particular, it will be necessary to **balance the potential advantages such instruments would bring about for the ailing bank subject to a resolution procedure and the effects the application of these instruments can have on third parties**, such as any banks which have contractual relations with the said bank or the financial market as a whole.

25. For cross-border banking groups, the **Cross-border Stability Groups⁵ (CBSG) could advise the college of supervisors and other relevant competent authorities on the appropriate resolution tools.** Again, this could work only if common definitions and "trigger conditions" are agreed for the identification of a crisis situation, and taking into account the situation of third-country banks with substantial business activities within the EU, together with international developments such as Basel Committee's recommendations.

26. Instruments, which may be useful for a successful application of resolution tools and which should therefore be analysed among others, are: Debt Equity Swaps, creating a 'good bank' (vs. the 'bad' bank) and third party guarantees in connection with resolution measures involving a transfer of assets and liabilities:

1. **Debt equity swaps** are proven restructuring methods;

⁵Created by the 2008 MoU and defined as: "a group which involves all relevant Parties from different Member States with the objective to enhance preparedness in normal times and which may facilitate the management and resolution of a cross-border financial crisis. A Cross-Border Stability Group is chaired by a Cross-Border Coordinator designated by the Group."

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2. The spin-off of parts of the ailing bank into a 'good bank' could also be an effective instrument to restructure the bank and to stabilise the operating business;
 3. Likewise, **third party guarantees** covering either all or certain liabilities of an ailing bank are an effective instrument to **avoid that the contractual parties of the relevant ailing bank either exercise termination rights under existing contractual agreements or cease to enter into any new transactions**, which may be essential for business continuity of the ailing bank.
 - Provisions on the **early termination of contractual agreements** are a key element of the netting provisions in the framework of master agreements for financial transactions (derivative transactions, securities lending transactions etc.). They are instrumental to allow the contracting parties to bring about a netting of the mutual positions (close-out netting) on the occurrence of events which are of relevance for the risk exposure of the counterparty, in particular insolvency or similar events. Netting results in the set-off of the mutual positions of the counterparties and thus directly reduces the credit risk exposure. Netting is an indispensable element of risk management (allowing risk management on a net-basis).
 - A third party guarantee for liabilities from any financial transactions entered into by the ailing bank subject to resolution measures would be an effective **incentive to all contracting parties not to rely on any termination rights in order to bring about a close-out netting of all open positions**. It would also, and even more importantly, **encourage the market to continue to enter into new financial transactions** (or extend contracts which have expired) with the relevant ailing bank and thus safeguard that the ailing bank remains in a position effect all financial transactions it requires to continue its business activities.
27. The introduction of **legal restrictions to the exercise of termination rights in netting agreements**, as suggested by the Commission⁶, **would have serious consequences for the counterparties as well as the institutions that were initially meant to be protected by such restrictions:**
- The exposure assumed by credit institutions under derivatives and securities financing transactions considerable differs from regular loan exposure. The loan exposure is limited by the lent amount whereas the exposure under derivatives and securities financing transactions as it depends on the movement in market values of the underlying assets and could, theoretically, increase ad infinitum. Contractual termination and close-out netting clauses form an integral part of an institution's management of such volatile credit risk. A credit risk manager, who, when granting a certain credit line bases this decision on a specific risk assessment, must be able to enforce such limit if the credit worthiness of the counterparty is materially deteriorated. The only instrument that he can use is the termination of the transaction and the close-out of the position.
 - Contractual termination and close-out netting clauses allow the credit institution to reduce its exposure to their counterparty's losses by netting the in-the-money and out-the-money transactions and the pledged collateral (if any). Restrictions to the right to bring about such a close-out would have serious repercussions on the risk

⁶ Accompanying Commission Staff Working Document, p. 37, paragraph 110

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exposure of the counterparties which relied on this ability, as the latter is now forced to reassess the credit risk involved. A stay, of termination rights (especially if its duration is unpredictable) would result in longer holding periods or margining period at risk which automatically result in uncollateralised gross potential future exposure. Considering that the counterparty’s creditworthiness is already deteriorated, the overall impact on the risk position is considerable.

