A common set of rules for liquidation for small and medium-sized banks - Eurofi article by Elke König

**The definition of a bank’s size as small, medium or big is relative. The Banking Union (BU) established a definition for significant institutions and a dedicated framework. However, there are many other institutions as well as significant institutions, which are not small but for which resolution will not be the option in case of failure. The EU framework makes clear and we have repeatedly stressed that resolution is for the few, not the many.**

The decision to put a failing institution into resolution depends on the outcome of a “public interest assessment” (PIA), determining if the preservation of a bank’s critical functions is required to maintain financial stability. If the PIA’s outcome is negative, a failing bank will be sent into national insolvency. In order to increase transparency the SRB recently published a paper on PIA presenting the methodology and how the SRB assesses the criteria set out by EU law.

In due consideration of proportionality in resolution planning, the loss absorption requirements for each institution are carefully adjusted to the choice of resolution tools. Banks, for which in case of failure no resolution is foreseen, do not have to build up Minimum Requirement for own funds and Eligible Liabilities (MREL) on top of their supervisory capital requirements for going concern. Hence, those banks do not face further costs apart from the regular costs for supervisory compliance and basic recovery and resolution planning. In contrast, for banks, whose preferred strategy is resolution, the SRB’s MREL policy and its expectations for resolvability provide for certain adjustments to allow for proportionality as well.

The SRB can also grant transitional periods for banks, based on features such as market conditions or a bank’s liability structure or market access, in order to allow for a gradual build-up of MREL requirements. However, the rules require, that before using the SRF significant losses must be absorbed by the bank’s equity- and bondholders. And it is undisputed that sufficient MREL is needed to implement any resolution strategy. In this regard the SRB must strike a careful balance between feasibility of the build-up of MREL and the credibility of the resolution strategy.

Building up the capital buffers may be challenging for smaller fully deposit funded banks. For this reason, a common set of rules for winding down such banks could be beneficial - for some SRB banks and all less significant banks. While we have one common European resolution scheme, in the BU we are faced with 19 different national insolvency laws when winding-down a (cross-border) bank. A set of common standards, practices and harmonised rules for the liquidation of banks would considerably facilitate

resolution planning, increase predictability and prevent diverging outcomes in different member states. Needless to say that administrative procedures might be preferable to judicial procedures. At the end of this process might stand the creation of a European bank liquidation regime - a European FDIC. Not only would this ensure centralised decision-making, but also the application of a harmonized and effective toolbox supported by a European deposit insurance. With this being a long decision-making process, legislators should wait no longer.

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