- There is also a regulatory component as higher probability of default and higher expected exposure at default (EAD) automatically result in higher risk weighted assets and capital charges.
- The right to terminate and close-out is not only relevant for credit institutions, it also essential for central counterparties: Their rules and regulations usually provide that a failing clearing member has to transfer its clearing positions to a replacement clearer. Many sovereigns and central banks use down-grading triggers for termination and close-out, which would also be impacted by an imposed “continuity of banking services”.
- There may also be implications for the rating of any financial instruments, such as covered bonds etc, in respect of which hedging transactions have been entered into and which would now be subject to such restrictions on close-outs. Rating agencies usually require for a AAA-rated structured covered bonds that the hedge counterparty maintains a certain minimum rating and that the issuer has the right to unilaterally replace the hedge counterparty if the latter is downgraded.
- In the event that a transfer would succeed, it should be clear that all transactions, including the pledged collateral, should be transferred to the transferee and that no cherry-picking should be allowed. Cherry-picking must be prevented as it would represent an important setback in relation to the progress achieved so far to ensure greater legal security in respect of the validity and enforceability of netting agreements in the EU. The confidence in financial markets would be undermined if the legal certainty over the validity and enforceability of netting agreements and the protection of pledged collateral is put into question, as evidenced by the turmoil in the failure of the Icelandic Banks. Furthermore, as the example in the UK in connection with the Safeguards Order (Restriction of Partial Property Transfers Order 2009) has shown, legislation must be drafted very carefully to avoid unwanted effects on netting and other effective risk mitigating techniques.

Such delay could exponentially impact the exposure and capital requirements of all non-defaulting contractual counterparties of the relevant financial institution subject to reorganisation measures and could evidently lead to a snow-ball effect.

- Finally the ability to bring about a close-out in a legally enforceable manner is an essential factor in the decision-making process before entering into financial transactions with a certain counterparty; thus, any restriction to the right to bring about a close-out in relation to a certain counterparty would directly affect the ability of the affected party to find counterparties willing to enter into transactions or will at least affect the terms on which potential counterparties would be prepared to enter into transactions substantially.

Although it is acknowledged that a systemic failure could lead to the collapse of multiple financial market counterparties, the EBF believes that **in the recent crisis the immediate**

operation of contractual termination clauses, such as in the Lehman Brothers Insolvency, **reduced losses for counterparties of failing parties**.

28. Moreover, such restrictions to the exercise of termination rights in netting agreements would necessarily only apply to agreements and transactions already entered into. They cannot prevent that counterparties may cease to enter into new transactions or extend agreements that expire. However, **new transaction and agreements may be just as important for business continuity as preserving existing agreements or transactions**.
29. Against this background EBF members recommend that risk mitigation techniques be exempted from any restriction on termination rights. Rather such techniques, whether enforceable netting agreements, repos and collateral should be safeguarded and further developed.

Should the Commission nevertheless seek to apply restrictions to termination rights also to risk mitigation techniques, any legislation must ensure to **minimise the potential negative repercussions of such restrictions and seek for:**

- (i) Clear and narrow definitions of the circumstances under which such restrictions apply. In that respect, it will be necessary to clarify that contractual rights arising out of other circumstances or events, e.g. termination rights because of non-performance of obligations or rights to demand additional collateral because of changes in the risk exposure, remain unaffected;
 - (ii) Determination of a sufficiently short time period within which these restrictions apply;
 - (iii) International harmonisation of all essential elements of such restrictions (specifically circumstances in which they arise and time period) in order to prevent competitive disadvantages or regulatory arbitrage.
30. Independently from the above it is also of paramount importance that reorganisation measures which serve to facilitate the transfer of assets and/or liabilities do not extend a right to transfer some but not all of the transactions entered into under a master agreement. Any legal uncertainty in this respect would invalidate the risk-reducing function of netting agreements, which presuppose that **all transactions constitute one single agreement**.
31. It is important to add that crisis resolution measures must **respect the rules of competition**, and, specifically in the case of insolvency, asset sales should be carried out through open auctions with the possibility of concurrent asset sales.

9. What should be the scope of an EU resolution framework? Should it only focus on deposit-taking banks (as opposed to any other regulated financial institution)?

10. If so, should it apply only to cross-border banking groups or should it also encompass single entities which only operate cross-border through branches?

32. The Commission believes that a European bank resolution framework should focus not only on deposit-taking institution, but on all the entities that belong to a cross-border financial group. The crisis clearly showed that, for example, the default of investment banks may put at risk the stability of the financial system as a whole.

However, the Commission maintains that some resolution measures which are appropriate for deposit-taking banks (e.g. a “bridge bank”) may not be suitable for other kinds of financial institutions. This derives from the fact that, for these financial institutions, the resolution should focus on other issues (e.g. trading, clearing and settlements, collaterals).

The EBF believes that **the Commission should refrain from putting in place different regimes that would justify a breakup of the group**; in an ongoing situation, this would moreover lead to the free rider phenomenon. A single EU resolution framework should be put in place for the whole EU financial sector.

33. The Commission considers that branches of cross-border banking groups should be covered by the new European bank resolution framework, consistently with the current EU Winding-up Directive. The EBF agrees. **The crisis, indeed, showed that branches’ default may affect in a significant way the financial stability of the host Member State where they are located.** This risk increases when the home Member State, which is in charge under relevant EU legislation of the resolution of the parent company, does not have the appropriate means to deal with a group’s default.
34. The Commission considers, furthermore, an alternative (and more restrictive) hypothesis, whereby the envisaged framework should apply to “systemically relevant” institutions only.

A significant drawback of this proposal is the difficulty to find a proper definition of “systemic relevance”. In their report to the G20 Finance Ministers, the FSB, the IMF and the BIS recognised three key criteria which are helpful in identifying the systemic importance of banks:

- (i) the size, defined as the volume of financial services provided by the individual component of the financial system;
- (ii) the substitutability (the extent to which other components of the system can provide the same services in the event of a failure); and
- (iii) the interconnectedness, the extent to which the bank is related to other components of the system.

The communication also points out that there cannot be an exhaustive list of systemically and non-systemically relevant institutions. Making such a clear distinction could result in overlooking important sources of systemic risk. As stated above in paragraph 6, diversity of structures is important for the financial sector as a whole. Therefore, the EBF believes that **the proposal to restrict the scope of the framework to “systemically relevant” institutions is not feasible.** Instead, **a single banking crisis management framework should be put in place for the whole EU financial sector.** The recent crisis demonstrated that even if a bank has small dimensions and nationally-based activities, but is very well interconnected, it can pose systemic risks and trigger intervention at international level. This is also relevant for those credit institutions which are associated in a network according to legal or statutory provisions.

11. Is it necessary to derogate from certain of the requirement imposed by the EU Company Law Directives and if so which conditions or triggers should apply to any such derogations? What

appropriate safeguards, review or compensation for shareholders, creditors and counterparties would be appropriate?

35. **The EBF considers that the adoption of an effective bank resolution framework at EU level requires some derogation from the shareholders' rights provided under the EU Company Law Directives.** In particular, the **need to guarantee to the authority which is in charge of the bank resolution (whoever it is) the power to promptly make any decision to fix the crisis** will require on certain subject-matters to depart from the shareholders' right to approve such decision at a general meeting. Particular consideration should be given to the ability of the responsible authorities to spin off and transfer individual business lines without the involvement of shareholders (as simple and rapid as possible). **Where shareholders fail to act in a responsible manner to address the crisis of their institution, it should be up to the competent authorities to impose the necessary measures to resolve the situation.**
36. Nevertheless, this **derogation from shareholders' rights should only occur as a last resort**, and exclusively affect those exceptional cases in which the shareholders do not collaborate with the measures adopted by the supervisor, or try to create obstacles to their implementation (see §17). In other words, in those cases in which shareholders, in the free exercise of their rights, adopt decisions that are coherent with the supervisor's requests, there should be no limitation of rights. If, on the other hand, the decisions made conflicted with the crisis management or prevention strategy designed by the public authorities, shareholders' rights would have to be derogated from.
37. This leads EBF Members to the conclusion that other shareholders' rights (e.g. to draft the agenda of the meeting) may be derogated as well. Furthermore, the provisions in the Third and the Sixth Company Law Directives that enable Member States to derogate from such rights in the event of an insolvency proceeding would not be coherent with a European bank resolution framework, as **such framework needs the enactment of similar provisions across Europe, hence excluding any national discretion.**
38. At the same time, shareholders (as well as creditors and counterparties) need to be compensated for the interferences caused by the public authorities and the limitation of their rights.

12. How can cooperation and communication between authorities and administrators responsible for the resolution and insolvency of a cross-border banking group be improved?

13. Is integrated resolution through a European resolution authority for banking groups desirable and feasible?

14. If this option is not considered feasible, what minimum national resolution measures for a cross-border banking group are necessary?

39. The underlying problem discussed in this part of the Communication is the need to find the most appropriate EU regime for cross-border banking groups.

Because a cross-border banking group is composed of several legal entities, which will trigger several national resolution procedures in the case of a crisis of the "group", the Commission suggests two main options to be explored:

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- (i) to create a coordination framework among the different competent authorities involved;
- (ii) to "centralise" the resolution in the hands of one authority.

The first one (i) envisages a simple exchange of information and a harmonisation of procedural rules for the coordination of the stabilisation plans; the second one (ii) provides for the appointment of a "lead administrator" in charge of an integrated resolution of group entities.

40. The Commission believes that mere coordination (i) may fail to address some features of the modern economic reality of cross-border banking groups (operational and commercial interdependence, centralisation of liquidity and so forth).

The EBF considers that, in case of a cross-border banking crisis, the foundation for the supervisory response should be the (core) colleges of supervisors led by the consolidating supervisor. The (core) colleges of supervisors would coordinate their actions with the relevant competent national authorities within the framework of the above-mentioned Cross-border Stability Groups (CBSG), for two main reasons:

- (i) the composition of the CBSG allows **reducing the possibility of conflict of interests for supervisory authorities**, which are caused by the fact that a majority of them are also responsible for monetary policy;
- (ii) the presence of Ministers of Finance permits an **early assessment** of whether or not to use public resources in bailing out an ailing bank.

41. Finally, it should also be borne in mind that the effective management of a crisis also requires a framework for coordination between Authorities at the international level. Further **cooperation and convergence of best international practices among national supervisors is also desirable.**

15. What is the most appropriate way to secure cross-border funding for bank resolution measures? What role is there for specific private sector funding?

16. Is establishing ex-ante crisis funding arrangements practical? If not, how could private sector solutions best address the issue? Is there scope to achieve greater clarity on burden sharing? If so, would the first priority be to define principles for burden sharing?

42. The Commission expresses its favour for the establishment of an *ex-ante* system which ensures the availability of private funds in case of crisis: for instance, deposit guarantee schemes can be used in this way, or a "European fund" may be put in place.

43. The EBF is aware that the ECOFIN Council clearly requested to put in place a framework where the use of private funds is prioritised; the EBF agrees with this approach. However, it is necessary to acknowledge that the usefulness of private funds can be limited: where they are too small, their possibility to play a meaningful role in a cross-border resolution process is highly limited; where their funding would be raised significantly this would put a burden on banks' lending capacities. Recent experience also showed that private funding can dry up even if the ailing bank still has a positive book value.

This is the reason why **the EBF believes that private funding arrangements could at best only play a limited role in a cross-border resolution process, and that public intervention, and therefore burden sharing, can hardly be avoided.**

However the last financial crisis also showed that public authorities lacked a suitable instrument to tackle large banking groups in financial distress within a short period of time. **This forced national governments into nationalising ailing banks, leading to higher public costs than necessary.**

For these reasons, new funding mechanisms should be made available.

44. The EBF underlines that **DGS could not fund cross-border resolution measures. DGS were not designed, nor calibrated, to tackle the failures of large, cross-border institutions.** In addition, involving DGS in cross-border crisis resolution would likely **impact their ability to fulfil their task of depositors' protection. Nevertheless, Member States remain free to use their national DGS in a preventive way for smaller entities.**
45. **The idea of a European resolution fund has some merits, which deserve to be studied more closely.** Specifically, it might help to define transparent processes for crisis resolution, thereby reducing uncertainty; be a tool for an appropriate burden sharing between the public and private sectors; help to address concerns about contagion to healthy financial institutions, and contribute to preserve the integration of the Single Market. Nevertheless, EBF Members **are at this stage not prepared to support the proposal to establish a European fund to finance cross-border resolution measures without the Commission further specifying and appropriately assessing this idea,** including how adequate (risk-based) contribution keys would be defined, and how to identify who would have the competence to trigger the use of such European fund.

Such assessment should fit within an **evolutionary approach**, whereby the Commission should **start by analysing current experiences and practices at national level with respect to funding resolution measures.**

46. **With regard to the "burden sharing" issue** (i.e. the division of the financial burden between Member States in case of a cross-border banking crisis), as stated in the general comments, the precise allocation and amount of the respective contributions to a bank resolution cannot be defined before the crisis occurs, not least because each crisis is different. Such distribution and contributions should therefore occur after the crisis has taken place. Nevertheless, **the EBF believes that setting up an ex-ante framework to allow preparing for burden sharing is crucial to iron out the inconsistencies related to the current fragmented European supervisory framework,** where the burden of failure or bail out costs are not necessarily aligned with the allocation of supervisory functions. The Icelandic case clearly showed that systemically relevant branches, albeit supervised by the home country, could call for host country financial support.
47. Such an ex-ante burden sharing framework for each cross-border banking group should help clarifying **who would take the lead in the case of a crisis** and speeding up the process in the CBSG, thereby enhancing the effectiveness of the resolution tools; it should also be designed in a way that leaves sufficient room for manoeuvre to adopt **case-by-case approaches and solutions.**
48. **Such 'preparatory' framework should be made legally binding** and should contain the elements of the formula on which ex-post burden sharing should then be determined.

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Following up on the de Larosière report (p. 35-36), **such formula** should incorporate (at least) the following items:

- a) role and responsibility of the Member State in the supervision of the cross-border group⁷;
- b) economic impact of the crisis on the Member State;
- c) origin of the deposits taken by the institution (if any);
- d) location of the assets of the institution;
- e) revenue flows of the institution;
- f) share of payment system flows of the institution

17. *Is a more integrated insolvency framework for banking groups needed? If so, how should it be designed?*

18. *Should there be a separate and self contained insolvency regime for cross-border banks?*

49. The Commission seems to see some merits in creating a so-called “28th regime” for insolvency law, i.e. a separate and self-contained regime, replacing the relevant national insolvency provisions, for the reorganisation and winding-up of cross-border groups. **In the EBF view, this hypothesis seems to be the most difficult one to achieve, considering the close relation of insolvency law with other areas of law (commercial law, contract law, property law and so forth) that normally reflect the social policy of a legal system.** Should the Commission consider a 28th regime for insolvency law as an alternative option, it should naturally carefully assess such approach and its operational implications, notably against its impact on the other areas of national law.

The EBF in that respect recalls, and agrees with, recital 11 of Council regulation 1346/2000 of 29 May 2000 on insolvency proceedings, which “*acknowledges the fact that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community. The application without exception of the law of the State of opening of proceedings would, against this background, frequently lead to difficulties. This applies, for example, to the widely differing laws on security interests to be found in the Community. Furthermore, the preferential rights enjoyed by some creditors in the insolvency proceedings are, in some cases, completely different*”.

50. The EBF notes that within the EU, insolvency proceedings of banks have been simplified by Directive 2001/24/EC on the winding up and reorganisation of credit institutions, by applying an insolvency proceeding to the banking group as a whole and prohibiting individual insolvency proceedings for branches within the EU. The *sic et simpliciter* extension of the scope of the reorganisation and winding-up Directive to **also cover subsidiaries is however not desirable because subsidiaries are separate legal entities that should be liable for their own obligation with their own capital.**

51. An evolutionary approach may also be the right approach to addressing national divergences in insolvency legislation:

⁷ The cooperation arrangements and division of responsibilities provided for in Article 129 and following of the CRD could serve as a blueprint; this point should also reflect where relevant agreements on delegation of tasks and responsibilities as provided in Article 131 of the CRD

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As a first step, the EBF supports that the **respective insolvency national frameworks in each EU Member State should be enhanced** so that they all allow coordinating the insolvency proceedings of individual banking groups’ entities within the same jurisdiction in order to better address the close relationships prevailing within a group of companies.

As said before, a key aspect in this harmonisation of insolvency legislations for banks would be to **establish the principle that authorities should have the power to act preventively without having to wait for the insolvency situation to unfold**, from the moment when a specific event is triggered (see under General comments and § 1 above).

In addition **clear and secure rules should be established to prevent and resolve any conflicts regarding the applicable law**, and to **allow effective coordination between the various insolvency regimes** applicable to the different entities of a banking group.

52. The EBF encourages the **Commission to explore ways for introducing as a longer term objective an EU wide framework to coordinate the insolvency proceedings of cross-border banking groups**. In that respect, most of the recommendations by UNCITRAL⁸ for improving the efficiency of domestic group insolvency proceedings seem to be useful. These recommendations do not change the principle that each legal entity has its own insolvency proceeding, but include the following ideas:

- joint application and procedural coordination of proceedings of different legal entities in a group;
- allowing intra-group financing/guarantees after insolvency proceedings have commenced;
- implementation of a joint reorganisation plan;
- contribution orders;
- extension of liability.

53. However, any single common insolvency procedure for banking groups would have to take into account the different international structures accepted by the EU legal framework and, therefore, to be defined accordingly.

54. UNCITRAL furthermore recommends the appointment of a **single administrator** for a group. The EBF agrees that this **could help to ensure coordination of the administration of the various group members, reduce costs and delays and facilitate the gathering of information on the group as a whole**. However, there is the risk that such a single administrator would lose his neutrality and independence in respect of the individual Member States and the respective creditors. Therefore, the EBF suggests that the framework should provide for the possibility to appoint one or more insolvency representatives to administer the entities in conflict.

55. Finally, UNCITRAL recommends a **substantive consolidation** (pooling of assets of different legal entities). This would, however, **undermine fundamental principles of company and contracts law**. Creditors of a more solvent entity would be commingled with creditors of a

⁸www.uncitral.org/uncitral/en/index.html

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financially weaker affiliate. The status of the affiliate would thus be effectively that of a branch office without offering the same transparency and leeway on governance. Another consequence would be that the assessment of the credit risk of such a counterparty would become much more difficult and in the worst case, not possible. Consequently, **the EBF would not support this idea of pooling the assets of different entities of a group.**

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